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## **Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards***

The Honorable Mayor and Board of Supervisors  
City and County of San Francisco

We have audited, in accordance with the 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, the financial statements of San Francisco Wastewater Enterprise (the Enterprise), an enterprise fund of the City and County of San Francisco, California (the City), which comprise the statement of net position as of June 30, 2019, and the related statements of revenues, expenses, and changes in net position, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated December 23, 2019.

### **Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the Enterprise's internal control over financial reporting (internal control) to determine the 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 Enterprise's internal control. Accordingly, we do not express an opinion on the effectiveness of the Enterprise's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. However, as described below, we did identify a certain deficiency in internal control that we consider to be material weakness.

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. We consider the deficiency described below as item 2019-001 to be a material weakness.

#### **2019-001: Incorrect Recognition of Construction in Progress**

An entity must establish and maintain effective internal control over financial reporting and on compliance with provisions of laws, regulations, contracts, and grant agreements that have a material effect on the financial statements. The Enterprise entered into an agreement with another City agency (the Agency) in fiscal year 2016 to fund a new facility for the Agency in exchange for the Enterprise to expand their operations into an existing facility owned by the Agency. During the years ended June 30, 2018 and 2017, the Enterprise incorrectly recorded building improvement and constructions costs in their financial records as construction in progress instead of expensing such costs in operating expenses on the Statements of Revenues, Expenses, and Changes in Net Position, resulting in an overstatement of net position and understatement of changes in net position. The error described is a due to lack of adequate oversight and communication amongst the



Enterprise and the Agency. The error resulted in amounts incorrectly capitalized as construction in progress during the years ended June 30, 2018 and 2017.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Enterprise's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described above as item 2019-001.

### **The Enterprise's Response to Findings**

Management acknowledges the identified control deficiency and has implemented additional internal controls to further strengthen the control environment supporting inter-agency construction costs, inclusive of adequate oversight and communication.

The Enterprise's response to the findings identified in our audit is described previously. The Enterprise's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the response.

### **Purpose of this Report**

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

**KPMG LLP**

San Francisco  
January 30, 2020