

CITY AND COUNTY OF SAN FRANCISCO

Report to Government Audit and Oversight Committee
Year Ended June 30, 2013

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Year Ended June 30, 2013

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Certified Public Accountants.

Sacramento

Oakland

LA/Century City

Newport Beach

San Diego

Seattle

Government Audit and Oversight Committee
Mr. Ben Rosenfield, Controller
City and County of San Francisco
San Francisco, California

We have audited the financial statements of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City and County of San Francisco, California (City), as of and for the year ended June 30, 2013. Our report includes a reference to other auditors. 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 Francisco International Airport, San Francisco Water Enterprise, Hetch Hetchy Water and Power, San Francisco Municipal Transportation Agency, San Francisco Wastewater Enterprise, San Francisco Market Corporation, and the Health Service System, as described in our report on the City's 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.

Professional auditing standards require that we provide you with information about our responsibilities under generally accepted auditing standards, *Government Auditing Standards* and U.S. Office of Management and Budget (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 Audit Plan to you dated July 25, 2013. Professional standards also require that we communicate to you other information related to our audit as discussed in the Required Communications section.

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

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

We have also included a recommendation identified in our audit in the accompanying Current Year Recommendation section of this report. The City's response to the recommendation is also described in the accompanying Current Year Recommendation section. The City's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it. In addition, we would be pleased to discuss the recommendation in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing this recommendation.

In addition, we have provided a status of the prior recommendations made by us.

We would like to thank City management and staff for the courtesy and cooperation extended to us during the course of our engagement.

The accompanying required communications, management comments, and recommendations are intended solely for the information and use of the Government Audit and Oversight Committee, Board of Supervisors, City management, and others within the organization, and are not intended to be and should not be used by anyone other than these specified parties.

Macias Gini & Connell LLP

Walnut Creek, California
November 27, 2013

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REQUIRED COMMUNICATIONS

I. 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 2 to the financial statements. As described in Note 2(s) to the financial statements, the City changed accounting policies related to the following:

- ***GASB Statement No. 60 – Accounting and Financial Reporting for Service Concession Arrangements***

This statement addresses how to account for and report service concession arrangements (SCAs), a type of public-private or public-public partnership that state and local governments are increasingly entering into. Common examples of SCAs include long-term arrangements between a transferor (a government) and an operator (governmental or non-governmental entity) in which the transferor conveys to an operator the right and related obligation to provide services through the use of infrastructure or another public asset in exchange for significant consideration and the operator collects and is compensated by fees from third parties. As of July 1, 2012, the City adopted the provisions of this statement, which did not have a significant impact on its financial statements.

- ***GASB Statement No. 61 – The Financial Reporting Entity: Omnibus***

This statement modifies existing requirements for the assessment of potential component units (as stated in GASB Statement No. 14 – *The Financial Reporting Entity* and Statement No. 34 – *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*) in determining what should be included in the financial reporting entity and financial reporting disclosure requirements. As of July 1, 2012, the City adopted the provisions of this statement, which did not have a significant impact on its financial statements.

- ***Statement No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements***

This statement incorporates into the GASB’s authoritative literature certain accounting and financial reporting guidance that is included in the FASB and AICPA pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements. As of July 1, 2012, the City adopted the provisions of this statement, which did not have a significant impact on its financial statements.

- ***GASB Statement No. 63 – The Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position***

This statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. This statement also amends the net asset reporting requirements in Statement No. 34 – *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*, and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. As of July 1, 2012, the City adopted the provisions of this statement, which did not have a significant impact on its financial statements.

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REQUIRED COMMUNICATIONS (Continued)

I. Qualitative Aspects of Accounting Practice (Continued)

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:

- a) Fair value of investments (including investment derivatives) and related net appreciation in the fair value of investments in the pension trust fund;
- b) Accrual and disclosure of claims liabilities;
- c) Estimated contractual adjustments and bad debt allowances for patient accounts receivable;
- d) Cost report settlement receivables and payable;
- e) Estimated bad debt allowance for accounts and loans receivable;
- f) Accrual of compensated absences;
- g) Depreciation estimates for capital assets, including depreciation methods and useful lives assigned to depreciable properties;
- h) Actuarial data of the pension plan and other postemployment benefits plans; and
- i) Estimated pollution remediation costs.

Management's judgments and estimates were based on the following:

- a) Management's estimate of the fair value of investments in the pension trust fund is discussed in Note 2(d) to the financial statements.
- b) Reserves for workers' compensation and general liability claims were based on actuarially evaluations using historical loss and other data. Reserves for other claims liabilities were determined by the City Attorney's judgment about the ultimate outcome of the claim.
- c) Estimated bad debt allowances for patient accounts receivable were based on historical experience. See d) below for basis for contractual adjustments.
- d) Estimated contractual adjustments and cost report balances were based on prior cost report adjustments, previous regulatory settlements, and potential future retrospective adjustments.
- e) Estimated bad debt allowance for accounts receivable was based on historical experience and loans receivable was based on the type of loan (e.g., forgivable, deferred, grant or amortizing) and management's estimate regarding the likelihood of collectability based on loan provisions and collateral.
- f) Accrual of compensated absences is based on unused employee sick leave and vacation and the employees' pay rates at year-end.

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REQUIRED COMMUNICATIONS (Continued)

I. Qualitative Aspects of Accounting Practice (Continued)

- g) Useful lives for depreciable property were determined by management based on the nature of the capital asset. The City uses the straight line method of depreciation and three different conventions for the amount of first-year depreciation based on the departments that purchased the capital assets.
- h) The actuarial pension and other postemployment benefits data, including the funded status and required contributions of the plans, are based on actuarial calculations performed by the City's independent actuaries.
- i) Estimated pollution remediation costs are based on reports from independent consultants.

We evaluated the key factors and assumptions used to develop these accounting estimates in determining that they are reasonable in relation to the financial reporting units (opinion units) that collectively comprise the City's basic financial statements.

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 disclosures related to pension benefits and other postemployment benefits. The disclosures about pension benefits and other postemployment benefits are described in Note 9 to the financial statements and are based on actuarial valuations.

The financial statement disclosures are neutral, consistent, and clear.

II. Difficulties Encountered in Performing the Audit

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

III. 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 summarizes uncorrected misstatements of the financial statements. Management has determined that their effects are immaterial, both individually and in the aggregate, to each opinion unit's financial statements taken as a whole. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to each opinion unit's financial statements taken as a whole.

IV. 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.

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REQUIRED COMMUNICATIONS (Continued)

V. Management Representations

We have requested certain representations from management that are included in the management representation letter dated November 27, 2013.

VI. 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 City'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.

VII. 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 City's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

VIII. Other Information in Documents Containing Audited Financial Statements

During the year, the City included its audited basic financial statements in various debt offering documents (e.g., official statements). We do not have an obligation to perform any procedures to corroborate other information contained in such debt offering documents. We were not associated with and did not have any involvement with such documents. Accordingly, we did not perform any procedures on these documents and provide no assurance as to the other information contained in the debt offering documents.

Our responsibility for other information in documents containing the City's basic financial statements and our report thereon does not extend beyond financial information identified in our report, and we have no obligation to perform any procedures to corroborate other information contained in these documents. We have, however, read the other information included in the City's comprehensive annual financial report for the year ended June 30, 2013, and no matters came to our attention that caused us to believe that such information, or its manner of presentation, is materially inconsistent with the information, or its manner of presentation, appearing in the financial statements.

With respect to the supplementary information accompanying the financial statements, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

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CURRENT YEAR RECOMMENDATION

Item 2013-1 – Other Matter
Governance of Payroll Process

eMerge PeopleSoft is an integrated Human Capital Management (HCM) System that provides improved human resources, benefits administration, and payroll services to the City.

In August 2012, the Controller's Office eMerge Division launched and replaced many of the City's existing human resources, benefits administration, and payroll processes and systems with one online system – eMerge PeopleSoft. While the Controller's Office eMerge Division oversees the operation of the payroll system, City departments had outdated policies and procedures based on the prior payroll system. The eMerge system as it is currently configured does not have a function to allow supervisory approval of pay rate changes in the system. As a result, certain departments have documented such approvals outside of the system and others may not retain any documentation indicating that pay rate changes were approved.

Given the City's complexity, a decentralized structure may be practical and create efficiencies in operations. However, the Controller's Office should be the oversight agency to (1) provide overall policy direction for departments in developing specific procedures to ensure decentralized processes are consistent with citywide policies and to (2) continually monitor departments for consistent application of established policies and procedures.

We recommend that the Controller's Office prioritize the drafting and release of formal payroll policies and procedures to be used as a guideline by all City departments to establish proper payroll controls citywide.

Management Response:

Consistent with the recommendations above, the Controller's Office has implemented a number of internal control procedures to ensure accurate and timely payroll processing. Specifically addressing the Auditors' recommendation that formal policies and procedures be drafted and distributed to departments, the Controller's Office issued to departments in January 2014 formal policies and procedures for using the new eMerge Peoplesoft system.

Since fall of 2013, the Payroll and Personnel Services Division of the Controller's Office (PPSD) have also implemented various key controls:

1. PPSD staff has resumed site visits of selected departments to review for adherence with internal controls and quality assurance, identifying payroll discrepancies and recommending mitigation measures to prevent errors and omissions.
2. Additional reporting and analysis has been developed to permit detailed comparisons between pay periods of all types of earnings and deductions prior to the authorization by PPSD that payroll be run and distributed.
3. Exception reporting for high-risk pay transactions such as large net pays is being performed and analyzed each pay period.
4. PPSD continues to hold monthly user group meetings.
5. The eMerge Division provides frequent payroll software training updates for new hires and as-needed training for existing human resources and payroll staff.

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CURRENT YEAR RECOMMENDATION

Item 2013-1 – Other Matter (Continued)

In addition, PPSD is updating procedures to ensure a formal approval process of pay rate changes is implemented. In the meantime, departments continue to use reports that identify pay rate changes to monitor and verify correct pay rates.

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STATUS OF PRIOR YEAR RECOMMENDATIONS

Successor Agency of the Redevelopment Agency

Reference Number:	2012-1 Internal Control Over Financial Reporting – Preparation of Financial Statements <i>Material Weakness</i>
Finding/ Comment:	Finding involved insufficient staffing to adequately support the Successor Agency’s financial reporting responsibilities resulting in a deficiency in internal controls.
Status of Corrective Action:	Implemented. The Successor Agency increased financial administration capacity and improved internal controls by contracting with the City for a Deputy Director for Finance and Administration who is experienced in the City’s financial management information system, as well as working with the City Controller’s Office and City Treasurer’s Office with other administrative tasks. In addition, the Successor Agency successfully concluded the Due Diligence Review processes for “Low and Moderate Income Housing Fund” and “Other Funds and Accounts” required by California Health and Safety Code (HSC) section 34179.5 and reached agreement with the California Department of Finance to remit \$11.5 million in unobligated funds for distribution to taxing entities. The completion of these reviews improved financial staff’s capacity for day-to-day operations and year-end financial reporting.

San Francisco City and County Employees’ Retirement System

Reference Number:	2012-2 New Pension Accounting Standards <i>Informational Comment</i>
Finding/ Comment:	In June 2012, the Governmental Accounting Standards Board (GASB) issued two new accounting and financial reporting standards for pension plans: Statement No. 67, <i>Financial Reporting for Pension Plans – an amendment of GASB Statement No. 25</i> , and Statement No. 68, <i>Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27</i> . These new standards will dramatically change the Retirement System’s and the City’s financial statements and disclosures and will result in the recognition of a net pension liability in the City’s financial statements. We recommend the City consult with the Retirement System’s actuary to develop a better understanding of and to quantify the impact of these new accounting and reporting standards on the City’s current financial statements.
Status of Corrective Action:	In progress. The City is currently analyzing its accounting practices to determine the potential impact on the financial statements of these new pronouncements.

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UNCORRECTED FINANCIAL STATEMENT MISSTATEMENTS

Index	Fund Type	Description	STATEMENT OF NET POSITION / BALANCE SHEET			STATEMENT OF CHANGES IN NET POSITION / FUND BALANCE		
			Assets DR (CR)	Liabilities DR (CR)	Net Position DR (CR)	Revenue DR (CR)	Expenses DR (CR)	
GOVERNMENTAL ACTIVITIES								
	General Fund	Effect of net adjustments from General Fund (see below)	\$ -	\$ (4,402,597)	\$ -	\$ -	\$ -	\$ 4,402,597
GAI	Governmental Activities	General Liabilities	-	7,207,000	-	-	-	-
	Governmental Activities	Legal Expenses	-	-	-	-	-	(7,207,000)
		<i>To adjust general liability for large case reserves.</i>						
		TOTAL GOVERNMENTAL ACTIVITIES	\$ -	\$ 2,804,403	\$ -	\$ -	\$ -	\$ (2,804,403)
BUSINESS-TYPE ACTIVITIES								
BA1	Business-Type Activities	Effect of net adjustments from SF General Hospital (see below)	\$ 2,934,468	\$ -	\$ -	\$ (2,934,468)	\$ -	\$ -
	Business-Type Activities	Effect of net adjustments from Laguna Honda Hospital (see below)	2,697,722	-	(310,905)	(2,386,817)	-	-
		TOTAL BUSINESS-TYPE ACTIVITIES	\$ 5,632,190	\$ -	\$ (310,905)	\$ (5,321,285)	\$ -	\$ -
GENERAL FUND								
GF1	General Fund	Expenditure	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 4,402,597
	General Fund	Accounts Payable	-	(4,402,597)	-	-	-	-
		<i>To record expenditures in the proper period.</i>						
		TOTAL GENERAL FUND	\$ -	\$ (4,402,597)	\$ -	\$ -	\$ -	\$ 4,402,597
SAN FRANCISCO GENERAL HOSPITAL								
SFGH1	SF General Hospital	Allowance for Contractual Adjustment	\$ 2,000,000	\$ -	\$ -	\$ -	\$ -	\$ -
	SF General Hospital	Medicare Contractual Adjustment - Inpatient	(2,000,000)	-	-	-	-	-
		<i>To reverse the contractual allowance cushion recorded in prior year.</i>						
SFGH2	SF General Hospital	Patient Accounts Receivable	2,934,468	-	-	-	-	-
	SF General Hospital	Medi-Cal Inpatient Revenue	-	-	-	(1,399,177)	-	-
	SF General Hospital	Net Position - Beginning	-	-	-	(1,535,291)	-	-
		<i>To accrue unrecorded FY 2013 patient revenues and receivables recorded in FY 2014 and the effect of the FY 2012 revenues recorded in FY 2013.</i>						
		TOTAL SAN FRANCISCO GENERAL HOSPITAL	\$ 2,934,468	\$ -	\$ -	\$ (2,934,468)	\$ -	\$ -

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UNCORRECTED FINANCIAL STATEMENT MISSTATEMENTS (Continued)

Index	Fund Type	Description	STATEMENT OF NET POSITION / BALANCE SHEET				STATEMENT OF CHANGES IN NET POSITION / FUND BALANCE					
			Assets		Liabilities		Net Position		Revenue		Expenses	
			DR (CR)	DR (CR)	DR (CR)	DR (CR)	DR (CR)	DR (CR)	DR (CR)	DR (CR)	DR (CR)	DR (CR)
LAGUNA HONDA HOSPITAL												
LHH1	Laguna Honda Hospital	Patient Accounts Receivable	\$	541,363	\$	-	\$	-	\$	-	\$	-
	Laguna Honda Hospital	Net Patient Service Revenue	-	-	-	-	-	-	(230,458)	-	-	-
	Laguna Honda Hospital	Net Position - Beginning	-	-	-	-	(310,905)	-	-	-	-	-
		<i>To accrue unrecorded FY 2013 patient revenues and receivables recorded in FY 2014 and the effect of the FY 2012 revenues recorded in FY 2013</i>										
LHH2	Laguna Honda Hospital	Patient Accounts Receivable		2,156,359		-		-		-		-
	Laguna Honda Hospital	Net Patient Service Revenue		-		-		-		(2,156,359)		-
		<i>To record the difference between the accounts receivable subsidiary ledger and the general ledger.</i>										
LHH2	Laguna Honda Hospital	Equity Investments		1,136,000		-		-		-		-
	Laguna Honda Hospital	Money Market Mutual Funds		(1,136,000)		-		-		-		-
		<i>To correct investment classification as of June 30, 2013.</i>										
		TOTAL LAGUNA HONDA HOSPITAL	\$	2,697,722	\$	-	\$	(310,905)	\$	(2,386,817)	\$	-
TIDA												
TIDA1	TIDA	Charges for Services Receivable	\$	23,020	\$	-	\$	-	\$	-	\$	-
	TIDA	Charges for Services Revenues	-	-	-	-	-	-	(23,020)	-	-	-
	TIDA	Expenses	-	-	-	-	-	-	-	23,020	-	-
	TIDA	Accounts Payable	-	-	(23,020)	-	-	-	-	-	-	-
		<i>To accrue rent payment for June 2013.</i>										
		TOTAL TIDA	\$	23,020	\$	(23,020)	\$	-	\$	(23,020)	\$	23,020

