



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

DATE ISSUED: December 20, 2013 REPORT NO: 14-008

ATTENTION: Honorable Members of the City Council and  
Audit Committee Members

FROM: Mary Lewis, Chief Financial Officer  
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 2013. While the Ordinance calls for an annual review and report, it is important to note that the City now 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. Internal Controls, by its very nature, is a continuous process of assessment, development, monitoring, remediation and refinement to achieve effective and efficient operations, accurate and complete financial data, and safeguard assets and resources. The ICS is currently using the SAP Governance, Risk and Compliance (GRC) 10 module to achieve these objectives and strengthen the City's control environment.

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.

## **Major Accomplishments in Internal Controls**

### **GRC10 Implementation**

The majority of 2013 was dedicated to the implementation of the newest, more extensive version of SAP Governance, Risk and Compliance (GRC) 10 module. As outlined in previous reports, this module is a solution that SAP has developed to integrate numerous applications involving systems access, role management, risk management, policy and process review and continuous control monitoring under one umbrella. This implementation has allowed the ICS to develop a global perspective covering all SAP systems including the Public Utilities Customer Care Solution and Financial Management's Public budget formulation Modules. Prior to this implementation, cross system analysis was not possible.

During the course of the implementation, we experienced several delays in both the configuration and hardware arenas, which in turn delayed the rollout to end users. Despite these delays, solutions to all issues were achieved without the added expense associated with the use of consultant expertise. Despite performing significant amounts of testing in both the Sandbox and Development Environments, the decision was made to assign testing activities in the Production Environment to members of the Internal Control team to ensure that what the end users ultimately received was accurate and reliable for monitoring purposes. After reviewing testing activities and fine tuning monitoring criteria for a period of three months, several testing protocols are currently being released on a phased basis.

To date some key statistics relating to the GRC 10 Module include:

- Generation of processes, subprocesses, and controls associated with 271 published Process Narratives

- Creation of 271 assessment surveys for each documented process
- Development of 1153 assessment related questions
- Implementation of 46 mitigating controls for segregation of duty violations

Assessment testing for Process Narratives owned and published by the Office of the City Comptroller is being conducted in December. In addition, manual test plans have been developed for testing the accuracy, validity and authorization associated with employee reimbursements in payroll and, reviewing the authenticity and appropriateness of procurement card transactions through the new Bank of America Procurement Card Program.

Using the legacy and GRC10 systems in parallel has allowed us to expand our analysis of segregation of duty violations across multiple systems. Segregation of duty (SOD) violations occur when one individual has control over conflicting phases of a transaction or activity. Due to the importance of maintaining controls around segregation of duty violations, continuous monitoring is performed by the ICS. During 2013, in the legacy system approximately 10,000 users were analyzed each month for segregation of duties user violations. The total amount of violations reported during the year was zero. 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.

<b>Month</b>	<b>Users Analyzed</b>	<b>Violations</b>
Dec	10,169	0
Jan	10,140	0
Feb	10,137	0
Mar	10,185	0
Apr	10,226	0
May	10,271	0
Jun	10,319	0
Jul	10,345	0
Aug	10,368	0
Sep	10,409	0
Oct	10,411	0
Nov	10,469	0

Using the added functionality of the GRC10 module, a new custom rule set for determining segregation of duties user violations has been developed in partnership with the ERP Security Team which will allow us to analyze violations which could occur when users have access to multiple systems. Currently, we are analyzing the segregation of duties user violations that are reporting through the Customer Care Solutions and its impact on user controls in SAP.

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. A key improvement in the GRC 10 functionality allows us to initiate testing in a more effective and efficient manner. A good example of this is where we can now run automated testing for risk mitigation purposes on a weekly basis as opposed to a daily basis. This will have the effect of maintaining the appropriate level of review while minimizing the amount of time that the test receiver will need to log into the system to perform their monitoring activities. As

can be seen from the table below, this has reduced the number of tests being performed while maintaining oversight and diminishing monitoring fatigue.

<b>Month</b>	<b>Tests Performed</b>
Dec	124
Jan	124
Feb	112
Mar	124
Apr	62
May	34
Jun	3
Jul	9
Aug	10
Sep	18
Oct	15
Nov	15

### **Process Documentation**

During the course of 2013, the ICS and City departments finished work on 61 process narratives and 61 workflow diagrams for a total of 312 posted Process Narratives and Workflow Diagrams. To date, process narratives have been completed and provide instruction and support in many key functions which can have an impact on the City's Internal Controls over Financial Reporting. Process narratives have been completed which address Accounts Payable, CAFR, Payroll, Public Utilities, Treasury, and numerous other functions.

At the end of calendar year 2013, there were an additional 28 process narratives submitted to the Internal Control Section for review and approval prior to posting on Citynet. Each of these 28 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 422 identified Process Narratives. At the end of December 2013, there were 28 process narratives being developed in current status and 21 past due process narratives. The ICS is in regular contact with all department stakeholders to facilitate the documentation of processes in a timely manner.

### **Procurement Card (P-Card) and Voyager Fuel Card**

In October, the City changed the credit card provider bank from US Bank to Bank of America. As a result, services for the existing Procurement Card (P-Card) and Voyager Fuel Card accounts are now being provided by the same bank, under one program. Prior to the new program implementation, ICS assisted the Comptroller's Office Disbursement Section in performing an analysis of each existing program (review of credit limits, cardholder assignments, spending patterns etc.) which resulted in recommendations designed to increase oversight and accountability, reduce the City's credit exposure and fraud risk while allowing departments to

effectively use the cards as necessary to support operational activities. In addition, ICS assisted in the Citywide training prior to the issuance of the new credit cards under this program.

As part of the post program implementation, reviews will be conducted of selected departments' P-Card spending activity and related supporting backup documentation (i.e. expense reports, receipts, etc.) using the testing capabilities in the GRC10 module as outlined above.

### **Partnership with Departments**

Calendar year 2013 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 Customer Care Solution (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.

Some delays have been experienced with the CCS Security Redesign Project, however, progress has been made by the Department of Information and Technology in the review of existing security, development of test plans and new roles and creation of new functionality based on new security roles in the development environment.

As part of the need for on-going internal controls support for the Public Utilities Department (PUD), ICS has added an Accountant position dedicated to support PUD. This position is responsible for, but not limited to, the following:

- Create and implement an internal control framework as it relates to the CCS Security Redesign Project.
- Analysis of process documentation submitted by PUD for control weaknesses and process gaps, provision of guidance and support resulting in publication of process documentation.
- Record and report PUD audit recommendations issued by both internal and external agencies.
- Integration of related process documentation and controls into the SAP GRC module in order to provide continuous control monitoring, segregation of duties analysis, and manual and automated control testing of PUD functions.

In addition, the ICS is also supporting the Purchasing and Contracting Departments detailed analysis of the Procure-to-Pay module. This analysis is being performed due to control weaknesses that were identified previously. The ICS will play a critical role in facilitating the identification of additional weaknesses if present and the development of appropriate mitigations where necessary.

### **Reporting**

On a monthly basis, the ICS maintains productivity statistics for all of the continuous activities that the section is performing and can easily report on current progress.

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 2014, we will continue to perform our daily functions in respect to the maintenance and continued development of a robust internal control environment. Our commitment to the publication of outstanding Process Narratives remains strong as we continue to strive towards the completion of all 422 items on the master pending list. As outstanding Process Narratives are published, we will develop testing protocols which will be placed into the SAP GRC 10 module to ensure that the internal controls over financial reporting are effective and are functioning as intended.

The ICS also intends to expand the scope of transactional testing and monitoring to additional business functions that are not currently being tested or monitored within the SAP GRC 10 module. Areas targeted for examination and inclusion include SAP system management, Purchasing and Human Capital Management.

Additionally, there are several other initiatives that we plan to pursue in 2014 and in subsequent years. The most significant of these initiatives relates to the performance of a comprehensive SAP Role Review followed closely thereafter by a User Access Review. Both of these activities would be performed by a joint team made up of members of the ICS and SAP Security sections. The ICS also intends to implement a process in the SAP GRC 10 module which would allow us to link the SAP role assignments and Process Narratives through an employee training and verification platform. This would support the goal that all employees who perform actions in SAP have been trained appropriately to perform their assigned responsibilities. Additionally, we would like to explore the potential to use other components contained within the SAP GRC 10 module, such as; Risk Management, Policy Management, Client User Provisioning to increase efficiency and effectiveness within the City.

### **Conclusion:**

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. A key measure of our success to date is the lack of material or significant audit findings being reported in our most recent audits of the Comprehensive Annual Financial Reports for Fiscal Years 2012 and 2013. Management continues to develop and strengthen its internal control environment and is making significant progress as many material key controls have been designed and implemented.

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.

**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 Operating Officer, Chief Financial Officer and City Comptroller

cc: Todd Gloria, Interim Mayor  
Jan Goldsmith, City Attorney  
Andrea Tevlin, Independent Budget Analyst

  
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Mary Lewis, Chief Financial Officer

  
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Kenton 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 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 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:   
Scott Chadwick, Chief Operating Officer

Date: 23 DEC 13

Signed:   
Mary Lewis, Chief Financial Officer

Date: 12/20/13

Signed:   
Kenton Whitfield, City Comptroller

Date: 12-20-13