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AGENDA REPORT

TO: Sabrina B. Landreth
City Administrator

FROM: Kirsten LaCasse
Controller

SUBJECT: Comprehensive Annual Financial
Report (CAFR) And Management
Letter

DATE: February 6, 2017

City Administrator Approval

Date:

2/16/17

RECOMMENDATION

Staff Recommends That The City Council Accept The Comprehensive Annual Financial Report (CAFR) And The Management Letter For The Year Ended June 30, 2016.

EXECUTIVE SUMMARY

The Finance Department, Controller's Bureau is pleased to present to the City Council the attached Comprehensive Annual Financial Report (CAFR) Audit and Management Letter.

The audit report incorporates the management's discussion and analysis, basic financial statements, notes to basic financial statements, and independent Auditor's 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 Auditor's unmodified opinion letter for the audit report mentioned above declared that the basic financial statements contained therein accurately represent the financial condition of The City of Oakland as of June 30, 2016. 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.

Macias, Gini & O'Connell, the City's external auditor, performed the Comprehensive Annual Financial audit for the year ending June 30, 2016 (**Attachment A**). The Independent Auditor's Report for Fiscal Year ended June 30, 2016 did not contain any findings and did not identify any deficiencies in internal controls.

City Council acceptance of the Fiscal Year 2015-16 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, which states in part, "*The Council shall engage during the first month of each fiscal year an independent certified public accountant who shall examine and report to the Council on the annual financial statement of the City.*"

Item: _____

Finance and Management Committee
February 28, 2017

BACKGROUND / LEGISLATIVE HISTORY

The Comprehensive Annual Financial Report

The Fiscal Year 2015-16 CAFR provides a description of the City's financial activities for the period of July 1, 2015 through June 30, 2016, 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; notes to the basic 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 unmodified 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 communication and recommendation 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 AND POLICY ALTERNATIVES

The Fiscal Year 2015-16 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 2015-16 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 "unmodified" 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 (MGO), 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 Successor Agency Audit (ORSA)
- Police and Fire Retirement System (PFRS) Audit
- A separate audit of the Port of Oakland.

Patel & Associates LLP, a certified public accounting firm and sub-contractor of MGO, performed the following audits:

- Measure Z – Violence Prevention & Public Safety Act Audit
- Measure C – Transient Occupancy Tax Surcharge Audit (Oakland Hotel Tax)
- GANN Appropriation Limit Attestation.

William, Adley & Company, LLP a certified public accounting firm and sub-contractor of MGO performed the following audits:

- Single Audit Report
- Child Care and Development Program Audits.

Grant & Smith, LLP a certified public accounting firm and sub-contractor of MGO performed the following audits:

- Measure B – Local Transportation Fund Audit
- Measure BB – Transportation Expenditure Program Audit
- Measure F – Vehicle Registration Fee Funds Audit
- Transportation Development Act Fund Audit.

Financial Highlights

For the Fiscal Year ended June 30, 2016, the City achieved the following key financial results:

- The City's net position as of June 30, 2016 was \$155.5 million net deficit, which is a reduction of the City's \$268.8 million net deficit from June 30, 2015.
- Total assets exceeded total liabilities at June 30, 2016 by \$44.3 million, compared to the negative net position of \$86.3 billion at June 30, 2015, which represents an increase in net position of \$130.7 million.
- Governmental funds reported combined ending fund balances of \$667.8 million, which are \$28.7 million or 4.5 percent more than the June 30, 2015 balances.
- Total long-term obligations were \$1.1 billion at June 30, 2016, which is a two percent decrease over last Fiscal Year.

Table 1: Summary of Net Position by Category – Fiscal Years 2016 and 2015:

(\$ in thousands)

CATEGORY	TOTAL	
	2016	2015
Assets	\$2,879,054	\$2,734,792
Deferred Outflows of Resources	117,946	113,230
Liabilities	2,880,292	2,735,396
Deferred Inflows of Resources	72,370	198,946
Total Net Position	\$44,338	(\$86,320)

Table 2: Net Position by Activity Type – Fiscal Years 2016 and 2015:

(\$ in thousands)

CATEGORY	Governmental Activities		Business Activities		TOTAL	
	2016	2015	2016	2015	2016	2015
Net Investment in Capital Assets	\$1,079,164	\$1,025,789	\$171,743	\$155,257	\$1,250,907	\$1,181,046
Restricted	\$555,205	\$140,950	-	-	\$555,205	\$140,950
Unrestricted (deficit)	(\$1,789,831)	(\$1,435,498)	\$28,057	\$27,182	(\$1,761,774)	(\$1,408,316)
Total Net Position	(\$155,462)	(\$268,759)	\$199,800	\$182,439	\$44,338	(\$86,320)

Current Year Recommendation (Attachment B):

2016-001 Significant Deficiency Over Financial Reporting - Accounting for Non-Routine Transactions and Incomplete Trial Balances

Observation:

In Fiscal Year 2016, the ORSA refunded three of its outstanding bonds: 2006A Subordinated Housing Set Aside Revenue Refunding Bonds; the 2006A-TE Central City East Redevelopment Project Tax Allocation Bonds; and the 2006C-TE Broadway/MacArthur/San Pablo Redevelopment Project Tax Allocation Bonds. The ORSA also partially refunded two of its outstanding bonds: 2006A-T Subordinated Housing Set Aside Revenue Bonds and the 2006B-TE Coliseum Area Redevelopment Project Tax Allocation Bonds. These are non-routine transactions of the ORSA. Due to the current financial system upgrade project and other changes in the allocation of personnel, the ORSA did not have adequate time to familiarize themselves with the accounting and financial reporting requirements associated with these types of transactions, which resulted in audit adjustments reducing ORSA's net position in the amount of \$1.4 million. In addition, the ORSA provided a trial balance for the year-end audit that did not include the ORSA's closing journal entries related to the unearned revenue and notes and loans receivable accounts. These errors were subsequently corrected during the audit.

Recommendation:

Management has the responsibility to ensure the entity's financial statements are presented fairly in accordance with GAAP. With the recent financial system upgrades and other changes in the allocation of personnel, we recommend that the ORSA dedicate adequate resources to properly prepare the ORSA's financial records in accordance with GAAP and to provide appropriate financial reporting training to its personnel.

Management's Response:

Management acknowledges that its decision to redeploy staff to the City's financial system upgrade caused certain oversights in timely classification of revenues and costs resulting from the bond refunding as insufficient staff were assigned to these tasks. Management is actively working on maintaining a sound internal control system over ORSA's financial reporting. This will include, but not be limited to, ensuring appropriate level of management reviews, improving communication and transparency over the annual audit, and providing training to staff. It is management's expectation that the weaknesses will be corrected for future audits.

Status of Prior Year Recommendation (Attachment B):

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 was partially implemented. Further action will be occurring in Fiscal Year 2017.

The City selected the Digital Realty Trust (DRT) site as a primary workload site for many business essential IT applications. The primary reason for moving the IT assets from City owned data centers to the DRT site was because of the redundancy and resiliency of critical infrastructure including HVAC, power, UPS, internet, etc. at the DRT data center site. In addition, the City is in the process of moving the back-up data and services to the Amazon cloud from the DRT site for disaster recovery. The new configuration is targeted for completion in the next year, will consist of a local robust and resilient data center for the business essential IT systems and critical data being backed-up in the cloud with geo-redundancy.

FISCAL IMPACT

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

PUBLIC OUTREACH / INTEREST

This item did not require any additional public outreach other than the required posting on the City's website. <http://www.oaklandnet.com/government/fwawebsite/accounting/CAFR.htm>

COORDINATION

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

SUSTAINABLE OPPORTUNITIES

Economic: There are no economic opportunities associated with this report.

Environmental: There are no environmental opportunities associated with this report.

Social Equity: There are no social equity opportunities associated with this report.

ACTION REQUESTED OF THE CITY COUNCIL

Staff Recommends That The City Council Accept The Comprehensive Annual Financial Report (CAFR) And The Management Letter For The Year Ended June 30, 2016.

Item: _____
Finance and Management Committee
February 28, 2017

ATTACHMENT A

Due to the size of the Comprehensive Annual Financial Report (CAFR), please view on the City of Oakland website using the following link:

<http://www.oaklandnet.com/government/fwawebste/accounting/CAFR.htm>

ATTACHMENT B

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

CITY OF OAKLAND

Communications to City Council

For the Year Ended
June 30, 2016



Certified
Public
Accountants

CITY OF OAKLAND

Communications to City Council
For the Year Ended June 30, 2016

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

In planning and performing our audit of 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, 2016, 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 City’s internal control. Accordingly, we do not express an opinion on the effectiveness of the City’s internal control. In addition, the Port of Oakland (Port), a discretely presented component unit, is audited by us under a separate engagement and a separate letter of required communications is submitted to 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, 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.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses. Given those limitations, during our audit of the City, we did not identify any deficiencies in internal control that we consider to be material weaknesses for the City. However, material weaknesses may exist that have not been identified.

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 deficiency in the City’s internal control, described in item 2016-001 in the accompanying Current Year Recommendations, to be a significant deficiency.

We have included in this report an informational recommendation on new standards that will impact the City’s accounting and reporting of retiree health insurance and other retiree benefits, described in the Current Year Recommendations section as item 2016-002. We have also included in this report a status of the prior year recommendation. These items do not affect our report dated December 16, 2016 on the basic financial statements of the City.

Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards, *Government Auditing Standards* and 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 our audit services plan provided on June 14, 2016. Professional standards also require that we communicate to you the information related to our audit discussed on pages 3 through 6. We would like to thank City management and staff for the courtesy and cooperation extended to us during the course of our engagement.

CITY OF OAKLAND

Communications to City Council
For the Year Ended June 30, 2016

REQUIRED COMMUNICATIONS

Significant Audit Findings

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 of Oakland (City) are described in Note (I) E to the basic financial statements. As described in Note (I) E to the basic financial statements, the City adopted the following pronouncements for the year ended June 30, 2016:

GASB Statement No. 72 – Fair Value Measurement and Application - This statement is intended to improve accounting and financial reporting for state and local governments' investments by enhancing the comparability of financial statements among governments by requiring measurement of certain assets and liabilities at fair value using a consistent and more detailed definition of fair value and accepted valuation techniques. This statement requires additional disclosures regarding fair value, which are presented in Note (II) A to the basic financial statements.

GASB Statement No. 73 – Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement No. 68, and Amendments to Certain Provisions of GASB Statements 67 and 68, GASB Statement No. 76, The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments, GASB Statement No. 79, Certain External Investment Pools and Pool Participants, and the early adoption of GASB Statement No. 82, Pension Issues – an amendment of GASB Statements No. 67, No. 68 and No. 73, did not have a material impact on the City's financial statements.

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, and thus, is 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.

CITY OF OAKLAND

Communications to City Council
For the Year Ended June 30, 2016

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 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.
- *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.
- *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.* 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 reports from the City's Public Works Department Environmental Services and external consultants.
- *Net pension liability, net other postemployment benefit obligations, and 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 deferred outflows of resources, deferred inflows of resources, obligations and funded status and required contributions of the plans, are based on actuarial calculations performed in accordance with the parameters set forth for the pension plans under GASB Statement No. 67, *Financial Reporting for Pension Plans*, and GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, 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.

We evaluated the key factors and assumptions used to develop these accounting estimates in determining that they are reasonable in relation to the financial reporting opinion units that collectively comprise its basic financial statements.

CITY OF OAKLAND

Communications to City Council
For the Year Ended June 30, 2016

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 investments, long-term obligations, and pension and other postemployment benefits. The disclosures about investments, long-term obligations, and pension and other postemployment benefits are described in Notes (II) A, (II) H, (III) A, and (III) B, respectively, to the financial statements.

The financial statement disclosures are neutral, consistent, and clear.

II. Difficulties Encountered in Performing the Audit

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

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. The attached schedule summarizes uncorrected misstatements of the financial statements. Management has determined that their effects are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. In addition, 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 report, a disagreement with management is 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 16, 2016.

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 City's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

CITY OF OAKLAND

Communications to City Council
For the Year Ended June 30, 2016

Other Matters

VIII. Required Supplementary Information

We 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 regarding 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 did not audit the RSI and do not express an opinion or provide any assurance on the RSI.

IX. Supplementary Information

We were engaged to report on the combining financial statements and schedules, which accompany the financial statements but are not RSI. With respect to this supplementary information, 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.

X. Other Information in Documents Containing Audited Financial Statements

We were not engaged to report on the introductory and statistical sections of the comprehensive annual financial report, which accompany the basic financial statements but are not RSI. We did not audit or perform other procedures on this other information and we do not express an opinion or provide any assurance on it.

During the year, the City included audited financial statements for the year ended June 30, 2016, 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
For the Year Ended June 30, 2016

CURRENT YEAR RECOMMENDATIONS

**2016-001 Significant Deficiency Over Financial Reporting
Accounting for Non-Routine Transactions and Incomplete Trial Balance**

Observation:

The Oakland Redevelopment Successor Agency (ORSA)'s financial records should be maintained in accordance with accounting principles generally accepted in the United States of America (GAAP) as promulgated by the Governmental Accounting Standards Board.

In fiscal year 2016, the ORSA refunded three of its outstanding bonds: 2006A Subordinated Housing Set Aside Revenue Refunding Bonds; the 2006A-TE Central City East Redevelopment Project Tax Allocation Bonds; and the 2006C-TE Broadway/MacArthur/San Pablo Redevelopment Project Tax Allocation Bonds. The ORSA also partially refunded two of its outstanding bonds: 2006A-T Subordinated Housing Set Aside Revenue Bonds and the 2006B-TE Coliseum Area Redevelopment Project Tax Allocation Bonds. These are non-routine transactions of the ORSA. Due to the current financial system upgrade project and other changes in the allocation of personnel, the ORSA did not have adequate time to familiarize themselves with the accounting and financial reporting requirements associated with these types of transactions, which resulted in audit adjustments reducing ORSA's net position in the amount of \$1.4 million. In addition, the ORSA provided a trial balance for the year-end audit that did not include the ORSA's closing journal entries related to the unearned revenue and notes and loans receivable accounts. These errors were subsequently corrected during the audit.

Recommendation:

Management has the responsibility to ensure the entity's financial statements are presented fairly in accordance with GAAP. With the recent financial system upgrades and other changes in the allocation of personnel, we recommend that the ORSA dedicate adequate resources to properly prepare the ORSA's financial records in accordance with GAAP and to provide appropriate financial reporting training to its personnel.

Management's Response:

Management acknowledges that its decision to redeploy staff to the City's financial system upgrade caused certain oversights in timely classification of revenues and costs resulting from the bond refunding as insufficient staff were assigned to these tasks. Management is actively working on maintaining a sound internal control system over ORSA's financial reporting. This will include, but not be limited to, ensuring appropriate level of management reviews, improving communication and transparency over the annual audit, and providing training to staff. It is management's expectation that the weaknesses will be corrected for future audits.

CITY OF OAKLAND

Communications to City Council
For the Year Ended June 30, 2016

CURRENT YEAR RECOMMENDATIONS (Continued)

2016-002 **New Accounting and Reporting Standards for Retiree Health Insurance and Other Retiree Benefits (Informational Matter)**

Recommendation:

Postemployment benefits other than pensions (OPEB) principally involve health care benefits, but also may include life insurance, disability, legal and other services. In June 2015, the Governmental Accounting Standards Board (GASB) issued Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, and Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which are intended to improve the accounting and financial reporting by state and local governments for postemployment benefits other than pensions (hereinafter referred to as "OPEB standards").

The OPEB standards are designed to improve the information reported on OPEB for decision-making and accountability purposes, comparability across governments, and transparency for those who avail themselves to it. They also are designed to provide state and local government policy makers and other users of governmental financial reports with information that would allow them to obtain a more comprehensive understanding of a government's financial portrait.

The new OPEB standards parallel the recently adopted pension standards under GASB Statement No. 67, *Financial Reporting for Pension Plans*, and GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, and intend to bring about fundamental changes in how OPEB is accounted for and reported. Similar to the changes made to the pension standards, these new OPEB standards provide a more comprehensive picture of what state and local governments have promised to their employees and the actual associated costs. Accordingly, the OPEB standards will affect the City in the following ways:

- Changes that affect how the long-term obligation and the annual costs of OPEB are measured,
- A requirement to recognize the net OPEB liability on the face of the financial statements, and
- A requirement to present more extensive note disclosures and related schedules.

The provisions in GASB Statement No. 74 affecting OPEB plans are effective for the fiscal year ending June 30, 2017. The provisions in GASB Statement No. 75 affecting employers that provide OPEB benefits are effective for the fiscal year ending June 30, 2018.

The City provides health plan coverage for eligible retirees and their dependents pursuant to CalPERS Health Benefit Program eligibility requirements and entered into an agreement with CalPERS to participate in the California Employer's Retiree Benefit Trust Fund Program (CERBT), an agent multiple-employer postemployment health plan, to prefund these benefits. CalPERS early implemented the requirements of GASB Statement No. 74 for its CERBT fund during the fiscal year ended June 30, 2016, which is one year earlier than required. Therefore, the City should immediately assess the impacts of the OPEB standards and determine whether it will implement the requirements of GASB Statement No. 75 in its fiscal year ending June 30, 2017 financial statements or wait one year until it is required. Due to the City's current procedure of not allocating OPEB obligations to its proprietary funds, the City will need to re-evaluate its current methodology and potential impact under these new standards and determine how to track and allocate OPEB costs among these funds. Regardless of the City's decision of when to implement, the City should work closely with CalPERS, actuaries and auditors to ensure that all relevant parties are involved in the process that ultimately affect its successful implementation.

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Communications to City Council
For the Year Ended June 30, 2016

STATUS OF PRIOR RECOMMENDATION

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 was partially implemented. Further action will be occurring in fiscal year 2017.

The City selected the Digital Realty Trust (DRT) site as a primary workload site for many business essential IT applications. The primary reason for moving the IT assets from City owned data centers to the DRT site was because of the redundancy and resiliency of critical infrastructure including HVAC, power, UPS, internet, etc. at the DRT data center site. In addition, the City is in the process of moving the backup data and services to the Amazon cloud from the DRT site for disaster recovery. The new configuration is targeted for completion in the next year, will consist of a local robust and resilient data center for the business essential IT systems and critical data being backed up in the cloud with geo-redundancy.

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Communications to City Council
For the Year Ended June 30, 2016

SUMMARY OF UNCORRECTED MISSTATEMENTS (Dollars in thousands)

Adjustment	Account Name and Adjustment Description	Debit	Credit
1	General Fund and Governmental Activities - Fines and Penalties General Fund and Governmental Activities - Accounts Receivable (To correct year-end parking citation accrual due to error when recording accrual.)	\$ 726	\$ 726
2	Municipal Capital Improvement - Other Revenue Municipal Capital Improvement - Unavailable Revenue (To offset receivable that was not received within the City's revenue recognition policy.)	\$ 160	\$ 160
3	General Fund and Governmental Activities - Information Technology General Fund and Governmental Activities - Accounts Payable (To accrue for an invoice that had a portion of the service period in FY 2016.)	\$ 165	\$ 165
4	Business-type Activities - Unrestricted Net Position Business-type Activities - OPEB liability Governmental Activities - OPEB liability Governmental Activities - Unrestricted Net Position Governmental Activities - OPEB liability Governmental Activities - General Government Expense Governmental Activities - Public Safety Expense Governmental Activities - Community Services Expense Governmental Activities - Community and Development Expense Governmental Activities - Public Works Expense Business-type Activities - Sewer Expense Business-type Activities - Parks and Recreation Expense Business-type Activities - OPEB liability (To restate beginning balance of net position for allocation of FY 2015 OPEB liability to the business-type activities. To allocate a portion of the FY 2016 change in the OPEB liability to the business-type activities.)	\$ 17,716 \$ 17,716 \$ 3,317 \$ 3,292 \$ 25	\$ 17,716 \$ 17,716 \$ 449 \$ 1,652 \$ 418 \$ 197 \$ 601 \$ 3,317
5	Business-type Activities - Net Position Business-type Activities - Depreciation Expense Business-type Activities - Accumulated Depreciation (To record depreciation from the date of when the notice of completion was approved by the City Clerk in FY 2013.)	\$ 207 \$ 35	\$ 242
6	Business-type Activities - Net Position Business-type Activities - Depreciation Expense Business-type Activities - Accumulated Depreciation (To record depreciation from the date of when the notice of completion was approved by the City Clerk in FY 2014.)	\$ 44 \$ 17	\$ 61
7	Governmental Activities - Net Position Governmental Activities - Public Works Expense (To correct overstatement of capitalized expenses in prior year due to capitalizing of non-capitalizable costs.)	\$ 13,091	\$ 13,091
8	Governmental Activities - Equipment Fund - Other Expense Governmental Activities - Equipment Fund - Net Position (To remove capitalized costs that should have been capitalized in FY 2015.)	\$ 3,187	\$ 3,187
9	Governmental Activities - Radio Fund - Net Position Governmental Activities - Radio Fund - Repairs and Maintenance Expense (To correct overstatement of capitalized expenses in prior year due to capitalizing of non-capitalizable costs.)	\$ 631	\$ 631