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OFFICE OF THE CITY CLERK
OAKLAND

2021 FEB 26 PM 1:45 **AGENDA REPORT**

TO: Edward D. Reiskin
City Administrator

FROM: Margaret O'Brien
Interim Director of Finance

SUBJECT: Comprehensive Annual Financial
Report and Management Letter

DATE: January 8, 2021

City Administrator Approval

Date: Feb 26, 2021

RECOMMENDATION

Staff Recommends That The City Council Receive The Comprehensive Annual Financial Report (CAFR) And The Auditor's Required Communication To City Council (Management Letter) For The Year Ended June 30, 2020.

EXECUTIVE SUMMARY

The Finance Department is pleased to present to the City Council the attached independent annual audit, referred to as the Comprehensive Annual Financial Report (CAFR), and the auditor's required communication to City Council, also known as the Management Letter.

The audit report incorporates management's discussion and analysis of the City's financial position, basic financial statements, notes to basic financial statements, and the 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.

Macias, Gini & O'Connell, the City's external auditor, audited the City's financial statements for the year ending June 30, 2020 (Attachment A). The auditor reported no findings and did not identify any deficiencies in internal controls. The auditor's unmodified opinion letter for the CAFR affirms that the basic financial statements contained therein accurately represent the financial condition of the City of Oakland as of June 30, 2020. The auditor expressed an opinion that the City's financial statements are fairly stated and in accordance with accounting principles generally accepted in the United States.

City Council acceptance of the Fiscal Year 2019-20 CAFR will provide relevant financial information to the City Council, residents and businesses of Oakland, creditors, investors, and other interested parties. This report also fulfills the City Council's responsibilities under 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."

Finance & Management Committee
March 8, 2021

BACKGROUND / LEGISLATIVE HISTORY

The Comprehensive Annual Financial Report

The FY 2019-20 CAFR provides a description of the City's financial activities for the period of July 1, 2019 through June 30, 2020, and is divided into the following major 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); and
- ***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, and provides advice on accounting policies, evaluates accounting estimates, proposes audit adjustments, and notes significant audit findings, the status of prior years' recommendations, corrected and uncorrected misstatements, disagreements with management, management representations, and 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 and Management Committee, Federal grantor agencies, and the management of the City.

ANALYSIS AND POLICY ALTERNATIVES

The FY 2019-20 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. This document includes an opinion from the City's external auditor that the City's financial statements for FY 2019-20 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.

Financial Highlights

For the fiscal year ended June 30, 2020, total liabilities and deferred inflows of resources exceeded total assets and deferred outflows of resources by \$65.0 million. This result compares to a negative net position of \$283.5 million at June 30, 2019 and reflects a \$218.4 million improvement in net position on a government-wide basis, as detailed in **Table 1**.

A \$235.7 million reduction in net other post-employment benefit (OPEB) liability was the major contributor to the improvement in net position. The reduction in net OPEB liability results primarily from negotiated changes to benefits for sworn employees and City contributions to an irrevocable trust, which reduced actuarial estimates of future benefit costs. This improvement was partially offset by increases of \$62.9 million in net pension liability and \$52.4 million in other liabilities. The government-wide increase in net position was also supported by a \$16.3 million increase in net position from business-type activities.

The City's deficit net position of \$65.0 million incorporates a \$2.1 billion deficit in unrestricted net position that has primarily resulted from the historical underfunding of pension and OPEB liabilities. The net pension liability accounts for \$1.7 billion of this deficit and the net OPEB liability accounts for \$0.6 billion.

Capital assets such as buildings, land, and equipment, less any related outstanding debt, account for \$1.4 billion of the City's net position. These capital assets are used to provide services to residents and are not available for future spending.

Resources that are subject to restrictions on their use, such as bond proceeds or grant funds, contribute an additional \$704.4 million to net position and are available to meet the City's ongoing obligations for specific programs, of which \$314.8 million pertains to Low and Moderate Income Housing Redevelopment, \$340.1 million is restricted for Housing and Community Development programs, and \$24.2 million is restricted for debt service.

Total fund balance for the City's governmental funds increased by 16.6 percent, or \$163.1 million, compared to the prior fiscal year, rising to \$1.1 billion. This increase is primarily attributed to the issuance of voter-approved debt for capital projects. Total fund balance in the consolidated General Fund decreased by \$22.8 million, or 5.3%, falling to \$404.3 million.

An imbalance between spending and revenues resulted in the City's General Purpose Fund Emergency Reserve falling below its required level of 7.5 percent of General Purpose Fund appropriations. Per the City's Consolidated Fiscal Policy, this shortfall will require the City Administrator to present a strategy to City Council to meet this policy requirement, which is anticipated to occur as part of the development of the FY 2021-23 biennial budget.

Table 1: Consolidated Statements of Net Position June 30, 2020 and 2019 (in thousands):

	Governmental Activities		Business-Type Activities		Total	
	2020	2019	2020	2019	2020	2019
Assets						
Current and other assets	\$1,945,415	\$1,715,707	\$82,302	\$73,648	\$2,027,717	\$1,789,355
Capital assets	1,423,245	1,430,104	255,190	245,373	1,678,435	1,675,477
Total Assets	<u>3,368,660</u>	<u>3,145,811</u>	<u>337,492</u>	<u>319,021</u>	<u>3,706,152</u>	<u>3,464,832</u>
Deferred outflows of resources						
Loss on refunding of debt	13,513	14,758	—	—	13,513	14,758
Related to pensions	317,386	318,377	2,045	3,826	319,431	322,203
Related to OPEB	40,797	39,111	556	19	41,353	39,130
Total Outflows	<u>371,696</u>	<u>372,246</u>	<u>2,601</u>	<u>3,845</u>	<u>374,297</u>	<u>376,091</u>
Liabilities						
Long-term liabilities	1,139,168	1,050,111	29,072	31,690	1,168,240	1,081,801
Other liabilities	318,401	268,942	5,647	2,689	324,048	271,631
Net pension liability	1,672,538	1,613,350	44,896	41,226	1,717,434	1,654,576
Net OPEB liability	588,107	828,065	10,462	12,578	598,569	840,643
Total Liabilities	<u>3,718,214</u>	<u>3,760,468</u>	<u>90,077</u>	<u>88,183</u>	<u>3,808,291</u>	<u>3,848,651</u>
Deferred inflows of resources						
Gain on refunding of debt	3,026	—	356	395	3,382	395
Related to pensions	38,163	37,770	1,283	1,563	39,446	39,333
Related to OPEB	290,396	231,400	3,952	4,600	294,348	236,000
Total deferred inflows	<u>331,585</u>	<u>269,170</u>	<u>5,591</u>	<u>6,558</u>	<u>337,176</u>	<u>275,728</u>
Net Position						
Net investment in capital assets	1,142,803	1,144,031	225,762	213,288	1,368,565	1,357,319
Restricted	704,387	666,949	—	—	704,387	666,949
Unrestricted (deficit)	(2,156,633)	(2,322,561)	18,663	14,837	(2,137,970)	(2,307,724)
Total net position	<u>\$ (309,443)</u>	<u>\$ (511,581)</u>	<u>\$244,425</u>	<u>\$228,125</u>	<u>\$(65,018)</u>	<u>\$(283,456)</u>

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.

COORDINATION

This report was prepared in coordination and with input from the Finance Department and City Attorney's Office. It presents financial information for all City departments as well as the Port of Oakland.

SUSTAINABLE OPPORTUNITIES

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

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

Race & Equity: There are no race or equity opportunities associated with this informational report.

ACTION REQUESTED OF THE CITY COUNCIL

Staff Recommends That The City Council Receive The Comprehensive Annual Financial Report (CAFR) And The Auditor's Required Communication To City Council (Management Letter) For The Year Ended June 30, 2020.

For questions regarding this report, please contact Stephen Walsh, Controller, at (510)-238-4906.

Respectfully submitted,

Margaret L. O'Brien

MARGARET O'BRIEN
Interim Director of Finance
Finance Department

Prepared by:
Stephen Walsh, Controller
Controller's Bureau

Attachments (2):

- A: Comprehensive Annual Financial Report For the Year Ended June 30, 2020
- B: Auditor's Required Communication to City Council (Management Letter)

ATTACHMENT A

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

<https://cao-94612.s3.amazonaws.com/documents/CAFR-2020.pdf>

ATTACHMENT B

Auditor's Required Communication to City Council

CITY OF OAKLAND

Communications to City Council

For the Year Ended
June 30, 2020



Certified
Public
Accountants

CITY OF OAKLAND

Communications to City Council
For the Year Ended June 30, 2020

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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 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, 2020, 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. 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.

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

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.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control over financial reporting 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 2020-001 in the accompanying Current Year Recommendations section, to be a significant deficiency. The identified significant deficiency is not considered to be a material weakness.

We have also included another identified matter involving internal control that is presented for your consideration together with a status of the prior year recommendations in this report.

The City's responses to the findings identified in our audit are also described in the Current Year Recommendations section. We did not audit the City's responses and, accordingly, we express no opinion on them.

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 the As-Needed Professional Service Agreement between the City of Oakland and Macias Gini & O'Connell LLP dated May 1, 2020. 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.

Macias Gini & O'Connell LLP

Walnut Creek, California
December 15, 2020

CITY OF OAKLAND

Communications to City Council
For the Year Ended June 30, 2020

REQUIRED COMMUNICATIONS

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, our responsibility, as described by professional standards, is to form and express an opinion 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 findings regarding a significant control deficiency over financial reporting and other matters noted during our audit.

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 2020. As described in Note I Section E to the basic financial statements, during the year, the City adopted Governmental Accounting Standards Board (GASB) Statement No. 95, *Postponement of the Effective Dates of Certain Authoritative Guidance*. The City also adopted certain provisions of GASB Statement No. 92, *Omnibus 2020*. There was no impact on the basic financial statements related to the implementation of these statements.

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Communications to City Council
For the Year Ended June 30, 2020

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 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. 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.

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Communications to City Council
For the Year Ended June 30, 2020

- *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 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 GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, 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 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, litigation, pension and other postemployment benefits, and uncertainty. The disclosures about investments, long-term obligations, and pension and other postemployment benefits are described in Note II Section A, Note II Section G, Note II Section H, and Note III Sections A, and B, respectively, to the financial statements. In addition, the uncertainty relating to COVID-19 impacts on the City is described in Note III Section E.

Significant Difficulties Encountered during the Audit

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

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 and each applicable opinion unit.

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. The attached schedule summarizes material misstatements that we identified as a result of our audit procedures were brought to the attention of, and corrected by, management.

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Communications to City Council
For the Year Ended June 30, 2020

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 15, 2020.

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 in Documents Containing Audited Financial Statements

Pursuant to professional standards, our responsibility as auditors for other information in documents containing the City's audited financial statements 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:

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 supplement 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.

Supplementary Information and Other Sections

We were engaged to report on the combining financial statements and schedules, which accompany the basic 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

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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 basic financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the basic financial statements or to the basic financial statements themselves.

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 or supplementary information. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

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 report includes an emphasis of matter paragraph to reference to Note III Section E to the basic financial statements for disclosures regarding the COVID-19 impact on the City. Our opinion is not modified with respect to this matter.

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Communications to City Council
For the Year Ended June 30, 2020

CURRENT YEAR RECOMMENDATIONS

**2020-001 Significant Deficiency in Internal Control Over Financial Reporting
Internal Control Over Financial Reporting and Reliability of Financial Statements**

Criteria:

As part of our audit procedures, we assess an organization's environment, risk assessment and monitoring of controls and determine whether internal controls have been effective over financial reporting. If controls do not exist, are poorly designed or not operating effectively, we must evaluate the control deficiency and report the deficiency to management, including whether the control deficiency is a significant deficiency or material weakness.

Condition:

We noted that the City faced significant turnover in the Finance Department over the past few years and was successful in backfilling the roles and responsibilities with current personnel. While the City was successful in recruiting replacements, the City had a significant time gap between when the person left the City and the recruitment and the onboarding of the replacement position. Furthermore, onboarding during the COVID-19 pandemic created additional challenges in knowledge transfers especially in areas that are complex and non-routine such as the City's accounting and financial reporting activities related to pensions and other postemployment benefits (OPEB).

Recommendation:

We recommend that the City complete its recruiting and onboarding of the significant unfilled positions in the Finance Department and improve on its personnel retention programs. In addition, we recommend that the City continue to improve the documentation of its year-end closing journal entries related to its complex computations such as its pension and OPEB computations.

Management's Response:

Management acknowledges that delays in filling vacant positions and gaps in the documentation of year-end closing activities have slowed the production of financial reports and increased opportunities for errors. The Finance Department continues to explore options for minimizing recruitment delays and improving knowledge transfer upon employee turnover, while recognizing the additional challenge of meeting these goals during the current financial crisis.

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Communications to City Council
For the Year Ended June 30, 2020

CURRENT YEAR RECOMMENDATIONS (Continued)

2020-002 Other Control Deficiency
Information Technology: City-Wide Information Security 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 addresses 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:

We noted weaknesses within the City's information security program. Specifically, the City does not have updated policies and procedures along with continuous risk assessment and testing programs in place to actively mitigate threats to the City's IT infrastructure from ransomware attacks, cyberattacks, and other unauthorized data breaches. During the pandemic, there was increased remote access within the City. The City's network is exposed without proper safeguards. In addition, we noted that a number of the City's software and equipment are getting close to the end of their useful life, such as Windows Server 2008 R2.

Recommendation:

We recommend the City evaluate its allocation of resources dedicated to cybersecurity threats and ensure resources are dedicated to update policies and procedures and to continuously perform periodic risk and vulnerability assessments, penetration testing, monitoring through scanning or agent-based software tools, or perform other cybersecurity activities in order to identify, track and resolve security threats. In addition, the City should continue its migration of its IT equipment to a co-location site that would provide the City with adequate cooling, power, bandwidth, and physical security for its IT equipment. The City should also develop a plan to upgrade the equipment or software that would become salvage within a short period of time.

CITY OF OAKLAND

Communications to City Council
For the Year Ended June 30, 2020

CURRENT YEAR RECOMMENDATIONS (Continued)

With the transition to a remote workforce, the City should work to improve its security protocols including:

- Access to Oracle from Personal Devices – Although Virtual Private Network (VPN) is required to connect to the City's Oracle financial management system, the City does not track the types of confidential information that may be downloaded to personal devices. As such, there is a risk that the user's device may be compromised with unauthorized data leakage without the City's knowledge. We recommend that the City implements a Mobile Device Management (MDM) solution to contain the City's sensitive data and allow remote removal of the City's contained information in case the personal device is lost or stolen.
- Asset Tracking – The City should ensure that its asset distribution procedure and inventory management system properly tracks assets assigned to employees.

Management's Response:

The City concurs with this recommendation concerning the need to improve the City-Wide Information Security Program in general, and the specific recommendations to: (1) accelerate the migration of servers from the legacy onsite data centers either to the Cloud or to our certified co-location facility at Digital Realty, and (2) increase the allocation of resources dedicated to cybersecurity detection and incident response.

CITY OF OAKLAND

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STATUS OF PRIOR RECOMMENDATIONS

**2019-001 Other Control Deficiency
Adequate Personnel in the Finance Department**

Recommendation:

During the fiscal year 2019 audit, we noted that the City was experiencing difficulty maintaining an adequate level of resources proficient in governmental accounting standards and federal compliance requirements to ensure timely completion of account reconciliations; technical evaluation of upcoming changes in accounting standards on the City's financial position; and financial and compliance reporting requirements. We recommended the City re-evaluate its current structure to ensure that all of the functions of the City's Finance Department are adequately staffed.

Status of Corrective Action:

In process – see current year finding 2020-001.

**2019-002 Other Control Deficiency
Information Technology: City-Wide Information Security Program**

Recommendation:

During the prior years' audits, we recommended the City evaluate its allocation of resources dedicated to cybersecurity threats and ensure resources are dedicated to update policies and procedures and to continuously perform periodic risk and vulnerability assessments, penetration testing, monitoring through scanning or agent-based software tools, or perform other cybersecurity activities in order to identify, track and resolve security threats.

Status of Corrective Action:

In process – see current year finding 2020-002.

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SUMMARY OF UNCORRECTED FINANCIAL STATEMENT ADJUSTMENTS
(Dollars in thousands)

No.	Fund	Account Name	Debit	Credit
#1	<i>To adjust the overstated gain on sale of properties in prior year.</i>			
	MCIF	Fund Balance		\$1,711
	MCIF	Miscellaneous	\$1,711	
#2	<i>To reclassify outstanding checks dated prior to June 30, 2020 from accounts payable.</i>			
	General Fund	Cash held in Treasury: City Pool		\$13,559
	General Fund	Payables	\$13,559	
#3	<i>To reclassify negative fund balance.</i>			
	Other General Fund	Unassigned Fund Balance	\$931	
	Other General Fund	Restricted Fund Balance		\$931

¹ MCIF – Municipal Capital Improvement Fund

CITY OF OAKLAND

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SUMMARY OF CORRECTED FINANCIAL STATEMENT ADJUSTMENTS
(Dollars in thousands)

No.	Opinion Unit	Account Name	Debit	Credit
#1		<i>To adjust the pension and OPEB liabilities and expenses to agree to actuarial results.</i>		
	Various	Deferred Outflows: OPEB		\$ 39,130
	Various	Net OPEB Liability		405,888
	Various	Deferred Inflows: OPEB	\$11,202	
	Various	OPEB Expense	433,816	
	Various	Deferred Outflows: Pension		178,780
	Various	Net Pension Liability	599	
	Various	Deferred Inflows: Pension		304
	Various	Pension Expense	178,485	