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NEWPORT BEACH

**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, City Council  
and Chief Financial Officer of the City of San Diego  
San Diego, California

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of San Diego, California (the "City"), as of and for the year ended June 30, 2009, which collectively comprise the City's basic financial statements and have issued our report thereon dated December 21, 2009. Our report was modified to include a reference to other auditors and the City's adoption of the provisions of Governmental Accounting Standards Board (GASB) Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. We conducted our audit 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. Other auditors audited the financial statements of the San Diego Housing Commission and the Southeastern Economic Development Corporation, as described in our report on the City's basic financial statements. This report does not include the results of the other auditors' 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, we considered the City's internal control over financial reporting as a basis for designing our auditing procedures 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 over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A *control deficiency* 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 misstatements on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the City's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the City's financial statements that is more than inconsequential will not be prevented or detected by the City's internal control.

We consider the deficiencies described in 2009-(a) through 2009-(e) in the accompanying schedule of current year findings and described in 2003-1 in the schedule of prior year findings to be significant deficiencies in internal control over financial reporting.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the City's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we consider items 2009-(a) and 2003-1 to be material weaknesses.

#### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City's financial statements are free of 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 an instance of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule current year findings as item 2009-(f) and also in the accompanying schedule of prior year findings as 2003-4. The conditions reported in 2003-4 also existed in the current year.

The City's responses to the findings identified in our audit are described in the accompanying schedules of current year findings and prior year findings. We did not audit City's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the City Council, Mayor, the City's audit committee, City management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

*Maciar Fini & O'Connell LLP*

Certified Public Accountants

San Diego, California  
December 21, 2009

**CITY OF SAN DIEGO**  
**Schedule of Current Year Findings**  
**For the Year Ended June 30, 2009**

**Financial Statement Findings:**

**Finding No. 2009 - (a) Risk Management – Public Liability**

**Observation** – The City’s internal controls over public liability reserves require the completion and authorization of a “Request for Action” form (RFA) by a claims adjuster documenting the rationale whenever an adjustment is required. In addition, changes in reserve amounts above \$100,000 are required to be reviewed and approved by a supervisor or manager. During our testing of internal controls, we noted eight (8) out of forty-five (45) transaction selected for testing where the RFAs did not indicate the rationale for the reserve adjustment, nor was there any indication that management had reviewed or authorized any of these RFAs. This is a repeat finding from the prior two (2) fiscal year audits.

**Recommendation** – The City’s Risk Management Department should implement procedures to ensure proper completion and authorization of an RFA whenever an adjustment is made to a public liability reserve.

**Management Response** - The Risk Management department has implemented controls to address this audit finding and has proceeded with training to ensure staff is fully aware and compliant with it. A limitation to the initial corrective measure put in place was that the “Request for Action” (RFA) process was a manual one. However, in May 2009, the Public Liability division implemented a new claims database system, iVos, to replace its custom developed legacy mainframe system. iVos will not save reserve adjustments unless a “comments” section containing justification for the reserve adjustment is completed by the adjuster. This systematic control is superior to and replaces the manual RFA control process. Additionally, any reserve adjustments exceeding \$100,000 are automatically and electronically sent to the Claims Supervisor for review and approval.

**Finding No. 2009 - (b) Risk Management – Expenditure Accruals**

**Observation** – During the testing of internal controls over the City’s Risk Management department’s cash disbursements related to claims liabilities, we noted that two (2) out of forty-five (45) transactions selected for testing were for services rendered in fiscal year 2008. These services were for outside legal counsel related to claims and judgments. These expenditures should have been recognized (accrued) when incurred in fiscal year 2008.

**Recommendation** – The City’s Risk Management Department should develop year-end accrual procedures that will include a follow up with vendors for invoices that have not yet been received for goods/services delivered before year end.

**Management Response** - The Risk Management department and the Comptroller’s Office are currently combining efforts to develop procedures for the review of transactions that occur in one fiscal year and are paid in the next fiscal year. More emphasis will be placed on review of the General Ledger after year end to determine actual payments made that relate to services or settlements that occurred in the prior fiscal year.

**CITY OF SAN DIEGO**  
**Schedule of Current Year Findings (Continued)**  
**For the Year Ended June 30, 2009**

There will also be a review related to the Comptroller Certificates that were issued during the year. Many of these certificates are issued for ongoing legal services with specific vendors. This will also be a joint review between departments to determine the amount paid to these vendors over the duration of the year, the amount remaining on the certificates and the status of the remaining available funds. This process will also include input from the Office of the City Attorney, since they provide the initial review of invoices for legal services prior to payment.

The Risk Management Department has procedures already in place for tracking settlement payments. Adding additional reviews of legal service payments and specific vendors on a periodic basis throughout the remainder of the current fiscal year will assist in tracking these types of payments, and ensure that they are being paid in a timely manner and applied to the correct fiscal year.

**Finding No. 2009 – (c) Timely Capitalization of Donated Capital Assets from Developer Contributions**

**Observation** – During the performance of our testwork over donated capital assets, we noted that fifty-seven (57) out of one hundred and fifty-four (154) donated assets that were capitalized in fiscal year 2009 were actually donated in and should have been capitalized in prior fiscal years (2006-2008).

**Recommendation** – The Development Services Department (DSD) should develop a policy that requires developers to submit as-built drawings immediately after the projects are completed to ensure that DSD can review the drawings and capitalize completed projects at the time of the notice of completion.

**Management Response** - DSD has worked with the Engineering & Capital Projects Department (E&CP), which performs the inspections of public improvement permits, to revise the project closeout procedures to assure all as-built requirements are completed prior to acceptance of the improvements and release of the bond or building permit occupancy. DSD is working with E&CP to implement the automated tracking of inspections and closeout requirements of public improvement permits in DSD's computerized Project Tracking System (PTS). Both of these efforts should be implemented during FY2010.

**Finding No. 2009 – (d) Land Held for Resale Documentation**

**Observation** – During the testing of internal controls over the Redevelopment Agency's (Agency) additions to property held for resale, we noted that for one (1) out of four (4) transactions selected for testing, the Agency could not provide the supporting documents to verify reasonableness of the historical value. The property was originally acquired as a capital asset prior to 1980, reported in the Agency financial statements as land, and transferred to property held for resale during fiscal year 2009.

**Recommendation** – We recommend that the Agency establish procedures and internal controls over documentation retention not only for recent transactions but also historical transactions where the item still exists in the Agency's financial statements.

**CITY OF SAN DIEGO**  
**Schedule of Current Year Findings (Continued)**  
**For the Year Ended June 30, 2009**

**Management Response** – The Redevelopment Agency agrees. All additions since fiscal year 2003 have been properly documented and the supporting transactions have been added to the land held for resale and capital assets permanent file. It is the Comptroller’s Office policy, and has been since fiscal year 2003, to permanently retain the supporting documentation until five years after the property’s disposition. The property described above was purchased prior to 1980. Due to the number of years since the purchase of the property, procurement records have been discarded pursuant to the City’s document retention policies. Efforts were made to support the value of the property including an appraisal by the Real Estate Assets Department which valued the property above its book value. Additionally, permanent records retained by the project area’s manager were searched and County records were requested without success.

**Finding No. 2009 – (e) Electronic Data Processing General Controls**

**Observation**– During the electronic data processing review, the following findings were observed:

- a. There is no formal policy and associated procedures in place to ensure that system and application access is rescinded for inactive users. The policy and associated procedures should state and ensure that system and application access is removed as part of the separation procedures for employees from the City.
- b. There is no formal policy and associated procedures in place to ensure all system and application access rights are up-to-date and at an appropriate level to enforce a proper segregation of duties.
- c. All transactional data is currently stored within the City’s core financial management application, AMRIS. As the amount of data stored within the core financial management system increases, system performance may be adversely affected.

**Recommendations** –

- a. The City’s Chief Information Officer (CIO) should continue to work to finalize and approve the City’s Information Technology (IT) administrative regulations to include a formal policy and implement associated procedures to ensure that system and application access is rescinded for inactive users. Also, the administrative regulations should require periodic reviews to ensure that computer user accounts to the network and applications are terminated upon the employee’s departure.
- b. The CIO should develop a formal policy and implement associated procedures to ensure all system and application access rights are up-to-date and at an appropriate level to enforce a proper segregation of duties. This standard should be enforced for both network access as well as access to the financial applications. The logical security policy should include procedures to ensure that all system and application access rights for users are periodically reviewed for appropriateness, noting that persons should have the minimum authorizations necessary to complete their assigned duties. The CIO should continue to work to finalize and approve its IT administrative regulations, which should include a formal policy to review access rights periodically. Because of the City’s shared responsibility for the IT environment with the San Diego Data Processing Corporation, the CIO should establish a formal policy to ensure access rights are reviewed periodically for all financial systems.

**CITY OF SAN DIEGO**  
**Schedule of Current Year Findings (Continued)**  
**For the Year Ended June 30, 2009**

- c. The Comptroller should continue its efforts to establish a data warehouse for the core financial management applications and develop an archiving and purging policy for data within the applications.

**Management Response –**

- a. The Department of Information Technology (Dept of IT) agrees with this recommendation. Administrative Regulation 90.64 (Protection of Sensitive Information and Data) was implemented in July 2009. This policy directs that departments take appropriate action to disable accounts or remove system access in no more than three (3) business days after an employee no longer needs such access. In addition, the Dept of IT will be receiving monthly reports of all user accounts that have not been used within the last ninety (90) days and contacting the departments to take appropriate action on those accounts (disable or delete). The Dept of IT will also be updating and recommending Citywide implementation of the “Departing Employee Checklist” by June 2010, to ensure that supervisors take the necessary steps for removing system access and retrieving City-issued property when an employee leaves their department (transfer, resignation, termination or otherwise).
- b. The Dept of IT agrees with this recommendation. The Dept of IT, in conjunction with the Comptroller’s Office (Internal Controls unit), have established procedures that require semi-annual review of user access to financial and other systems containing sensitive information (A.R. 90.64), which must be certified by each department head. The City’s IT Security Guidelines and Standards provide minimum requirements for system-level and application-level security. These standards were last revised in July 2006 and are in the process of being updated to meet ISO 17799 standards (due to be complete by June 2010). In addition, the Comptroller’s Office has had a procedure and practice in place since January 2007, which requires department heads to validate and re-certify authorization semi-annually, for their specified employees to have access to financial or other secure systems. Further, the new A.R. 90.63 (Information Security Policy) is planned to be released in Spring 2010, which provides over-arching information security policies (logical and physical). The policy requires an annual review by a Citywide Information Security Committee of both the A.R. and the standards, including recommendations for any necessary updates or revisions.
- c. The City’s “OneSD” implementation of SAP as its Enterprise Resource Planning (ERP) system was built in a new computing environment that includes separate data storage for both the new financial data created in SAP and also historical financial data from the various mainframe applications that have been replaced. The OneSD Support Department is responsible for managing and monitoring the systems to ensure system performance is maintained at necessary operational levels, as well as planning for capacity growth. The Comptroller will work with the OneSD Support Department to ensure financial data is maintained for the minimum time required by law, that data backups and archives are properly created and maintained, and the data is eventually purged, as allowed.

**CITY OF SAN DIEGO**  
**Schedule of Current Year Findings (Continued)**  
**For the Year Ended June 30, 2009**

**Compliance Findings:**

**Finding No. 2009 - (f) Continuing Annual Disclosure Requirements**

**Observation** – During the performance of our testwork over continuing annual disclosure requirements, we noted that the Redevelopment Agency of the City of San Diego (Agency) did not submit one (1) out of the thirty-five (35) required Annual Reports for fiscal year 2008 to the National Recognized Municipal Securities Repository Agencies within the required time frame (270 days after year-end).

**Recommendation** – The Agency should establish procedures to ensure that all reports are submitted in a timely manner to avoid noncompliance with the continuing disclosure requirements stated with their bond covenants. The City should also oversee all of its debt compliance requirements to ensure that various entities that administer the debt such as the Southeastern Economic Development Corporation (SEDC), Centre City Development Corporation (CCDC), and City Planning & Community Investment (CPCI) agencies/departments are in compliance with the debt compliance requirements, as ultimate responsibility lies with the City since it is the named responsible organization in the bond documents.

**Management Response** – The Redevelopment Agency agrees. The continuing disclosures were not filed by the Southeast Economic Development Agency (SEDC), as a result of the turnover of management personnel responsible for making these filings. The SEDC on behalf of the Agency did file a “Failure to File” on the date that the continuing disclosure was required to be filed. An internal control annual requirements calendar has been put into place to prevent this from recurring. The delinquent continuing disclosures will be filed prior to the next filing date in 2010.

**CITY OF SAN DIEGO**  
 Schedule of Prior Year Findings  
 For the Year Ended June 30, 2009

**Findings related to the Financial Statements:**

<b>Reference Number:</b>	<b>2008-(a)</b>
Topic	Risk Management – Public Liability
Audit Finding	The City’s internal controls over public liability reserves require the completion and authorization of a “Request for Action” form (RFA) documenting the rationale whenever an adjustment is required. In addition, changes in reserve amounts above \$100,000 are required to be reviewed and approved by a supervisor or manager. During our testing of internal controls, we noted eight instances out of forty sample items where the RFAs did not indicate the rationale for the reserve adjustment, nor was there any indication that management had reviewed and authorized any of these RFAs.
Status of Corrective Action	Not corrected, see current year finding 2009-(a).  The Risk Management department has implemented controls to address this audit finding and has proceeded with training to ensure staff is fully aware and compliant with it. A limitation to the initial corrective measure put in place was that the “Request for Action” (RFA) process itself was a manual one. However, in May 2009, the Public Liability division implemented a new claims database system, iVos, to replace its custom developed legacy mainframe system. iVos will not save reserve adjustments unless a “comments” section containing justification for the reserve adjustment is completed by the adjuster. This systematic control is superior to and replaces the manual RFA control process. Additionally, any reserve adjustments exceeding \$100,000 are automatically and electronically sent to the Claims Supervisor for review and approval.

<b>Reference Number:</b>	<b>2007-(a)</b>
Topic	Risk Management – Public Liability
Audit Finding	The City’s internal controls over public liability reserves require the completion and authorization of a “Request for Action” form (RFA) documenting the rationale whenever an adjustment is required. During our testing of internal controls, we noted that none of the seven RFAs we tested indicated the rationale for the reserve adjustment, nor was there any indication that management had reviewed or authorized any of these RFAs. The City’s Risk Management Department should implement procedures to ensure proper completion and authorization of an RFA whenever an adjustment is made to a public liability reserve.



**CITY OF SAN DIEGO**  
 Schedule of Prior Year Findings (Continued)  
 For the Year Ended June 30, 2009

Status of Corrective Action      Not corrected, see current year finding 2009-(a).

The Risk Management department has implemented controls to address this audit finding and has proceeded with training to ensure staff is fully aware and compliant with it. A limitation to the initial corrective measure put in place was that the “Request for Action” (RFA) process itself was a manual one. However, in May 2009, the Public Liability division implemented a new claims database system, iVos, to replace its custom developed legacy mainframe system. iVos will not save reserve adjustments unless a “comments” section containing justification for the reserve adjustment is completed by the adjuster. This systematic control is superior to and replaces the manual RFA control process. Additionally, any reserve adjustments exceeding \$100,000 are automatically and electronically sent to the Claims Supervisor for review and approval.

**Reference Number:      2003-1**

Topic      Material Weakness in Internal Controls over the Financial Reporting Process

Audit Finding:      There were inadequate policies, procedures, internal controls and personnel to ensure the preparation of an accurate and reliable CAFR on a timely basis. Specifically, deficiencies were noted in the following areas:

CAFR Preparation; Pension Accounting; Capital Asset Accounting; Metropolitan Wastewater Utility; Risk Management; City Treasurer’s Cash and Investment Pool; Procurement; Accounts Payable and Accrued Expense; Human Resources; Accounts Receivable; Information Technology. As a result of this, numerous material corrections to the CAFR for the year ended June 30, 2003 in the amount of \$1 billion were proposed and booked.

Status of Corrective Action      Partially corrected and in progress. However, prior to the issuance of this report several modifications to the City’s financial reporting process and control environment have been made. These modifications include the hiring of new management to oversee financial reporting and internal controls, and the implementation of revised policies, procedures and training for employees.

Additionally, the implementation of OneSD will dramatically change (and improve) the year-end process; however, the preparation of the Fiscal Year 2009 Comprehensive Annual Financial Report was completed using the City’s current accounting systems. Also during fiscal year 2009, the City began implementing the Governance Risk Compliance (GRC) module of SAP which will assist in documenting, monitoring and testing internal controls within SAP.

**CITY OF SAN DIEGO**  
 Schedule of Prior Year Findings (Continued)  
 For the Year Ended June 30, 2009

Also a new year-end processing master schedule was developed and has been implemented since fiscal year 2008. It identifies tasks necessary to complete the CAFR by responsible staff member; identified items contingent on information from other sections within the Comptroller's Office and other departments within the City. Use of the master schedule along with the year-end closing calendar already in use will allow management to more effectively monitor progress toward completion of the CAFR and ensure critical components are not omitted.

Notwithstanding the improvements made prior to the issuance of this report, management agrees further improvement is necessary and remains committed to continuing to strengthen its internal controls and procedures over financial reporting. Over 200 procedures have been identified and will be documented and implemented over the next 18 months.

**Findings related to Compliance:**

**Reference Number: 2008-(b)**

Topic	Continuing Annual Disclosure Requirements
Audit Finding	The City did not submit its June 30, 2007 audited or unaudited financial statements to the National Recognized Municipal Securities repository agencies within the required time frame (285 days after year end). The City was therefore not in compliance with its continuing disclosure requirements.
Status of Corrective Action	In progress. See current year finding 2009-(f).

**Reference Number: 2008-(c)**

Topic	Redevelopment Agency – Annual Report Submission to the City Council
Audit Finding	The California Health and Safety Code section 33080.1 states that “every redevelopment agency shall submit an annual report to its legislative body within six months of the end of the agency’s fiscal year.” The annual report should include: “(1) an independent financial audit report for the previous fiscal year, (2) a fiscal statement for the previous fiscal year that contains the information required pursuant to Section 33080.5, (3) a description of the agency’s activities in the previous fiscal year affecting housing and displacement that contains the information required by Sections 33080.4 and 33080.7, (4) a description of the agency’s progress, including specific actions and expenditures, in alleviating blight in the previous fiscal year, (5) a list of, and status report on, all loans made by the redevelopment agency that are \$50,000 or more, that in the previous fiscal year were in

**CITY OF SAN DIEGO**  
Schedule of Prior Year Findings (Continued)  
For the Year Ended June 30, 2009

*default, or not in compliance with the terms of the loan approved by the agency, (6) a description of the total number and nature of the properties that the agency owns and those properties the agency has acquired in the previous fiscal year.”*

We noted that the Redevelopment Agency (Agency) did not submit a complete annual report to the legislative body within six months of the end of the Agency’s current fiscal year. The financial statements for the previous year were not submitted with audited numbers because the audit was in progress during the time that the Agency submitted its annual reports.

Status of Corrective Action      Corrected. The Agency prepared and submitted a complete annual report for the fiscal year ended June 30, 2009, to the Board of Directors before December 31, 2009.

**Reference Number:                      2003-4**

Topic                                      Violations of Securities Laws

Audit Finding                              In November 2006, the Securities and Exchange Commission (SEC) entered an Order sanctioning the City of San Diego for committing securities fraud by failing to disclose to the investing public important information about its pension and retiree healthcare obligations. To settle the action, the City agreed to cease and desist from future securities fraud violations and to retain an independent consultant for three years to foster compliance with its disclosure obligations under the federal securities laws.

In issuing the Order, the SEC made the following determinations:

- The City failed to disclose the City’s unfunded liability to its pension plan was projected to dramatically increase.
- The City failed to disclose that it had been intentionally underfunding its pension obligations so that it could increase pension benefits but defer the costs.
- The City knew or was reckless in not knowing that its disclosures were materially misleading.
- The City made these misleading statements through three different means:
  - The City made misleading statements in the offering documents for five municipal offerings in 2002 and 2003 that raised over \$260 million from investors. The offering documents included offering statements.
  - The City made misleading statements to the agencies that gave the City its credit rating for its municipal bonds.
  - The City made misleading statements in its “continuing disclosure statements”, which described the City’s financial condition.

**CITY OF SAN DIEGO**  
Schedule of Prior Year Findings (Continued)  
For the Year Ended June 30, 2009

Status of Corrective Action

Partially corrected and in progress. The City consented to the SEC order and as part of the applicable remediation, the City has retained an independent monitor to oversee the City's compliance with and remediation of the issues identified in the Order. The City continues to work on improving its internal control framework and address other material weaknesses which are part of the underlying cause of this finding. The City's response to this finding has been a combination of staffing changes, modified policies and procedures along with systems initiatives to correct the internal control weaknesses that created the materially misleading disclosures. Furthermore, the City has established an audit committee and a Disclosure Practices Working Group (DPWG). The DPWG is responsible for reviewing the City's annual financial statements to ensure that all material items are appropriately disclosed and reported in the City's CAFR. The independent monitor required by the SEC order has reported on the City's progress with respect to several remediation issues from the SEC order. The 2008 report was dated March 25, 2008 and the 2009 report was released on April 24, 2009; both reports are available for review.



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NEWPORT BEACH

December 21, 2009

To the Audit Committee  
of the City of San Diego

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of San Diego (the "City") for the year ended June 30, 2009. We did not audit the financial statements of the San Diego Housing Commission, a discretely presented component unit, or the Southeastern Economic Development Corporation, a blended component unit. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for the San Diego Housing Commission and the Southeastern Economic Development Corporation is based on the reports of the other auditors. We audit the financial statements of the San Diego City Employees' Retirement System (SDCERS) as part of a separate engagement; however, our communications are made directly to the SDCERS board in a separate communications letter. This letter does not include any communication matters related to the San Diego Housing Commission or the Southeastern Economic Development Corporation. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and *Government Auditing Standards* and OMB Circular A-133, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated August 6, 2009. Professional standards also require that we communicate to you the following information related to our audit.

#### Our Responsibility under U.S. Generally Accepted Auditing Standards and OMB Circular A-133

As stated in our engagement letter dated August 6, 2009, our responsibility, as described by professional standards, is to express opinions about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of your responsibilities.

In planning and performing our audit, we considered the City's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide assurance on the internal control over financial reporting. We also considered internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

As part of obtaining reasonable assurance about whether the City's financial statements are free of material misstatement, we performed tests of its compliances with certain provisions of laws, regulations, contracts, and grants, 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. Also in accordance with OMB Circular A-133, we are in the process of examining, on a test basis, evidence about the City's compliance with the types of compliance requirements described in the "U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement" applicable to each of its major federal programs for the purpose of expressing an opinion on the City's compliance with those requirements. While our audit will provide a reasonable basis for our opinion, it will not provide a legal determination on the City's compliance with those requirements.

#### Planned Scope and Timing of the Audit

We performed the audit according to the planned scope and timing previously communicated to you in our engagement letter dated August 6, 2009.

#### Other Information in Documents Containing Audited Financial Statements

The City's audited basic financial statements are included in its Comprehensive Annual Financial Report (CAFR.) Our responsibility for the other information in the CAFR containing the basic financial statements and our report does not extend beyond the financial information identified in our audit report. We do not have an obligation to perform any procedures to corroborate other information contained in these documents. However, we read the other information and considered whether such information, or its manner of presentation, was materially inconsistent with information, or the manner of its presentation, appearing in the basic financial statements. Nothing came to our attention that caused us to believe that such information, or its manner of presentation, is materially inconsistent with the information, or manner of its presentation, appearing in the basic financial statements.

During the year, the City included its fiscal year 2008 audited basic financial statements in the Official Statement for the \$124,070,000 City of San Diego, California 2009-10 Tax and Revenue Anticipation Notes, Series A, Series B and Series C (\$18,610,000 for Series A; \$55,825,000 for Series B; and \$49,635,000 for Series C).

During the year, the City's Redevelopment Agency (a blended component unit of the City) included its fiscal year 2008 audited basic financial statements in the Official Statement for the \$13,930,000 Redevelopment Agency of the City of San Diego North Park Redevelopment Project Subordinate Tax Allocation Bonds, Series 2009A.

Our responsibility for the other information in such documents containing the financial statements and our report does not extend beyond the financial information identified in our audit report. We do not have an obligation to perform any procedures to corroborate other information contained in these documents. However, we read the other information and considered whether such information, or its manner of presentation, was materially inconsistent with information, or the manner of its presentation, appearing in the financial statements. Nothing came to our attention that caused us to believe that such information, or its manner of presentation, is materially inconsistent with the information, or manner of its presentation, appearing in the financial statements.

## Significant Audit Findings

### *Qualitative Aspects of Accounting Practices*

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City are described in Note 1 to the financial statements. As discussed in Note 1 to the financial statements, the City changed accounting policies related to its reporting for pollution remediation obligations, its reporting of endowments and its accounting policies related to identifying the sources of accounting principles by adopting Governmental Accounting Standards Board (GASB) Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*, Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments* and Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statement on Auditing Standards*, respectively. We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the City's financial statements were:

- Management's estimates of the workers' compensation, general liability, auto liability and malpractice liability are based on actuarial evaluations using historical loss, employee and other data.
- Management's estimates of pollution remediation costs were based on independent consultant valuations as well as internal valuations.
- Management's estimate of the City's Annual Required Contribution (ARC) for pension benefits and OPEB benefits is based on annual actuarial valuations using an accepted actuarial method and various actuarial assumptions. The Net Pension Obligation (NPO) and the Net OPEB Obligation (NOPEBO) are a function of the respective ARC and are estimated by comparing the ARC with the actual funding during the current year and applying an interest rate factor and an amortization adjustment factor to the prior year's NPO and NOPEBO.
- Management's estimates of useful lives for depreciable property were based on the nature of the capital asset.
- Management's estimates of bad debt allowances for accounts and other receivables were based on historical experience on collections related to outstanding accounts.
- Management's estimates of claim losses and contingencies were based on advice from legal counsel about the ultimate outcome of the claim.
- Management's estimates for the landfill closure and postclosure care liability were based on the percentage of the landfill capacity used to date applied to the cost estimates for closure, monitoring and postclosure maintenance, less actual costs incurred.

- Management's estimates for the fair values of investments, except real estate, are based on quoted market values. Directly owned real-estate assets (SDCERS investments) are stated at appraised values as determined by SDCERS real estate managers and third party appraisal firms.

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the financial statements were:

- The disclosure related to the funded status of the City's defined benefit pension plan and the City's NPO in Note 12 to the financial statements.
- The disclosure related to the funded status of the City's OPEB plan and the City's NOPEBO in Note 13 to the financial statements.
- The disclosure related to the contingencies affecting the City in Note 18 to the financial statements.

#### *Difficulties Encountered in Performing the Audit*

We encountered no significant difficulties in dealing with management in performing and completing our audit.

#### *Corrected and Uncorrected Misstatements*

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. The attached Schedule B summarizes uncorrected misstatements of the financial statements. Management has determined that their effects are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. The attached Schedule A summarizes the misstatements detected as a result of audit procedures that were corrected by management.

#### *Disagreements with Management*

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

#### *Management Representations*

We have requested certain representations from management that are included in the management representation letter dated December 21, 2009.

#### *Management Consultations with Other Independent Accountants*

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards



require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

*Other Audit Findings or Issues*

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the governmental unit's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

This information is intended solely for the use of the Audit Committee of the City of San Diego and management of the City and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

*Macias Fini & O'Connell LLP*

Certified Public Accountants

**City of San Diego**  
**Schedule of Corrected Misstatements (Schedule A)**  
**Fiscal Year Ended June 30, 2009**

	Statement of Net Assets			Statement of Activities			
	Assets	Liabilities	Net Assets	Revenues	Expenses	Change in Net Assets	
						Current Year	Prior Year
<b>Governmental Activities</b>							
1 To properly accrue for the liability settlement amounts for Grantville Case that settled during FY 09	\$ -	\$ 39,200,000	\$ -	\$ -	\$ 39,200,000	\$ (39,200,000)	\$ -
<b>Financial statement amounts</b>	<u>\$ 6,565,710,000</u>	<u>\$ 2,307,507,000</u>	<u>\$ 4,258,203,000</u>	<u>\$ 1,824,559,000</u>	<u>\$ 1,718,512,000</u>	<u>\$ 104,822,000</u>	<u>\$ 213,558,000</u>
<b>Impact as a percentage of financial statement amounts</b>	<u>0.00%</u>	<u>1.70%</u>	<u>0.00%</u>	<u>0.00%</u>	<u>2.28%</u>	<u>-37.40%</u>	<u>0.00%</u>

City of San Diego  
Schedule of Uncorrected Misstatements (Schedule B)  
Fiscal Year Ended June 30, 2009

GOVERNMENTAL FUNDS Description (Nature) of Audit Difference	Balance Sheet			Statement of Revenues, Expenditures, and Changes in Fund Balance			
	Assets	Liabilities	Fund Equity	Revenues	Expenditures	Net Change in Fund Balance	
						Current Year	Prior Year
<b>General Fund</b>							
1 To adjust the over-accrual of the Accounts Receivable for Mission Bay Revenues	\$ (604,621)	\$ -	\$ -	\$ (604,621)	\$ -	\$ (604,621)	\$ -
2 To adjust the over-accrual of the Transient Occupancy Taxes Receivable	\$ (2,763,002)	\$ -	\$ -	\$ (2,763,002)	\$ -	\$ (2,763,002)	\$ -
3 To re-classify current year Workers' Compensation expenditures to prior year	\$ -	\$ -	\$ (594,452)	\$ -	\$ (594,452)	\$ 594,452	\$ -
<b>Total uncorrected misstatements</b>	<u>\$ (3,367,623)</u>	<u>\$ -</u>	<u>\$ (594,452)</u>	<u>\$ (3,367,623)</u>	<u>\$ (594,452)</u>	<u>\$ (2,773,171)</u>	<u>\$ -</u>
<b>Financial statement amounts</b>	<u>\$ 175,242,000</u>	<u>\$ 60,850,000</u>	<u>\$ 114,392,000</u>	<u>\$ 1,014,631,000</u>	<u>\$ 1,106,115,000</u>	<u>\$ (10,389,000)</u>	<u>\$ (7,267,000)</u>
<b>Impact as a percentage of financial statement amounts</b>	<u>-1.92%</u>	<u>0.00%</u>	<u>-0.52%</u>	<u>-0.33%</u>	<u>-0.05%</u>	<u>26.69%</u>	<u>0.00%</u>
<b>Aggregate remaining fund information</b>							
4 To accrue interfund receivables related to the Grantville settlement	\$ 39,200,000	\$ 39,200,000	\$ -	\$ -	\$ -	\$ -	\$ -
5 To accrue the interfund payable related to the Grantville settlement	\$ 39,200,000	\$ 39,200,000	\$ -	\$ -	\$ -	\$ -	\$ -
<b>Total uncorrected misstatements</b>	<u>\$ 78,400,000</u>	<u>\$ 78,400,000</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
<b>Financial statement amounts</b>	<u>\$ 7,130,993,000</u>	<u>\$ 1,252,623,000</u>	<u>\$ 5,878,370,000</u>	<u>\$ 196,896,000</u>	<u>\$ 1,215,134,000</u>	<u>\$ (937,100,000)</u>	<u>\$ (64,017,000)</u>
<b>Impact as a percentage of financial statement amounts</b>	<u>1.10%</u>	<u>6.26%</u>	<u>0.00%</u>	<u>0.00%</u>	<u>0.00%</u>	<u>0.00%</u>	<u>0.00%</u>
<b>Statement of Net Assets</b>				<b>Statement of Activities</b>			
Government-wide (Governmental Activities)	Assets	Liabilities	Net Assets	Revenues	Expenses	Change in Net Assets	
						Current Year	Prior Year
<b>Internal Service Funds</b>							
6 To adjust the net assets beginning balance to correctly reflect prior period capital asset additions	\$ -	\$ -	\$ 14,283,911	\$ (14,283,911)	\$ -	\$ (14,283,911)	\$ 14,283,911
<b>Total uncorrected misstatements</b>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 14,283,911</u>	<u>\$ (14,283,911)</u>	<u>\$ -</u>	<u>\$ (14,283,911)</u>	<u>\$ 14,283,911</u>
<b>Financial statement amounts</b>	<u>\$ 286,722,000</u>	<u>\$ 277,848,000</u>	<u>\$ 8,874,000</u>	<u>\$ 242,821,000</u>	<u>\$ 216,140,000</u>	<u>\$ 41,512,000</u>	<u>\$ 30,428,000</u>
7 To adjust the net assets beginning balance to correctly reflect prior period donated assets	\$ -	\$ -	\$ 7,847,000	\$ (7,847,000)	\$ -	\$ (7,847,000)	\$ 7,847,000
* Summarized impact on Governmental activities	\$ 35,832,377	\$ 39,200,000	\$ 21,536,459	\$ (25,498,534)	\$ (594,452)	\$ (24,904,082)	\$ 22,130,911
<b>Financial statement amounts</b>	<u>\$ 6,565,710,000</u>	<u>\$ 2,307,507,000</u>	<u>\$ 4,258,203,000</u>	<u>\$ 1,824,559,000</u>	<u>\$ 1,718,512,000</u>	<u>\$ 104,822,000</u>	<u>\$ 213,558,000</u>
<b>Impact as a percentage of financial statement amounts</b>	<u>0.55%</u>	<u>1.70%</u>	<u>0.51%</u>	<u>-1.40%</u>	<u>-0.03%</u>	<u>-23.76%</u>	<u>10.36%</u>