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AGENDA REPORT

TO: DEANNA J. SANTANA
CITY ADMINISTRATOR

FROM: Osborn K. Solitei

SUBJECT: Comprehensive Annual Financial
Report and Management Letter for
FY 2011-12

DATE: January 16, 2013

City Administrator
Approval

Date

1/29/13

COUNCIL DISTRICT: City-Wide

RECOMMENDATION

Staff recommends that the City Council accept the Comprehensive Annual Financial Report (CAFR) and the Management Letter for the year ended June 30, 2012.

EXECUTIVE SUMMARY

The City Administrator's Office, Office of the Controller is pleased to present to the City Council the attached Comprehensive Annual Financial Report (CAFR) and the Management Letter for FY 2011-12.

The CAFR incorporates the audited basic financial statements of the City's financial activities and operations, including the Oakland Redevelopment Agency (ORA), the Oakland Redevelopment Successor Agency (ORSA), the Oakland Municipal Employees' Retirement System (OMERS), the Police and Fire Retirement System (PFRS), and the Port of Oakland.

The Management Letter outlines the Auditor's responsibilities, provides advice on accounting policies, and makes recommendations designed to improve operational efficiencies that further strengthen internal controls.

The Auditor's unqualified opinion letter for the audit report mentioned above declared that the basic financial statements contained therein accurately represent the financial condition of the City as of June 30, 2012. The auditors expressed an opinion that the City's financial statements are fairly stated and in accordance with accounting principles generally accepted in the United States.

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Finance and Management Committee
February 13, 2013

There were no audit findings or recommendations for the City's Comprehensive Annual Financial Report for the year ended June 30, 2012. Prior year's audit findings for the City have already been addressed and corrective actions have been either implemented or are in progress.

OUTCOME

City Council acceptance of the FY 2011-12 CAFR will provide relevant financial information to the City Council, residents of Oakland, creditors, investors and other interested parties. Also, the City will be in compliance with Section 809 of the City Charter and California Government Code Sections 25250 and 25253.

BACKGROUND/LEGISLATIVE HISTORY

The Comprehensive Annual Financial Report

The FY 2011-12 CAFR provides a description of the City's financial activities for the period of July 1, 2011 through June 30, 2012, and is generally divided into the following sections:

- **Introductory Section:** This section intends to familiarize the reader with the organizational structure of the City, the scope of City services and the City general government operations. This section also highlights the Government Finance Officers Association's (GFOA) Certificate of Achievement for Excellence in Financial Reporting award for the previous fiscal year.
- **Financial Section:** This section contains the City's audited financial statements; the Independent Auditor's Report and Management's Discussion and Analysis (MD&A).
- **Statistical Section:** This section provides ten years of summary financial data, as well as demographic, economic, and statistical information related to the City and its operations.

The auditor's opinion contained in the Financial Section of the CAFR represents their unqualified opinion that the City's financials are presented fairly and in conformity with Generally Accepted Accounting Principles (GAAP).

The Management Letter or Auditor's Required Communication to City Council

The Management Letter is a required communications and recommendations by Statement on Auditing Standards (SAS) No. 114. The letter outlines the Auditor's responsibility, planned scope and timing of the audit, provides advice on accounting policies, evaluates accounting estimates, proposes audit adjustments, significant audit findings, status of prior years' recommendations, corrected and uncorrected misstatements, disagreement with management, management representation, and outlines any major difficulties encountered in performing the audit.

The Management Letter is intended solely for the information and use of the City Council, the Finance Committee, the Federal grantor agencies, and the management of the City and is not intended to be and should not be used by anyone other than these specified parties.

ANALYSIS

The FY 2011-12 CAFR provides a comprehensive review of the City's financial operations. The CAFR is submitted to the City Council for consideration and acceptance and to provide relevant financial information to the residents of Oakland, creditors, investors, and other interested parties. Ensuring the financial integrity of our public institutions is crucial to maintaining the public's trust.

The auditors expressed an opinion that the City's financial statements for FY 2011-12 are fairly stated in conformity with accounting principles generally accepted in the United States. This is the most favorable conclusion and is commonly known as an "unqualified" or "clean" opinion. The independent auditor's report is included in the Financial Section of the CAFR.

The City contracted with Macias, Gini & O'Connell LLP, a certified public accounting firm, licensed to practice in the State of California to perform the following annual independent audits:

- The Comprehensive Annual Financial Report (CAFR),
- The Oakland Redevelopment Agency Audit Report,
- The Oakland Redevelopment Successor Agency Audit Report,
- The Single Audit Report, and
- A separate audit of the Port of Oakland.

Williams, Adley & Company LLP, a certified public accounting firm and sub-contractor, performed the tests and fieldwork for the Single Audit, the Oakland Municipal Employees Retirement System (OMERS) and the Police and Fire Retirement System (PFRS).

Patel & Associates LLP, a certified public accounting firm and sub-contractor, performed the audit of the Measure Y – Violence Prevention & Public Safety Act of 2004 audit report.

Yano Accountancy Corporation, a certified public accounting firm and sub-contractor, performed the audits of the Oakland Wildlife Prevention Assessment District Audit Report, the Measure C – Transient Occupancy Tax Surcharge Compliance Audit ("Hotel Tax"), and the GANN Appropriation Limit attestation.

Financial Highlights

For the fiscal year ended June 30, 2012, the City achieved the following key financial results:

- Total assets exceed total liabilities at June 30, 2012 by \$1.1 billion (net assets).
- Governmental funds reported combined ending fund balances of \$711.5 million at June 30, 2012, which are \$320.2 million or 31.0 percent less than the June 30, 2011 balances.
- Unassigned fund balance for the General Fund is \$68.7 million at June 30, 2012 and represents 26.8 percent of the total General Fund balance.
- Total long-term obligations decreased by \$600.2 million during FY 2011-12 to \$1.39 billion at June 30, 2012, a decrease of 30.2 percent over the amount of \$1.99 billion at June 30, 2011.

PUBLIC OUTREACH/INTEREST

This item did not require any additional outreach other than the required posting on the City's website.

COORDINATION

This report was prepared in coordination with the City Attorney's Office and the Budget Office.

COST SUMMARY/IMPLICATIONS

This is an informational report only; there is no fiscal impact.

SUSTAINABLE OPPORTUNITIES

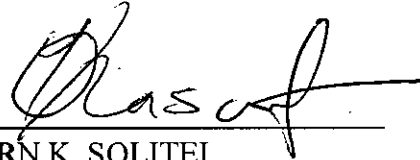
Economic: No direct economic opportunities have been identified.

Environmental: No environmental opportunities have been identified.

Social Equity: No social equity opportunities have been identified.

For questions regarding this report, please contact Osborn K. Solitei, Controller at (510) 238-3809.

Respectfully submitted,



OSBORN K. SOLITEI
Controller, City Administrator's Office
Office of the Controller

Link:

Comprehensive Annual Financial Report for the Year Ended June 30, 2012

Web Link: <http://www.oaklandnet.com/government/fwaweb site/accounting/CAFR.htm>

Attachment:

Management Letter

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Finance and Management Committee
February 13, 2013

CITY OF OAKLAND

Communications to City Council

For the Year Ended June 30, 2012



Certified Public Accountants.

CITY OF OAKLAND

Communications to City Council
Year Ended June 30, 2012

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Sacramento

Oakland

LA/Century City

Newport Beach

San Diego

Seattle

Honorable Mayor and Members of the City Council
City of Oakland, 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 of Oakland (City) as of and for the year ended June 30, 2012. Our report includes a reference to other auditors. Our report also includes explanatory paragraphs indicating that the Oakland Redevelopment Agency was dissolved, that the City became the Successor Agency to the Redevelopment Agency of the City of Oakland on February 1, 2012 to oversee the dissolution of the City's former redevelopment agency, and that the effect of issues raised by State authorities related to Redevelopment Dissolution Law is uncertain.

Professional auditing standards require that we provide you with information about our responsibilities under generally accepted auditing standards, *Government Auditing Standards*, 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 August 20, 2012. Professional standards also require that we communicate to you other information related to our audit as discussed on pages 3 through 6.

Management of the City is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit of the City's basic financial statements in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

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 City'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 second paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or 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.

In addition, we have provided a status of the prior year 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 Mayor, City Council, 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

Oakland, California
December 21, 2012

CITY OF OAKLAND

Communications to City Council
Year Ended June 30, 2012

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. No new accounting policies were adopted and the application of existing policies was not changed during the year ended June 30, 2012.

The City presents the Port of Oakland (Port) in a unique manner as compared to other local governmental entities with port operations. All local government entities we sampled reflect their ports as departments of the organization rather than as a discretely presented component unit. Some of these ports have similar management structures with a Board of Commissioners appointed by the sponsoring city's mayor/city council to oversee the operations of the port. Management's representation to us was that the Port operates with a separate legal standing (i.e. using its own corporate powers) under the City Charter, which would allow for this presentation. In addition, the City Attorney's Office has represented that the Port operates very similar to a corporation with the Charter acting as its Articles of Incorporation and By-Laws. Ultimately, the City's presentation of the Port makes it less comparable to other cities that have port operations, thus, being a unique presentation.

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:

- *Fair value of investments.* The City's investments are generally carried at fair value, which is defined as the amount that the City could reasonably expect to receive for an investment in a current sale between a willing buyer and a willing seller and is generally measured by quoted market prices.
- *Estimated unbilled sewer service revenue.* The estimates for unbilled sewer service revenue are based on an evaluation of the sewer service reports from the East Bay Municipal Utility District (EBMUD), cash flows, monthly billing cycles, and historical billings.
- *Estimated allowance for losses on accounts receivable.* The allowance for losses on accounts receivable represents aged receivables over 360 days.
- *Estimated allowance for losses on loans receivable.* The allowance for losses on loans receivable is based on the types of loan (e.g., forgivable, deferred, grant or amortizing) and management's estimate regarding the likelihood of collectability based on loan provisions and collateral.
- *Depreciation estimates for capital assets, including depreciation methods and useful lives assigned to depreciable properties.* The estimated useful lives of capital assets were determined based on the nature of the capital assets and management's estimate of the economic life of the assets.

CITY OF OAKLAND

Communications to City Council (Continued)
Year Ended June 30, 2012

REQUIRED COMMUNICATIONS (Continued)

I. Qualitative Aspects of Accounting Practices (Continued)

- *Accrual of compensated absences.* Accrual of vacation and sick leave is based on unused employee sick leave, vacation, and other compensatory time, and employees pay rates at year-end.
- *Estimated claims liabilities.* Reserves for estimated claims liabilities were based on actuarial evaluations using historical loss, other data, and attorney judgment about the ultimate outcome of the claims.
- *Valuation of the net pension asset.* The net pension asset is the amount that exceeded the City's actuarially determined annual required contribution, which is based upon certain approved actuarial assumptions. This amount is then amortized over the amortization period used by the actuary to recognize the excess contribution as pension costs over time.
- *Annual required contributions to pension and other postemployment benefit plans.* The City is required to contribute to its pension plans at an actuarially determined rate and to measure other postemployment benefit costs based upon certain approved actuarial assumptions.

The actuarial pension and other postemployment benefits data, including the funded status and required contributions of the plans, is based on actuarial calculations performed in accordance with the parameters set forth in GASB Statements No. 27, *Accounting for Pensions by State and Local Governmental Employers*, and No. 50, *Pension Disclosures—an amendment of GASB Statements No. 25 and No. 27* for the pension plans and GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* for the other postemployment benefits, which incorporate actuarial methods and assumptions adopted by the City.

- *Estimated environmental costs.* Estimated environmental costs are based on reports from the City's Public Works Department Environmental Services and external 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 statements taken as a whole.

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the financial statements are the disclosures related to pension and other postemployment benefits. The disclosures about pension and other postemployment benefits are described in Notes 16 and 17, respectively, to the financial statements and are based on actuarial valuations.

II. Difficulties Encountered in Performing the Audit

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

CITY OF OAKLAND

Communications to City Council (Continued)
Year Ended June 30, 2012

REQUIRED COMMUNICATIONS (Continued)

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 clearly trivial, and communicate them to the appropriate level of management. 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.

V. Management Representations

We have requested certain representations from management that are included in the management representation letter dated December 21, 2012.

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 governmental unit'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 governmental unit'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

Our responsibility for other information in documents containing the City's 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, 2012, 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.

CITY OF OAKLAND

Communications to City Council (Continued)
Year Ended June 30, 2012

REQUIRED COMMUNICATIONS (Continued)

VIII. Other Information in Documents Containing Audited Financial Statements (Continued)

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.

During the year, the City included audited financial statements for the year ended June 30, 2011 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.

CITY OF OAKLAND

Communications to City Council (Continued)
Year Ended June 30, 2012

CURRENT YEAR RECOMMENDATIONS

None reported.

STATUS OF PRIOR YEAR RECOMMENDATIONS

2010-2 Lack of Information Technology Risk Assessments
Significant Deficiency

Industry best practices suggest that agencies, departments and business units perform a risk assessment. An information technology (IT) risk assessment is a process to determine what information resources exist that require protection, and to understand and document potential risks from IT security failures that may cause loss of information confidentiality, integrity, or availability. The purpose of a risk assessment is to help management create appropriate strategies and controls for stewardship of information assessments.

The City has not conducted an IT risk assessment and therefore has no mechanism to determine whether current operations are designed to effectively mitigate risk within its environment. The City currently does not have a comprehensive risk assessment process whereby operations are evaluated for risk. The City should begin efforts to develop a risk assessment process within its IT department and consider developing a City-wide risk assessment process. The risk assessment could either be 1) performed internally by the City's internal audit function in unison with the IT department management and staff or 2) conducted by an external third party experienced in performing IT risk assessments.

Status of Corrective Action:

Alternative measures have been implemented.

The Department of Information Technology (DIT) last performed a comprehensive IT risk assessment for all agencies/departments in 2005. Due to budget cuts, the DIT has not been able to conduct a similar City-wide IT risk assessment since that time. To minimize risk, it performs security assessments as new technologies are deployed. In 2011, the Department of Information Technology in collaboration with multiple security vendors implemented additional security measures to improve the City's overall network security. These additional measures included the implementation of new technologies as well as an internal review of IT security policies and procedures. In 2012 The Department of Information Technology worked with Trustwave, a leading provider of on-demand data security and payment card industry management solutions, to complete PCI compliance measures.

CITY OF OAKLAND

Communications to City Council (Continued)
Year Ended June 30, 2012

STATUS OF PRIOR YEAR RECOMMENDATIONS (Continued)

2010-3 Inadequate IT Back-up Recovery Site Location

Significant Deficiency

Best practices for disaster recovery suggest that a back-up location should be at least 20 miles away from the main location and in a location that is not susceptible to the same types of disasters (flood, fire, terrorist acts, etc.) as the main location. The reason for this control is to ensure that the City's systems can be restored in the event of a disaster. The City's current back-up location is four blocks away from the main data center. This second location was chosen because it is a City building with good safety features, including a recent upgrade to withstand significant earthquakes. The City should research back-up locations outside of the 20 mile radius of the main location. Once back-up location options are determined, budgetary resources should be granted to fund the establishment of a back-up location that aligns with best practices and assures the City's back-up financial information and data are secured.

Status of Corrective Action:

Corrective action is in progress.

The Department of Information Technology (DIT) has a routine for daily incremental and monthly full back-ups. Back-up tapes are rotated between Iron Mountain's Sacramento facility and a local site. DIT has requested funding as part of the 2013-2015 capital improvement project planning process for the relocation or collocation of the City's primary Data Center.