

# **ATTACHMENT B**

**Auditor's Required Communication to City Council**

**CITY OF OAKLAND**

Communications to City Council

For the Year Ended June 30, 2023

**CITY OF OAKLAND**

Communications to City Council  
For the Year Ended June 30, 2023

*Table of Contents*

	<i>Page</i>
Transmittal Letter.....	1
Required Communications.....	3
Current Year Recommendation .....	8
Status of Prior Recommendation .....	10
Summary of Uncorrected Financial Statement Adjustments.....	11

Honorable Mayor and Members of the City Council  
City of Oakland, California

In planning and performing our audit of the basic financial statements of the City of Oakland (City) as of and for the year ended June 30, 2023, 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, we considered the City's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting. In addition, the Oakland Police and Fire Retirement System (PFRS), a pension trust fund, and the Port of Oakland (Port), a discretely presented component unit, are audited by us under separate engagements and separate required communications are submitted to the PFRS' Board of Administration and the Port's Board of Commissioners.

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 over financial reporting, 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. A reasonable possibility exists when the likelihood of an event occurring is either reasonably possible or probable as defined as follows:

- *Reasonably possible.* The chance of the future event or events occurring is more than remote but less than likely.
- *Probable.* The future event or events are likely to occur.

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 material weaknesses. Given these limitations, during our audit we did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Our audit was also not designed to identify deficiencies in internal control that might be significant deficiencies. 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 considered the deficiency in the City's internal control, described in item 2023-001 in the accompanying Current Year Recommendation section, to be a significant deficiency. The identified significant deficiency is not considered to be a material weakness.

The purpose of this communication, which is an integral part of our audit, is to describe, for management and those charged with governance, the scope of our testing of internal control and the results of that testing. Accordingly, this communication is not intended to be and should not be used for any other purpose.

In addition, professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards, Government Auditing Standards and the Uniform Guidance, as well as certain information related to the planned scope and timing of our audit. We have communicated such information to the City in the As-Needed Professional Service Agreement between the City of Oakland and Macias Gini & O'Connell LLP dated May 1, 2020, as amended. Professional standards also require that we communicate to you the information related to our audit as discussed in the accompanying Required Communications section.

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

The Required Communications section is intended solely for the information and use of the Mayor, City Council, City management, and others within the organization, and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink that reads "Macias Gini & O'Connell LLP". The signature is written in a cursive, flowing style.

Walnut Creek, California  
December 27, 2023

## CITY OF OAKLAND

Communications to City Council  
For the Year Ended June 30, 2023

### **REQUIRED COMMUNICATIONS**

We have audited the financial statements of the City as of and for the year ended June 30, 2023, and have issued our report thereon dated December 27, 2023. Professional standards require that we advise you of the following matters relating to our audit.

#### **Our Responsibility in Relation to the Financial Statement Audit**

As communicated in the As-Needed Professional Service Agreement between the City of Oakland and Macias Gini & O'Connell LLP dated May 1, 2020, as amended, our responsibility, as described by professional standards, is to form and express opinions about whether the financial statements that have been prepared by management with your oversight are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America. Our audit of the financial statements does not relieve you or management of your respective responsibilities.

Our responsibility, as prescribed by professional standards, is to plan and perform our audit to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control over financial reporting. Accordingly, as part of our audit, we considered the internal control of the City solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

We are also responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures for the purpose of identifying other matters to communicate to you.

We have provided our finding regarding a significant control deficiency over financial reporting noted during our audit in the Current Year Recommendation section of this communication.

#### **Planned Scope and Timing of the Audit**

We conducted our audit consistent with the planned scope and timing we previously communicated to you.

#### **Compliance with All Ethics Requirements Regarding Independence**

The engagement team, others in our firm, as appropriate, our firm, and our network firms have complied with all relevant ethical requirements regarding independence.

#### **Qualitative Aspects of the City's Significant Accounting Practices**

##### *Significant Accounting Policies*

Management has the responsibility to select and use appropriate accounting policies. A summary of the significant accounting policies adopted by the City is included in Note I to the basic financial statements. There have been no initial selection of accounting policies and no changes in significant accounting policies or their application during 2023, except the City's implementation of Governmental Accounting Standards Board (GASB) Statement No. 96, *Subscription-Based Information Technology Arrangements*, as described in Note I.E to the financial statements.

## CITY OF OAKLAND

Communications to City Council  
For the Year Ended June 30, 2023

During the year, the City also adopted GASB Statement No. 91, *Conduit Debt Obligations*; Statement No. 94, *Public-Private and Public-Public Partnerships and Availability Payment Arrangements*; and certain requirements of GASB Statement No. 99, *Omnibus 2022*. There was no material impact on the financial statements related to the implementation of these statements.

No matters have come to our attention that would require us, under professional standards, to inform you about (1) the methods used to account for significant unusual transactions and (2) the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus, except for the presentation of the Port of Oakland (Port) as discussed below.

The City presents the 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, and thus, is a unique presentation.

### *Significant Accounting Estimates*

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's current judgments. Those judgments are normally based on 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 markedly from management's current judgments.

The most sensitive estimates affecting the City's financial statements are:

- *Fair value of investments.* The City's investments are generally carried at fair value, which is defined as the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. Fair value is a market-based measurement using observable market transactions or available market information. The fair value of the City's investments (including the Police and Fire Retirement System) is generally measured based on Level 1 inputs, which are quoted prices in active markets, or Level 2 inputs, which are inputs other than quoted prices in Level 1 that are observable for the asset, either directly or indirectly. To a lesser extent, the City has some investments measured based on Level 3 inputs, which are not observable.
- *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, 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.

## CITY OF OAKLAND

Communications to City Council  
For the Year Ended June 30, 2023

- Estimated allowance for losses on loans receivable. The allowance for losses on loans receivable is based on the types of loans (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. Depreciation is recorded on a straight-line basis over the estimated useful lives of the capital assets.
- *Accrual of compensated absences.* Accrual of vacation, sick leave, and compensatory time is based on unused employee sick leave, vacation, and other compensatory time, and employees pay rates at year-end.
- *Estimated claims liabilities.* Estimated claims liabilities were based on actuarial evaluations using historical loss, other data, and attorney judgment about the ultimate outcome of the claims.
- *Estimated environmental costs.* Estimated environmental costs are based on valuation reports from the City’s Public Works Department and external consultants.
- *Net pension liability, net other postemployment benefits (OPEB) liability, and deferred outflows and inflows of resources related to pension and OPEB.* The City is required to contribute to its pension and OPEB plans at an actuarially determined rate. The actuarial pension and OPEB data, including the liabilities, deferred outflows of resources, and deferred inflows of resources, are based on actuarial calculations performed in accordance with the parameters set forth for the pension plans under GASB Statement No. 68, *Accounting and Financial Reporting for Pensions* and for the OPEB plan under GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which incorporate actuarial methods and assumptions adopted by the City.
- *Discount rate used for the calculation of lease liabilities, lease receivables and subscription-based information technology arrangements (SBITA) liabilities.* The discount rate used for the calculation of the lease liabilities, lease receivables, and SBITA liabilities are based on the City’s estimated incremental borrowing rate using daily treasury yield curve rates adjusted for spreads.

We evaluated the key factors and assumptions used to develop these accounting estimates in determining that they are reasonable in relation to the basic financial statements taken as a whole and in relation to the applicable opinion units.

### *Financial Statement Disclosures*

Certain financial statement disclosures involve significant judgment and are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the financial statements are the disclosures related to investments, long-term obligations, leases and SBITAs, litigation, and pension and other postemployment benefits. The disclosures about investments, long-term obligations, leases, litigation, and pension and other postemployment benefits are described in Note II Section A, Note II Section G, Note II Section H, Note II Section I, and Note III Sections A and B, respectively, to the financial statements.

### **Significant Difficulties Encountered during the Audit**

We encountered no significant difficulties in dealing with management relating to the performance of the audit.



## **CITY OF OAKLAND**

Communications to City Council  
For the Year Ended June 30, 2023

### **Corrected and Uncorrected Misstatements**

For purposes of this communication, professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that we believe are trivial, and communicate them to the appropriate level of management. Further, professional standards require us to also communicate the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole and each applicable opinion unit. The attached schedule summarizes uncorrected financial statement misstatements whose effects in the current and prior periods, as determined by management, are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

In addition, professional standards require us to communicate to you all material, corrected misstatements that were brought to the attention of management as a result of our audit procedures. None of the misstatements identified by us as a result of our audit procedures and corrected by management were material, either individually or in the aggregate, to the financial statements taken as a whole or applicable opinion units.

### **Disagreements with Management**

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter, which could be significant to the City's financial statements or the auditor's report. No such disagreements arose during the course of the audit.

### **Representations Requested from Management**

We have requested certain representations from management, which are included in the City's management representation letter dated December 27, 2023.

### **Management Consultations with Other Accountants**

In some cases, management may decide to consult with other accountants about auditing and accounting matters. Management informed us that, and to our knowledge, there were no consultations with other accountants regarding auditing and accounting matters.

### **Other Significant Matters, Findings or Issues**

In the normal course of our professional association with the City, we generally discuss a variety of matters, including the application of accounting principles and auditing standards, operating and regulatory conditions affecting the entity, and operational plans and strategies that may affect the risks of material misstatement. None of the matters discussed resulted in a condition to our retention as the City's auditors.

### **Other Information Included in Annual Comprehensive Financial Report**

Pursuant to professional standards, our responsibility as auditors for other information, whether financial or nonfinancial, included in the annual comprehensive financial report, does not extend beyond the financial information identified in the audit report, and we are not required to perform any procedures to corroborate such other information. However, in accordance with such standards:

## CITY OF OAKLAND

Communications to City Council  
For the Year Ended June 30, 2023

### *Required Supplementary Information*

We have applied certain limited procedures to the management’s discussion and analysis, the pension and other postemployment benefits schedules, and the budgetary comparison schedules for the General Fund and the Other Special Revenue Fund, which are required supplementary information (RSI) that supplements the basic financial statements. Our procedures consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management’s responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

### *Supplementary Information*

We were engaged to report on the combining financial statements and schedules, which accompany the financial statements but are not RSI. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America.

### *Other Information*

We were not engaged to report on the introductory section and statistical section, which accompany the financial statements but are not RSI or supplementary information. Our opinions on the basic financial statements do not cover the other information, and we do not express an opinion or any form of assurance thereon.

Our responsibility also includes communicating to you any information which we believe is a material misstatement of fact. Nothing came to our attention that caused us to believe that such information, or its manner of presentation, is materially inconsistent with the information, or manner of its presentation, appearing in the basic financial statements.

### **Modification of the Auditor’s Report**

Our auditor’s report includes an emphasis of a matter paragraph describing the City’s adoption of GASB Statement No. 96, *Subscription-Based Information Technology Arrangements*. Our opinions are not modified with respect to this matter.

**CITY OF OAKLAND**

Communications to City Council  
For the Year Ended June 30, 2023

**CURRENT YEAR RECOMMENDATION**

**2023-001      Significant Deficiency in Internal Control  
Information Technology Program**

***Criteria:***

Internal controls over financial reporting are reliant on effectively designed information technology (IT) controls. In that regard, an effectively designed IT control environment is one where an organization:

- (a) develops, documents, and disseminates to appropriate personnel, policies that address purpose, scope, roles and responsibilities, management commitment, coordination among organizational departments, and compliance; and procedures to facilitate the implementation of the policy and associated controls;
- (b) periodically reviews and updates the current policies and procedures; and
- (c) systematically monitors and tests its environment to ensure that policies and procedures are operating as designed.

An entity-wide information security management program is the foundation of a security control structure and a reflection of senior management’s commitment to addressing security risks. Overall policies and plans are developed at the entity-wide level. System and application-specific procedures implement the entity-wide policy. Ongoing monitoring of control design, implementation, and operating effectiveness should also be applied so that the program includes continuous monitoring processes.

Critical within a well-established information security program are updated documented policies, procedures, and guidance; security roles and responsibilities identified and appropriately delineated across the organization; and ongoing evaluations to ensure that policies and controls intended to reduce risk are effective. Without these aspects, security controls may be inadequate; responsibilities may be unclear, misunderstood, or improperly implemented; and controls may be inconsistently applied. In addition, continuous monitoring of the City’s systems is necessary to mitigate threats from cyberattacks, which have increasingly impacted other local governmental entities ability to issue payments, assist with client services, receive remittances, and perform basic governmental functions.

***Condition:***

During our audit for the year ended June 30, 2023, we continued to note weaknesses within the City’s information security program that were identified in prior years’ audits. Specifically, while the City has developed security policies and procedures, they are not yet fully implemented. Additionally, although the City has plans for a continuous risk assessment and testing program to actively mitigate threats to the City’s IT infrastructure from ransomware attacks, cyberattacks, and other unauthorized data breaches, this work has not started. During February 2023, the City became a victim of a ransomware attack. The City’s enterprise resource planning and 911 emergency systems were not impacted by the incident but many systems were taken offline while the City coordinated with law enforcement and third parties to investigate, respond to, and fully recover from the attack.

***Cause and Effect or Potential Effect:***

The City’s staffing and resource constraints have challenged its efforts to fully implement information security policies, processes, and procedures. As such, despite the progress made, the City is still exposed to threats from ransomware attacks, cyberattacks, and other threats.

**CITY OF OAKLAND**

Communications to City Council  
For the Year Ended June 30, 2023

**CURRENT YEAR RECOMMENDATION (Continued)**

***Recommendation:***

The City should continue working on fully implementing its policies and procedures related to security controls. In addition, the City should complete periodic IT assessments to improve identification and investigations of system risks. The ransomware attack occurred during the year ended June 30, 2023 reinforced the importance of prioritizing City’s staffing and resources to develop and implement information security policies, processes, and procedures.

***Management’s Response:***

Since the February 2023 ransomware incident, the City has made significant progress towards improving its cybersecurity controls, such as the implementation of mandatory cybersecurity training for all employees, multifactor authentication and additional account protections, and deployment of extended detection response (XDR) systems with 24/7 monitoring and remediation. In addition, the City has developed policies and procedures aligned with NIST SP850 Moderate levels and plans to complete the implementation of these policies and procedures by Fall 2024. Further, the City has multiple IT projects underway to upgrade, enhance, and replace outdated infrastructure and systems, which will further strengthen the City’s security posture. Finally, through the City Auditor’s Office, the City is actively working to execute a multiyear contract for ongoing cybersecurity assessments, scanning, and testing.

**CITY OF OAKLAND**

Communications to City Council  
For the Year Ended June 30, 2023

**STATUS OF PRIOR RECOMMENDATION**

**2022-001      Significant Deficiency in Internal Control  
Information Technology Program**

***Recommendation:***

The City should assign formal security responsibilities and continue working on developing updated policies and procedures related to security controls. In addition, the City should complete periodic IT assessments to improve identification and investigations of system risks.

***Status of Corrective Action:***

In process – see current year finding 2023-001.

**CITY OF OAKLAND**

Communications to City Council  
For the Year Ended June 30, 2023

**SUMMARY OF UNCORRECTED FINANCIAL STATEMENT ADJUSTMENTS**  
**(Dollars in thousands)**

<b>Account and Adjustment Description</b>	<b>(Amount in Thousands)</b>	
	<b>Debit</b>	<b>Credit</b>
<i>Current Year PAJE #1</i>		
Expenses - Interest on Long-Term Debt	\$ 21,837	
Beginning Net Position		\$ 21,837
(Governmental Activities - To adjust the income statement impact of over-accrual of interest payable as of June 30,		
<i>Current Year PAJE #2</i>		
Expenses - General Government	\$ 12,450	
Claims liability		\$ 12,450
(Governmental Activities - To adjust claims liability estimates to reflect updates provided by the City Attorney.)		