

Internal Control Letter

City of San Antonio

March 29, 2018



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Audit and Accountability Committee and City Management
City of San Antonio, Texas

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Ladies and Gentlemen:

In connection with our audit of the City of San Antonio's (the "City") financial statements as of September 30, 2017 and for the year then ended, auditing standards generally accepted in the United States of America ("US GAAS") require that we advise management and the Audit and Accountability Committee (hereinafter referred to as "those charged with governance") of the following internal control matters identified during our audit.

The auditors of San Antonio Fire and Police Pension Fund, San Antonio Fire and Police Retiree Health Care Fund, HemisFair Park Area Redevelopment Corporation, San Antonio Economic Development Corporation, Urban Renewal Agency of the City of San Antonio dba Office of Urban Redevelopment of San Antonio (OUR SA), Westside Development Corporation, and Visit San Antonio; blended component units; CPS Energy, San Antonio Water System, Brooks Development Authority, Port Authority of San Antonio dba Port San Antonio, SA Energy Acquisition Public Facility Corporation, San Antonio Housing Trust Finance Corporation, San Antonio Housing Trust Foundation, Inc., and San Antonio Housing Trust Public Facility Corporation, discretely presented component units; and the San Antonio Early Childhood Education Municipal Development Corporation (Pre-K 4 SA), a major fund, are required to separately communicate internal control matters identified during their respective audits.

Our responsibilities

Our responsibility, as prescribed by US GAAS, is to plan and perform our audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to fraud or error. An audit includes consideration of internal control over financial reporting (hereinafter referred to as "internal control") as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we express no such opinion on internal control effectiveness.

Identified deficiencies in internal control

We identified the following internal control matters that are of sufficient importance to merit your attention.

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Material weaknesses

A deficiency in internal control (“control deficiency”) 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 City’s financial statements will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control was not designed to identify all deficiencies in internal control that, individually or in combination, might be material weaknesses; therefore, material weaknesses may exist that were not identified. However, we consider the following identified control deficiency to be a material weakness.

Proper Evaluation of Component Unit

In fiscal year 2016, the City reported the San Antonio Bexar County Soccer Public Facility Corporation (“SABC PFC”) as a joint venture of the City and recorded its equity interest of \$9,505 as an Investment in Joint Venture in governmental activities on the statement of net position. In fiscal year 2017, the City reviewed the final executed agreements, and concluded that the SABC PFC should have been reported as a discretely presented component unit in the prior year, rather than an Investment in Joint Venture. It was noted that final, executed agreements were available prior to the issuance of the fiscal year 2016 audit opinion that would have allowed the City the ability to evaluate all agreements and make a determination of the proper reporting of the SABC PFC entity during the 2016 fiscal year.

The City’s control to evaluate new entities created by the City, although designed effectively, did not operate effectively in that the Finance department failed to obtain available, final, executed agreements related to the SABC PFC transaction in order for the Finance department to appropriately analyze the reporting and presentation of the SABC PFC for the fiscal year 2016 financial statements. The lack of timely communication between City departments resulted in the Finance Department basing its conclusion on draft information.

As a result of the above situation, the change in reporting entity resulted in a correction of an error and a restatement of beginning net position for the governmental activities and aggregate discretely presented component units. The governmental activities beginning net position was restated to decrease the balance by \$9,505, to \$2,171,827, to eliminate the City’s investment in joint venture and the aggregate discretely presented component unit’s beginning net position was restated to increase the balance by \$22,335 to \$5,935,563 to account for SABC PFC’s total fiscal year 2016 ending balance

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We recommend the City should strengthen its controls in place to ensure executed transactions are communicated timely and incorporate as part of its assessment of the proper reporting for newly created entities that all executed agreements be obtained before a final conclusion is determined to ensure timely and accurate reporting.

Management Response:

The City agrees with the recommendation of obtaining timely and complete data for newly created entities in order to accurately determine and present component units in the City's financial statements. In validating SABC PFC's classification in the City's 2017 financial statements, the City determined that SABC PFC's prior presentation as a joint venture was inaccurate. This resulted in the City restating SABC PFC as a component unit thereby recording the full value of its assets and operations, and not just the City's share. The City's total beginning net position including both government-wide and discretely presented component units was \$8.1 billion. While the City understands the accounting rules regarding materiality of unaudited component units, the City feels that the adjustment to its total beginning net position of \$12.8 million (0.2 percent) is immaterial to the entity as a whole.

Significant deficiencies

Our consideration of internal control was not designed to identify all deficiencies in internal control that, individually or in combination, might be material weaknesses or significant deficiencies; therefore, material weaknesses or significant deficiencies may exist that were not identified.

A deficiency in internal control ("control deficiency") 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 City's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

We consider the following identified control deficiencies to be significant deficiencies.

Security Administration Access to PARIS

The San Antonio International Airport utilizes PARIS, a billing and accounts receivable software system, to handle its monthly parking permits. We noted through the review of users responsible for administering security for PARIS, that three (3) individuals had inappropriate access within the application which constitutes a segregation of duties issue. Additionally, PARIS application management did not perform user access reviews on a periodic basis to ensure appropriateness of access exists within the application.

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We recommend that the responsibility of administering security within financially critical systems be transferred to IT system administrators, who do not perform financial reporting processes/controls, or a third party. All security administration rights within financially critical systems granted to personnel performing financial reporting processes and controls should be revoked. Additionally, periodic, formal reviews of the user accounts and permissions within all financially critical systems should be performed. These reviews should take place at a pre-defined, risk-based frequency, semi-annually at a minimum, and should create an audit trail such that a third-party could determine when the reviews were performed, who was the business owner performing the review, and what access changed as a result. The business owner performing the review should have the appropriate competencies to attest to the ability granted by each role/permission/authority and the rationale for considering access appropriate for each user. These reviews should evaluate both the necessity of existing user ID's as well as the appropriateness of user-to-group assignments, with due consideration being given to adequate segregation of duties.

Management Response:

The City agrees with the recommendations that access be separated between department staff and ITSD personnel, and has added PARIS to ITSD's review schedule.

Security administration for the PARIS system has been transferred to ITSD system administrators and is managed per a Service Level Agreement between ITSD and the Airport Parking Office. The Office of the Chief Information Security Officer will ensure that there are documented semi-annual reviews to determine the appropriateness of access to the Airport parking revenue systems.

ITSD has implemented annual review of policies, procedures, and controls that apply to the City's financial systems including SAP and PARIS. These reviews will be led by the Office of the Chief Information Security Officer.

Preparation of the Schedule of Expenditures of Federal Award (SEFA) and Schedule of Expenditures of State Awards (SESA)

We identified the following deficiency in internal controls over financial reporting as related to the preparation of the fiscal years 2017 SEFA and SESA, specifically for the Highway Planning and Construction program:

The City over-reported expenditures in the amount of \$2,180,903 and \$46,788 on the fiscal year 2017 SEFA and SESA, respectively.

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Additionally, we noted that the City had initially recorded all Highway Planning and Construction program expenditures on the fiscal year 2017 SEFA, rather than separating out the state expenditures and reporting them on the SESA. However, these corrections were made during the current year.

Schedule of Expenditures of Federal Awards:

- In prior years, the City did not record \$977,968 in federal expenditures on the SEFA as they inaccurately classified those costs as being funded through local matching funds. The City corrected the classification of these expenditures in the 2017 SEFA to correctly report cumulative federal spending for the grant.
- Additionally, the City reported \$1,202,935 in expenditures on the fiscal year 2017 SEFA that should have been reported in fiscal year 2016 as the related expenditures were incurred in fiscal year 2016.

Schedule of Expenditures of State Awards:

- In prior years, the City did not record \$46,788 in state expenditures on the SESA as they inaccurately classified those costs as being funded through local matching funds. The City corrected the classification of these expenditures in the 2017 SESA to correctly report cumulative state spending for the grant.
- Furthermore, the City reported approximately \$205,000 and \$595,000 of state expenditures for the Highway Planning and Construction Program in the fiscal year 2015 and 2016 SEFA, respectively, rather than report those costs in the fiscal year 2015 and 2016 SESA.

We recommend City employees responsible for federal and state grants have adequate training of the SEFA and SESA reporting process and requirements. We also recommend the City establish and implement internal controls to ensure financial information received from departments that is used to prepare the SEFA and SESA is complete and accurate.

Management Response:

The City agrees grant training should include discussions and process surrounding preparation of SEFA and SESA reporting. The City further agrees that internal controls should be strengthened across City departments managing grants to incorporate communication with granting entities on the allocation of grant funding and matches at least once a year, at fiscal year-end.

The City's Finance Department is currently amending its Grant Administrative Directive to include addressing the issues found during the audit, specifically: (1) the importance of identifying federal awards versus state awards; (2) to address when match journal entries should be executed in its accounting system; and (3) to further strengthen the reviews and

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identification of subgrantees versus vendors. Formal training will be provided to the City's Departmental Fiscal Administrators, as well as the City's grant program staff, to ensure understanding of reporting and contract requirements. The City will further enhance communication requirements with grantor agencies for multi-funded grants to ensure the allocation of federal and state expenditures is accurately reported.

Control deficiencies

A deficiency in internal control ("control deficiency") 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.

We identified the following control deficiencies.

1. Policies and Procedures – Security Administration and Change Management, User Provisioning Process (Modifying Access), Disabling Access on a Timely Basis

- a. Security Administration and Change Management policies were not reviewed, updated, and approved appropriately for the fiscal year 2017 audit period;
- b. Modifying user access control is not performed consistently across the selected sample; and
- c. Account terminations were not conducted in a timely manner.

We recommend that:

- a. Management review and update Security Administration and Change Management policies and procedures on a periodic basis, if changes are necessary;
- b. Management amend the process for modifying access to IT systems in order to ensure that all modified users (FTE, Contract, and Temporary) have detailed access provisioning documentation. Management should also review controls to ensure that the system/product owner or an authorized change approver for each application is verified before a users' access is granted to applications; and
- c. Management should implement controls to ensure that terminations are entered into the system on a timely basis. Additionally, in cases where a user's account is kept active, but the password is reset, management should ensure appropriate documentation is generated and retained as evidence that this occurred.

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Management Response:

IT Management has implemented annual review of policies, procedures, and controls that apply to the City's financial systems including SAP and PARIS. These reviews will be led by the Office of the Chief Information Security Officer.

IT Management has developed and implemented more specific requirements for staff on the documentation requirement for provisioning requests. Staff is required to make changes only with proper documentation and is responsible that that documentation is properly retained as evidence of the request.

IT Management has developed and implemented requirements that accounts are disabled more timely based on termination notifications. Staff is required to retain documentation of any exceptions requested.

2. Transfer of Completed Construction in Progress

During testing of construction in progress, we noted that several projects were completed and had not been accounted for as having been placed into service. The adjustments resulted in a reclassification of \$9,241,503 of construction in progress (CIP) to depreciable capital assets for assets that were placed into service from fiscal year 2015 and 2016 in the governmental activities and a corresponding increase in depreciation expense of \$621,389 for the same time period.

The City has a process of reviewing all construction-in-progress projects to determine if the assets are complete and should be placed into service. Terminology differences between accounting and capital project close-out resulted in the City not placing the assets into service timely. Therefore, we recommend that the City strengthen their process of inquiring of City departments the status of outstanding CIP projects as well as incorporate a more comprehensive discussion of all outstanding construction in progress projects to determine if assets should be placed into service. Additionally, the City should provide ongoing training to the applicable departments to ensure that they fully understand the requirements related to capitalizing an asset when placed in service versus final close-out of construction projects.

Management Response:

The City's Finance Department implemented various controls and procedures in prior years to address the timely capitalization of construction-in-progress projects to include the creation of the Capital Project Administrative Directive and bi-annual meetings with departments to review the entire CIP listing for accounting considerations. Projects were not removed from CIP and capitalized in a timely manner due to a misunderstanding of accounting terminology among the Project Management staff in departments. Project Managers considered CIP to be complete

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when the project was fully closed out; whereas, accounting rules require assets to be capitalized when placed in service. The City is currently in the process of updating its Capital Project Administrative Directive to provide more clarity around capital project phases, necessary accounting and project management notifications. Furthermore, Finance and TCI have worked together expanding the capital project phases to allow for an in service phase - used to identify the transition date for capitalization purposes, but still allow the project to remain open for additional required work; and a fiscal close out phase - that in essence completes and closes out the project. TCI management additionally began working with their Project Managers effective January 2018 in detail reviewing each project within their CIP portfolio and creating a report detailing the project phase, estimated time to completion, close out and savings for each project. This report is being provided to Finance bi-annually.

City response

The City's written response to the internal control matters identified herein has not been subjected to our audit procedures and, accordingly, we express no opinion on it.

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The purpose of this communication is solely to describe the scope of our testing of internal control and the result of that testing, and not to provide an opinion on the effectiveness of the City's internal control. This communication is an integral part of an audit performed in accordance with Government Auditing Standards in considering the City's internal control. Accordingly, this communication is not suitable for any other purpose.

Very truly yours,

