



City of San Diego

Governance Over the Audit and the
Financial Statements

City Council Meeting
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Certified
Public
Accountants



Presenters

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Overview

- o Governance and Required Communications
- o Review of a Comprehensive Annual Finance Report (CAFR)

Governance and Required Communications





Basic Terminology

Standard Setting Bodies

- o GASB – Governmental Accounting Standards Board
- o FASB – Financial Accounting Standards Board
- o AICPA – American Institute of Certified Public Accountants
- o GAO – Government Accountability Office

Professional Organizations*

- o GFOA – Government Finance Officers Association
- o CSMFO – California Society of Municipal Finance Officers

*organizations of public officials to enhance and promote the management of governmental financial resources



Statement on Auditing Standards (SAS's)

- Issued by the American Institute of Certified Public Accountants (AICPA)
- Applicable to all industries and organizations
- Establishes the professional framework for performing financial statement audits



Definitions

Those Charged with Governance

“Persons with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity.”

Management

“Persons responsible for achieving the objectives of the entity and who have the authority to establish policies and make decisions by which those objectives are to be pursued.”



Roles

Governing Body

- Typically responsible for approving/accepting the entity's financial statements
 - (includes overseeing the financial reporting process)
 - (encompasses board of directors or audit Committees)

Management

- Responsible for the financial statements
 - (includes designing and implementing effective internal controls over financial reporting)



Purpose of an Audit Committee

- Valuable tool for ensuring that all those responsible for financial reporting meet their respective responsibilities
 - management, the independent auditors, and the governing body
- The audit committee is an “arm” of the City Council to provide oversight and monitoring
- Provides independent review and oversight of –
 - financial reporting processes;
 - internal controls over financial reporting; and
 - independent audit



Who Needs an Audit Committee?

- Government Finance Officers Association (GFOA) urges every governing body, no matter how small the governmental entity, should have an audit committee
 - Practical means for assisting the governing body to meet its oversight responsibilities and for making independent recommendations without the need of the entire governing body
 - Allows the City Council to delegate the detail review while preserving their oversight role
 - Provides for outside citizen participation and financial expertise



Goals of an Audit Committee

Assurance or satisfaction that management is maintaining a comprehensive framework of internal controls

Ensure that management's financial reporting practices are objectively assessed

- o Needs to determine that the financial statements are properly audited and any problems/issues disclosed during the course of the audit process are satisfactorily resolved



Purpose of Communication

- o Communicate the responsibilities of the auditor in relation to the financial statement audit (an overview of the scope and timing of the audit)
- o Provide timely observations arising from the audit that are relevant to their responsibility in overseeing the financial reporting process
- o Communicate in writing any significant findings (internal controls, noncompliance with laws or regulations, fraud, etc.)
- o Oversight and monitoring of follow-up and corrective action taken by management regarding findings



Communicating Auditor Responsibilities

Matters communicated may include:

- o How the auditor proposes to address significant risks due to fraud or error
- o Auditor's limited approach relating to internal control
- o Concept of materiality (quantitatively)
- o Extent of reliance on an internal audit function (work conducted by the City Auditor's Office)



Financial Reporting Process

- o Management is responsible for the financial statements
- o The audit committee and/or governing body should oversee and monitor the process throughout the year
- o Part of the review process can include monthly or quarterly unaudited budgetary statements



Internal Controls

- Management is responsible for establishing and monitoring the internal controls and their effectiveness
- The audit committee and/or governing board is ultimately responsible for the **oversight** of the controls
- Testing and review of the internal controls should be performed on a cyclical basis and the process and product should be reviewed by the audit committee



Assessing the Internal Control Framework

The audit committee should consider:

- Findings of the external auditors and the City Auditor's Office
- Significant audit adjustments
- Code of conduct
- Management's involvement with internal controls
- New system implementations
- Implementation of new City programs
- Complaints
- Changes in accounting
- Changes in laws and regulations



Internal Controls Over Financial Reporting

- The City of San Diego has a Disclosure Practices Working Group (DPWG)
- Reviews financial disclosures within the draft CAFR to ensure accuracy and compliance with federal and state securities laws
- Comprised of senior City officials, legal staff, and independent disclosure counsel
- Audit Committee can appoint a representative for participation along with the IBA and City Auditor.



Internal Controls Over Financial Reporting

City of San Diego CAFR Review Process

- o Audit Committee representation participating in the DPWG
- o Audit Committee reviews the audited draft CAFR
 - Presentation of CAFR by City management
 - Presentation of the results of the audit by the external auditors
 - Audit Committee poses due diligence questions to management and the independent auditor
 - Certifications and written responses to questions posed received in advance of the meeting



Assessing Internal Controls in Connection with the Audit

- o Before year-end the auditor documents and assesses the internal controls surrounding the various processes as part of the audit procedures
- o The controls and the results of these tests determine how much reliance we can place on the internal controls
- o Used for designing our audit procedures
- o The annual audit **does not** include an audit of internal controls



Written Communication on Controls

- o Requires the auditor to communicate, in writing, to management and those charged with governance, significant deficiencies and material weaknesses identified in an audit
- o Letter is referred to as the Report on Internal Controls Over Financial Reporting



Indicators of a Material Weakness

- Identification of fraud on the part of senior management
- Restatement of prior financial statements to correct a material error
- Identification of a material misstatement that was not detected by the entity's internal control
- Ineffective oversight of the entity's financial reporting process and internal controls

CAFR Overview





C A F R

**INTRODUCTION &
TRANSMITTAL LETTER**

INDEPENDENT AUDITOR'S OPINION

MANAGEMENT'S DISCUSSION AND ANALYSIS

Government-Wide (Full Accrual)

Governmental Activities

Business-Type Activities

(No Internal Service or Fiduciary Funds)

Fund

Governmental (Modified Accrual)

Proprietary (Full Accrual)

Fiduciary (Full Accrual)

Notes to the Financial Statements

REQUIRED SUPPLEMENTAL INFORMATION

(Other Than MD&A)

SUPPLEMENTARY INFORMATION

STATISTICAL SECTION



CAFR Contents

- o Introductory section
- o Independent auditor's opinion
- o Management discussion & analysis (MD&A)
- o Government-wide financial statements
- o Fund financial statements
- o Budgetary comparison information
- o Notes to the financial statements
- o Statistical information



Independent Auditor's Report

What does the Auditor's Opinion Cover?

- Basic Financial Statements (pages 54-67)
- Notes to the Basic Financial Statements (pages 68-188)
- Combining and Individual Fund Financial Statements and Schedules (pages 205-289)

What is Not Covered by the Auditor's Opinion?

- Introductory Section (pages 13-30)
- Management's Discussion and Analysis (pages 37-50)
- Required Supplementary Information (pages 191-193)
- Statistical Section (pages 293-331)



What to Look for in the Introductory Section

- o Introductory Section
 - Transmittal letter
 - Letter to the citizens from Mayor and Executive Management
 - Highlights the year's activities
 - Future plans
 - Opportunity to “story tell”
 - Major accomplishments



What to Look for in the Independent Auditor's Report

- o Report should indicate be in accordance with *Government Auditing Standards*
- o Report should indicate what was audited
- o Report will outline both management and the auditor's responsibilities
- o Opinion should be unqualified – “clean” opinion
- o Date of opinion – why is this important?



What to Look for in the MD&A

- o **Management's Discussion & Analysis (MD&A)**
 - Highlights at a summary level overall financial position and changes in financial position
 - Discusses reasons for significant changes
 - Separately address governmental and business-type activities
 - Important economic factors that had an effect/impact on operations



What to Look for in the Government-wide Financial Statements

Government-wide Reporting for Primary Government

- Accrual basis of accounting - all funds
- **Statement of Net Position**
 - Focus on net economic worth (long-term assets and liabilities are included)
- **Statement of Activities**
 - Focus on program expenses and how programs are financed
 - Program revenues
 - General revenues



Government-wide Statements Include Components Units

- o Discretely presented component units
 - Financially and legally separate from the primary government
 - Not included within the primary government
 - Shown in a separate column on the Statement of Net Position and the Statement of Activities
 - The City has discretely presented component units:
 - San Diego Convention Center Corporation
 - San Diego Housing Commission



Government-wide Statements Include Components Units

- o Blended component units – are included within the primary government
 - Civic San Diego
 - Convention Center Expansion Financing Authority
 - Public Facilities Financing Authority
 - San Diego Facilities & Equipment Leasing Corporation



Government-wide Statements Include Components Units

- o Blended component units – are included within the primary government (continued)
 - San Diego Industrial Development Authority
 - Tobacco Settlement Revenue Funding Corporation



What to Look for in the Fund Financial Statements

o Fund-level Reporting

- Focus on “major funds” for governmental & business type funds
- All other funds combined into a single column
- Governmental funds use modified accrual
- Proprietary / business-type funds use full accrual
- Reconciliation between fund & government-wide financial statements
- Detail of “other funds” in the supplemental section of CAFR



What to Look for in Budgetary Information

- o **Budgetary Comparison Schedules**
 - General Fund – Required Supplementary Information (RSI)
 - Original adopted budget
 - Final amended budget
 - Actual expenditures
 - Variance between final budget and actual expenditures



What to Look For in Note Disclosures

- o Note 1- Accounting policies, overview of the reporting entity and components units
- o Note 5 and 6 - Long-term debt
- o Note 11 - Pension plans
- o Note 12 - Other postemployment benefits
- o Note 16 – Commitments
- o Note 17 - Contingencies
- o Note 23 - Subsequent events



What to Look for in the Statistical Section

o **Statistical Section**

- Ten-year trend information
 - *Net position by component*
 - *Changes in net position*
 - *Principal taxpayers*
- Debt statistics
- Various demographic information



Questions & Contact Information

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Thanks for Listening.

Questions?