AIRPORT COMMISSION
CITY AND COUNTY OF SAN FRANCISCO
SAN FRANCISCO INTERNATIONAL AIRPORT

Schedule of Findings and Responses

Year ended June 30, 2014

I. Summary of Auditors' Results

1. The type of report issued on the basic financial statements: **Unmodified opinion**

2. Significant deficiencies in internal control were disclosed by the audit of the financial statements: **None reported**

   Material weaknesses: **Yes**

3. Noncompliance which is material to the financial statements: **None**

4. Significant deficiencies in internal control over the passenger facility charge program: **None reported.** Material weaknesses: **None**

5. The type of report issued on compliance for the passenger facility charge program: **Unmodified opinion**

6. Any audit findings: **Yes**

II. Findings and Responses Related to the Passenger Facility Charge Program

None

2014-01 Lack of controls over identifying and recording capital assets as well as appropriately recording depreciation expense in accordance with established policies

Criteria

According to Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, paragraph 19, as amended, capital assets include land, improvements to land, easements, buildings, building improvements, vehicles, machinery, equipment, works of art and historical treasures, infrastructure, and all other tangible or intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period. Further, GASB Statement No. 34 paragraphs 21, as amended, and 22 require the net cost recorded for capital assets (historical cost less estimated salvage [or residual] value) to be depreciated and reported in the statement of activities over their estimated useful lives in a systematic and rational manner.

Condition

In fiscal year 2013, the accounting department embarked upon a process of evaluating the appropriateness of the Airport's capitalization policy and determination of useful lives. Extensive clean-up was accomplished in fiscal year 2013.

During fiscal year 2014, Airport Management continued to enhance its controls over the annual review of capital assets. During this process, Management recorded adjustments totaling $41.4 million to capital assets for 1) items that did not meet the definition of a capital asset; 2) assets that no longer exist; and 3) assets for which depreciation was calculated based on incorrect useful lives.

Management identified $20.6 million of expenditures that were incorrectly recorded as capital assets in periods prior to July 1, 2012. These assets should have been expensed when the costs were incurred as they did not meet the definition of a capital asset. In addition, $2.9 million of assets were found to be in the capital assets as of June 30, 2014 but no longer existed and should have been removed from the Airport's capital assets in periods prior to July 1, 2012.

Further $90.6 million of capital assets were found to have been depreciated using an incorrect useful life. The Airport revised useful lives for certain assets and adjusted the net book value of those assets accordingly in fiscal year 2013. However, in 2014 the Airport discovered additional assets for which the revised useful life should have been applied in 2013. This was a result of capital assets being categorized in the system to the incorrect asset classification. Correction of the useful lives resulted in $17.9 million in depreciation expense that should have been recorded in fiscal year 2013.

Management identified the above adjustments through an internal review of capital assets. During fiscal year 2014, Management confirmed the inventory of capital assets and met with various project managers and reviewed the overall reasonableness of the capital assets. Management recorded the adjustments to properly present capital assets.

Cause and Effect

The errors described above are due to lack of timely review and monitoring of capital asset records. In all the adjustments described above, had Management strengthened controls in previous years, it appears likely the errors would have been discovered in the year in which they occurred and corrected at that time.

Recommendation

Management should continue to perform an annual review of fixed assets and continue to analyze capital improvement projects to ensure that assets are appropriately identified, capitalized and depreciated. This may involve assessing the sufficiency of the resources available to perform this function. Any errors discovered should be corrected on a timely basis. Moreover, Management should focus on the appropriate accounting and reporting of fixed asset transactions as the Airport's fixed assets are growing significantly. Furthermore, Management should implement capital asset guidelines and/or procedures to help ensure consistency in what is being capitalized.

Views of Responsible Officials

Airport Management concurs with the auditors' recommendation to continue to strengthen controls of the internal review of capital assets. The untimely adjustments resulted from the complexity of the fixed asset accounts clean-up process and the magnitude of the Airport's fixed asset net book balance at $3.87 billion as of June 30, 2014.