



THE CITY OF SAN DIEGO  
**REPORT TO THE CITY COUNCIL**

DATE ISSUED: December 21, 2012 REPORT NO: 13-001  
ATTENTION: Honorable Members of the City Council and  
Audit Committee Members  
FROM: Ken Whitfield, City Comptroller  
SUBJECT: Annual Report on Internal Controls

**REQUESTED ACTIONS:**

Informational only.

**Background**

In October 2004, City Council adopted Ordinance 19320 to achieve a “high standard of quality in and efficacy of the City’s financial and disclosure practices.” Municipal Code **§22.0708 Annual Report on Internal Controls**, implements this ordinance and requires that an annual report on the City’s internal controls be presented to the City Council. Accordingly, this report has been prepared for the calendar year 2012. While the Ordinance calls for an annual review and report, it is important to note that the City has a dedicated unit, the Internal Controls Section (ICS), in the Office of the City Comptroller that is daily assessing, developing and improving the City’s internal controls. The ICS continues to record and publish statistics which indicate the status and level of continued progress made in the internal controls environment, a structural improvement that surpasses the Municipal Code requirement for annual assessment and reporting.

**Discussion**

It is management’s role and responsibility to establish an internal controls environment across all City operations and other areas that have a financial impact on the citywide financial reports. This includes City departments, offices, agencies, and affiliated “related entities” as defined in the San Diego Municipal Code Section 22.4102<sup>1</sup>. While it is the responsibility of every City employee to ensure that work is conducted in accordance with established policies and procedures which support the City’s internal controls framework, the responsibility of internal controls design and monitoring resides with the Internal Controls Section (ICS), within the Office of the City Comptroller.

<sup>1</sup> Municipal Code §22.0708 states that the term “related entity” is defined in §22.1702 of the Municipal code, however, “related entity” is actually defined in §22.4102.”

The ICS coordinates the development and documentation of the City's financial policies and procedures. The section reviews new Process Narratives and works with department personnel to ensure adequate controls exist within each process that may have an impact on the financial statements. These Process Narratives form the basis for the ongoing monitoring and remediation of processes and control deficiencies. The ICS is currently developing the monitoring and remediation platform utilizing the tools contained within the SAP Governance, Risk and Compliance (GRC) module to strengthen the City's control environment. Once this monitoring and remediation process has been implemented, test results will indicate the level of compliance with the City's stated policies and procedures.

Currently, the ICS utilizes the GRC module to perform several key functions, including the management of segregation of duty conflicts that arise through role assignments in SAP and specific financial transaction testing. Where necessary, the ICS either develops mitigating controls that are applied to the user violation or recommends an alternative approach which will eliminate the segregation of duty violation entirely. The transaction testing process which is currently being performed supports the objective of ensuring that only transactions that have been reviewed and authorized are posted. These key functions are performed on a continuous, daily basis.

Management's internal control efforts include the citywide coordination of completing audit recommendations. The City is audited regularly both by external auditors and our internal auditors (Office of the City Auditor). Based on the findings of each audit, there is usually a list of recommendations proposed which are designed to improve operational effectiveness or correct an on-going error or non-compliance. The ICS manages a master audit recommendation database which keeps track of all open and completed audit recommendations. This database is shared with the Office of the City Auditor.

## **Major Accomplishments in Internal Controls**

### **Audit Recommendations**

The Internal Control Section (ICS) plays an active role in the monitoring and reporting of management's remediation activities of Audit Recommendations put forward by both the Office of the City Auditor and external auditing entities. During 2012, in total the ICS tracked and reported the completion of 188 Audit Recommendations by management, 133 of which were deemed as implemented by the respective auditors. This resulted in the closing of 8 audit reports in the database. During the course of the year, 20 new audits were added to our database and are currently being tracked and reported.

The ICS has continued to maintain a strong relationship with the Office of the City Auditor through continuous periodic reporting of completed audit recommendations by management. As of the end of December 2012, there were 178 open audit recommendations in the database from both internal and external audits. There are 48 individual audit reports that are marked as open. An audit will remain as open until all audit recommendations have been completed by City management and have been verified by the auditing agency (i.e. the Office of the City Auditor or an external auditing firm).

As a result of the efforts by the City over the last several years to improve internal control over financial reporting, we have seen a reduction in the number of audit findings for our annual Comprehensive Annual Financial Report (CAFR). For the FY12 CAFR there were no significant or material audit findings reported, which illustrates in part, the success that has been achieved with our internal controls program.

### **Process Documentation**

During the course of 2012, the ICS and City departments finished work on 39 process narratives and 39 workflow diagrams for a cumulative total of 270 posted Process Narratives and Workflow Diagrams. Completed process narratives provide instruction and support in many key functions which can have an impact on the City's Internal Controls over Financial Reporting. Completed process narratives address Accounts Payable, Treasury, Payroll and numerous other functions.

At the end of calendar year 2012, there were an additional 18 process narratives submitted to the Internal Control Section for review and approval prior to posting on Citynet. Each of these 18 submitted process narratives has been assigned to members of the Internal Control team and are currently in various stages of the completion process. ICS continues to publish its Master Schedule and distributes it via email to the desktop of each assigned process owner. The Master Schedule Summary indicates that there are now a total of 419 identified Process Narratives. At the end of December 2012, there were 27 process narratives being developed in current status and 103 past due process narratives. The ICS is in regular contact with all department stakeholders to facilitate the documentation of processes in a timely manner.

### **Partnership with Departments**

Calendar year 2012 presented additional opportunities for the ICS to enhance the internal controls culture of the City. Through partnerships with various departments, the ICS has been in a position to either participate directly or provide technical advice and guidance in several key business activities including the Annual Risk Assessment, CCS Security Redesign Project and the implementation of GRC10. By participating in these activities, internal controls are being integrated into the operations of the City at both the process level and the policy level.

### **Reporting**

On a monthly basis, the ICS maintains productivity statistics for all of the continuous activities that the section is performing. When requested, the ICS prepares a report for the Audit Committee detailing current progress.

### **Internal Controls Plan**

The Internal Controls Plan that was published in December 2011 and presented to Audit Committee and City Council in January 2012 contained two essential components: performance

of a Risk Assessment and the upgrading of Governance, Risk and Compliance (GRC) applications to the latest versions. An update on each aspect of the plan is outlined below:

**Risk Assessment**

As this was the first risk assessment performed by the Internal Controls Section, it was decided that it should be broken out into two distinct subject matter assessments. The first assessment (Citywide) focused on the environment within which business is conducted on a day to day basis. The second assessment (IT) was designed to focus on the Information Technology activities that are performed in the City. Each of these assessments were designed to establish a baseline from which to examine the structures in place which support internal control over financial reporting as opposed to strictly concentrating on financial reporting.

The Citywide assessment was developed with the majority of the questions falling within the scope of the Control Environment and Control Activities as defined by COSO. The intent of the Internal Controls Section was to solicit responses to the questions presented utilizing a top down approach. To accomplish this objective, the risk assessment was delivered to employees at the unclassified and unrepresented levels for all Mayoral departments and included employees from supervisory levels up to the Mayor and every person in between.

The IT assessment was developed using the principles set forth in both the COSO and CobiT framework. A targeted approach was also employed in the delivery of this risk assessment. Assessments were delivered to employees at the Senior Information Systems Analyst and above level for all Mayoral departments.

Assessments were designed in a user friendly format with an expected completion time of 15 minutes or less. Each assessment was delivered to the email inbox of each employee with a response date outlined. To protect the integrity of the assessments, recipients were advised that all responses would be treated confidentially and that any reporting that would take place would be on an aggregated basis.

Participation rates for the assessments were as follows:

Risk Assessment	Recipients	Completed	Uncompleted	Completed	Uncompleted
Citywide	455	285	170	62.6%	37.4%
IT	67	39	28	58.2%	41.8%

While the responses from the assessments are still being evaluated and strategies being developed to incorporate the results, several highlights exist within the following areas:

Tone at the Top

One of the key tools to conveying integrity and ethical values throughout the organization is through the use of an employee code of conduct. A question posed in the survey was designed to

determine the degree to which employees at all levels are familiar with the City's Employee Code of Conduct and the degree of awareness of their responsibilities with respect to the Code. Responses indicate that 59% of respondents reported being trained on the Employee Code of Conduct with only 41% of respondents reporting that they had received additional training to reinforce Code standards.

### Training

Assessment responses appear to indicate a further investment in training and staff skill development is required. Approximately 60% of respondents indicated that the current approach encompassing continuous learning, staff skill development, and the delivery of training ranks at a level of adequate or higher. This viewpoint is further confirmed by 54% of responses indicating that a demonstrated commitment exists to provide and retain sufficient and competent analytical and financial personnel to keep pace with the growth or complexity of departmental business.

### Business Continuity

An important component of a risk assessment is the determination of the risks associated with business continuity. Questions were posed in each of the assessments that were designed to gauge the awareness of employees to the existence of a business continuity (disaster recovery) plan for their specific department, in addition to the frequency of testing and subsequent revisions to ensure that the plan is relevant. For the Citywide assessment, approximately 41% of respondents were aware of the existence of a plan in comparison to the 60% reported in the IT assessment. Responses were consistent in respect to the frequency of testing and revision in that the majority reported that the plans were tested and updated on an as-needed basis.

### GRC10 Upgrade

While some delays have been experienced, forward progress on the movement to SAP GRC 10 has been constant. To date, training on both of the major components (Access Controls and Process Controls) has been received by both the Security and Internal Control project leaders. The application upgrade was initially installed in a sandbox environment where the project leaders were able to continue their knowledge and skill development and begin configuration of a simplified version. A limited amount of functionality testing was also performed in this environment with very positive results.

The project team then transitioned to a development environment where a scaled back model of City activities was used to populate the environment upon completion of the configuration tasks. This model was used to facilitate rigorous testing of the system and unfortunately issues were identified. In several instances, we moved to a new development environment where it was more efficient and expedient to apply the fix that SAP provided and begin again, rather than to try and repair the existing environment. This is where we experienced a significant delay. Currently, the team is working in the development environment on the configuration of the system. Once this configuration work is completed, the Master Data Upload Template, which has already been developed, will be used to populate the production environment. While delays in getting to the production environment have been experienced, the project team is confident of the

work performed to date. Without having to employ external consultants, we estimate the City has saved between a quarter and a half million dollars.

**SAP Governance, Risk and Compliance (GRC) Module**

ICS continues to work on resolving segregation of duties user violations. During 2012, approximately 10,000 users were analyzed each month for segregation of duties user violations. The total amount of violations reported during the year was 292. As can be seen below, the majority of violations occurred in March as a result of a technical failure which has since been corrected. As can be seen in the following table, we have been very successful in keeping the number of violations reported as close to zero as possible.

Month	Users Analyzed	Violations
Dec	10,210	1
Jan	10,161	1
Feb	10,167	2
Mar	10,052	282
Apr	9,891	6
May	9,967	0
Jun	10,018	0
Jul	10,029	0
Aug	10,077	0
Sep	10,073	0
Oct	10,084	0
Nov	10,117	0

The ICS has also continued using the GRC module to perform automated testing. Currently, testing is performed in key approval processes in the Accounts Payable, Payroll and Accounting functions. During 2012, we developed and implemented several new tests which have helped mitigate potential internal control deficiencies.

Month	Tests Performed
Dec	156
Jan	148
Feb	145
Mar	150
Apr	151
May	155
Jun	139
Jul	2
Aug	129
Sep	124
Oct	127
Nov	125

There are no other required reports for external entities or regulating bodies concerning the City's internal controls environment. The Office of the City Comptroller meets annually with Macias Gini and O'Connell, the City's contracted independent financial auditors, to discuss the current sufficiency of our internal controls environment. After these discussions, the independent auditor then makes an assessment as to the level of audit risk assigned to the City engagement which determines the scope of audit field work. The Audit Committee in their due diligence review of the City's CAFR asks questions of the external auditor related to the City's internal control environment.

### **Future Activities**

During the coming year, we will complete the implementation of the SAP GRC 10 module and roll it out to City users in phases. We will also participate in the CCS Security redesign and incorporate Public Utilities activities into our monitoring programs. In addition, we will also begin performing tests of controls in areas such as petty cash and procurement card purchases.

### **Conclusion:**

Since management's evaluation of the City's internal control environment within the past 90 days, there have not been any significant changes in internal controls policies or operations or in other factors that could significantly affect internal controls over financial reporting, including any corrective actions with regard to significant deficiencies and material weaknesses.

Management is continuing to develop and strengthen its internal control environment and is making significant progress. Many material key controls over financial reporting and transaction processing have been designed and implemented. Internal controls are being embedded into the City's financial processes and the City departments have made strong gains in implementing internal controls into daily business activities.

**RECOMMENDATIONS** N/A

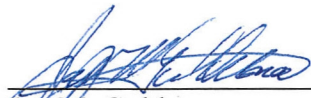
**FISCAL CONSIDERATIONS:** N/A

**COMMUNITY PARTICIPATION AND PUBLIC OUTREACH EFFORTS:** N/A

**KEY STAKEHOLDERS AND PROJECTED IMPACTS:** N/A

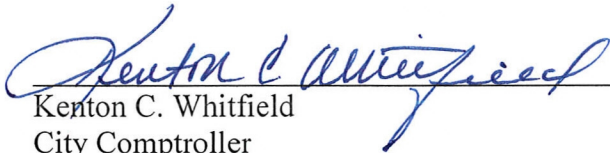
Attachments: 1. Certification by the Chief Financial Officer and City Comptroller

cc: Mayor Bob Filner  
Jan Goldsmith, City Attorney  
Andrea Tevlin, Independent Budget Analyst



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Jay M. Goldstone  
Chief Financial Officer



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Kenton C. Whitfield  
City Comptroller

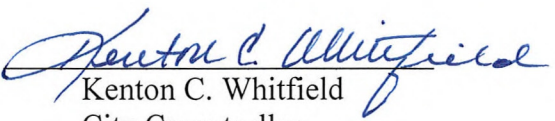


**CERTIFICATION BY MAYOR AND CHIEF FINANCIAL OFFICER**

In accordance with the requirements of §22.0708 of the San Diego Municipal Code, the Mayor's designee, the Chief Financial Officer and the City Comptroller 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 90 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 or not 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:   
Jay M. Goldstone  
Chief Financial Officer

Signed:   
Kenton C. Whitfield  
City Comptroller

Date: 1-28-13

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