



City of Oakland

Office of the City Clerk
Oakland City Hall,
1 Frank H. Ogawa Plaza,
Room 201
Oakland, California 94612

Legislation Text

File #: 003575, **Version:** 1

Subject: Comprehensive Annual Financial Report (CAFR)
From: Financial Services Agency
Recommendation: Receive an informational report regarding the Fiscal Year 2001-2002 Comprehensive Annual Financial Report (CAFR) and Oakland Redevelopment Agency Financials
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Agenda Report

TO: Office of the City Manager

ATTN: Robert C. Bobb

FROM: Financial Services Agency

DATE: June 24, 2003

RE: FY 2001-02 Comprehensive Annual Financial Report and Oakland
Redevelopment Agency Financials

SUMMARY

The attached City of Oakland Comprehensive Annual Financial Report (CAFR) and Oakland Redevelopment Agency Financials are herewith presented to the Finance and Management Committee. The CAFR incorporates the Oakland Municipal Employees' Retirement System (OMERS), the Police and Fire Retirement System (PFRS), the Oakland Redevelopment Agency (ORA) and the Port of Oakland financial statements. The City and Agency implemented the Governmental Accounting Standards Board (GASB) Statements 34, 37 and 38 and

Governmental Accounting Standards Board Interpretation 6. A description of these new pronouncements be-ins on page 29 of the CA-FR. Also attached are the Management Letter from the City's outside auditors, KPMG, LLP and the auditor's letter of SAS 61 required communications. The Management Letter notes no material weaknesses in the City's internal controls and financial operations.

FISCAL IMPACT

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

BACKGROUND

The Comprehensive Annual Financial Report is presented in three sections.

The Introductory Section includes information about the organizational structure of the City, its accounting and budgetary systems, and its fund structure. This section also has summarized data reflecting the City's financial condition, including an overview of the City and its economy, general government operations, enterprise and internal service fund operations, and debt administration.

The Financial Section includes the General Purpose Financial Statements as an overview of the City's entire financial operations. A new requirement under GASB 34 is the inclusion of a Management's Discussion and Analysis, which provides a high level

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FY2001-02 Comprehensive Annual Financial Report

overview of the City's financial activities. The new Government-wide statements provide a consolidated view of the City's financial activities and condition on a full accrual basis. Separate information is provided for the City's governmental funds and business-type activities (Sewer Service Fund and Golf Courses). Revenues are recognized when earned and expenses are recognized when incurred. Capital Assets, including infrastructure, and the liability for the City's long-term debt are included in the Statement of Net Assets.

Combining- and individual fund and account group statements present the separate funds and account groups that are material. Schedules provide other information and details of data summarized in the financial statements. These statements and schedules pertain to those operations which, when taken together, make up the reporting entity of the City. These financial statements also include the financial activities of the Oakland Municipal Employees' Retirement System (OMERS), the Police and Fire Retirement System (PFRS), the Oakland Redevelopment Agency (ORA), the Port of Oakland, and the Oakland-Alameda County Coliseum Authority. Also included in the financial section of the CAFR is the Independent Auditor's Report that states, in the opinion of the auditors, the financial statements accurately represent the financial condition of the City as of June 30, 2002.

The audit of the City of Oakland's financial records was performed by the accounting firm of KPMG,LLP under the terms of an extension to their original two-year agreement. The audits of the OMERS, PFRS, Oakland Redevelopment Agency and Port of Oakland were separately audited by other independent accounting firms.

The Statistical Section provides ten years of summary financial data as well as various demographic, economic and statistical information related to the City and its operations.

The Management Letter contains comments and recommendations from the City's outside auditors, KPMG, LLP. In the current year, no material weaknesses were noted. Also attached is a letter of required communications from KPMG, LLP.

ACTION REQUESTED OF THE FINANCE COMMITTEE

Staff recommends that the Finance and Management Committee accept the June 30, 2002 CAYR, ORA Financials and Management Letter.

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ancial Services Agency

William E. Noland
APPROVED AND FORWARDED TO Controller
THE FINANCE AND MANAGEMENT
COMMITTEE Item 10-24ce-

ORAIEnuneil
July 15, 2003
Office of the City Manager

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Three Embarcadero Center
San Francisco, CA 94111

May 2, 2003,

The Honorable Members of the City Council
Oakland, California:

We have audited the basic financial statements of the City of Oakland, California, (the City) for the year ended June 30, 2011, and have issued our report thereon dated May 2, 2003. In performing our audit of the basic financial statements of the City we considered internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements. An audit does not include an evaluation of the effectiveness of internal control and does not provide assurance on internal control. The maintenance of adequate internal control designed to fulfill control objectives is the responsibility of management. Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, controls found to be deficient at a point in time may later be found deficient because of the performance of those responsible for applying them, and there can be no assurance that controls currently in existence will prove to be adequate in the future as changes take place in the organization.

However, we noted certain matters involving internal control and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions are matters coming to our attention that, in our judgment, relate to significant deficiencies in the design or operation of internal control and could adversely affect the organization's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Our consideration of internal control would not necessarily disclose all matters in internal control that might be reportable conditions. Furthermore, reportable conditions do not include potential future internal control problems; that is, control problems coming to our attention that do not affect the preparation of financial statements for the period under audit.

The reportable conditions noted during our audit, all of which have been discussed with the appropriate members of management, are summarized as follows:

Year-End Closing and Financial Reporting Process

The City completed its Comprehensive Annual Financial Report (CAFR) approximately 10 months after the end of its fiscal year. This delay appears to have been caused by:

- The reliance by the Financial Services Agency on other departments to record certain transactions which were not reported in accordance with generally accepted accounting principles,

- The implementation of Governmental Accounting Standards Board (GASB) Statement No. 34 which dramatically changed the City's data accumulation and financial statement presentation processes. and
- A lack of skilled resources in the Financial Services Agency to respond to the challenges that routine accounting presents and to the unique challenges presented by GASB No. 334.

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From a control standpoint, the inability to effectively close out the financial accounts and records in a timely manner could result in material errors going undetected for extended periods of time. We recommend that the City:

- Consider its decentralized accounting structure and determine if it can be improved or if it should be changed to allow for more centralized oversight and control of key accounting areas,
- Evaluate the process used to prepare its GASB No. 34 compliant CAFR and define key milestones necessary to accelerate the year end closing process, and
- Evaluate its resource needs and fill any gaps between existing resources and the needs of the Financial Services Agency.

Management's Response:

The implementation of GASB No. 34 was responsible for a majority of the delay in reporting. The Commission is assembling a checklist of the required information under the new reporting model and assigning responsibility and due dates for each item, in order to assure a more timely closing. Key staff members will receive refresher and more advanced training on the new model. The Commission will also review its decentralized accounting structure and make up of its accounting staff to determine where improvements can be made.

Reconciliation and Review of Cash and Investments on a Timely Basis

The City's cash and investments are deposited in approximately forty different bank or trust accounts which require monthly and monthly reconciliations to the City's records. We noted that the City did not perform the majority of their monthly cash and investment reconciliations on a timely basis. Furthermore, the City's June 30, 2002 unrestricted cash and investments were not reconciled until November 2002. Once completed, the reconciliation of the unrestricted cash and investments revealed several material items that required adjustment in the City's general ledger.

The periodic reconciliation of the balances recorded in the general ledger to the statements provided by the financial institution is not only a key control over this significant asset of the City, but also over other significant accounting processes such as procurement and employee compensation.

We reconimerid that all monthly cash and investment accounts be reconciled and reviewed on a timely basis to ensure that adequate controls are maintained to detect and/or prevent the occurrence of material errors.

Management Response:

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The Honorable Members of the Citv Council
City of Oakland, California
May 2, 2003
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AlthouLh not considered to be reportable conditions, we also noted certain matters involving internal control and other operational matters that we would like to present for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of mana.-ement, are intended to improve internal control or result in other operatima efficiencies and are summarized as follows:

Accounting for Non Routine Transactions

Non-routine transactions are transactions that are unusual, either due to size or nature, or that occur infrequently. Due to the nature of non routine transactions, they often involve complex calculations or accounting principles which may require:

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- Greater management intervention to specify the appropriate accounting treatment
- Greater manual intervention for data collection and processma
- Greaterjud.-ment in determirim.a amounts

The nature of non-routme transactions may make it difficult for management to implement effective controls to prevent or detect and correct a si.-nificant muisstatement as compared to routine transactions.

Durin.g the year, the City experienced difficulties in accountin,g for certain non routine types of transactions, such as:

Recording the Issuance ofDebt - For purposes offinacial reporting:

In accordance with GASB Statement No. 34, transactions derived from the issuance of debt related to governmental activities should be reported in the governmental funds as follows:

- The cost of issuance of debt should be reported as an expenditure;
- The face amount of the debt should be reported as an other financing source; and,
- Any discount or premium incurred should be reported as an other financing use/source.

The City had not properly segregated certain transactions involving the issuance of debt related to governmental activities. Specifically, certain bond proceeds were initially reported net of issuance costs, discounts and premiums as an other financing source. In other instances, debt issuance costs were included with other expenditures instead of being reported separately.

Recording Debt Service Activities - For purposes of fund level reporting, the payment of principal and interest on debt administered by governmental activities are to be reported individually as debt service expenditures. During the year, the City had incorrectly reported certain interest payments as "principal retirement" expenditures and certain principal payments as "interest and fiscal charges" expenditures. The principal balance of certain notes payable had also been inappropriately reduced for payments that had not been returned to the lender, and the defeasance of certain notes payable had not appropriately recorded in the year in which the defeasance occurred. We understand that the City's decentralized organizational structure contributed to the occurrence of these errors.

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The Honorable Members of the City Council
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The above discrepancies resulted in several audit adjustments to properly report the outstanding balance of the City's long-term debt as of June 30, 1-002.

Long-term Loan Receivables - Allowance for Potentially Uncollectible Loans

In conjunction with the housing and community development programs, the City frequently sponsors long-term loans to low income families and developers of low income housing or other desired community development projects. Certain loans contain clauses which effectively defer the repayment of the loaned amount for an extended period of time. In accordance with generally accepted accounting principles, the City is required to establish a reserve for potentially uncollectible loans based on known facts and prior collection experience. Prior to fiscal year 2001-02, the City had met this requirement by establishing a deferred credit (liability) equal to the total outstanding loan receivable balance. With the implementation of GASB Statement No. 34, the City had to estimate the potentially uncollectible portion of the loan receivables, and establish an allowance which effectively reduces the loan receivable and deferred credit balances by equal amounts.

At our request, the City had conducted an analysis of the long-term loans for purposes of estimating the uncollectible portion, and recorded a significant adjustment to establish an allowance for potentially uncollectible loans.

We recommend the City examine staff training requirements, lines of interdepartmental communication, and the existing organizational structure to ensure adequate controls are in place to detect or prevent material errors from occurring.

Management's Response:

The Financial Services Agency - Accounting Division has now taken over primary responsibility for the recording of debt related activities, which should eliminate the need for adjustments in the future. Accounting has also instituted regularly scheduled meetings with the Community and Economic Development Agency, which administers the City's loans, to review loan receivables and collectibles along with other accounting items.

Reconciliation of Payroll Registers to General Ledger on a Timely Basis

The City utilizes its Oracle system to process payroll transactions. For each payroll cycle, reports and registers detailing all payroll amounts are generated and reviewed by the Payroll Department and all of the City's agencies for reasonableness.

Once the payroll reports and registers are reviewed for reasonableness, the data is then uploaded and recorded into the general ledger system. Because the payroll registers lack subtotal information, the City does not reconcile the detailed payroll data to the amounts recorded in the general ledger system to verify the completeness and accuracy of the data recorded in the general ledger.

The Honorable Members of the City Council
City of Oakland, California
May 2, 2003
Page 5

As payroll is a significant expense category for the City, we recommend the City consider performing a monthly reconciliation of the detailed payroll registers to the general ledger system to ensure the completeness and accuracy of the payroll expenditures/expenses and corresponding liabilities reported in the City's basic financial statements.

Management Response:

The City currently performs limited reconciliations of its payroll data to the general ledger entries. The City will develop improved payroll reporting, following the current upgrade to its financial systems, to enable more thorough reconciliations of payroll information.

Accounting for Capital Assets

Due to certain system limitations within the City's existing capital asset accounting system, management elected to acquire a standalone capital asset accounting software package to record and manage the City's capital assets. We understand management intends to transfer this data into the capital asset module of the City-wide financial accounting system once the system limitations have been addressed.

We believe the use of a standalone capital assets package was the right short-term solution to address the

City's immediate needs. However, having a system that is not integrated with the general ledger introduces additional inefficiencies and control risks. Therefore, we recommend that the City examine alternative solutions to further integrate its capital asset data with its general ledger system.

Management's Response:

The current release of the City's corporate accounting system did not provide suitable flexibility to incorporate, value, categorize and depreciate over 20 years of capital asset information required under GASB 34. For this reason, the City used a third party financial package to assemble this information. The City is currently implementing an upgrade to a new release of its corporate accounting system. Once this upgrade is completed, the information will be uploaded into the capital asset system.

These conditions were considered in determining the nature, timing, and extent of the audit tests applied in our audit of the 2002 basic financial statements, and this report does not affect our report on these financial statements dated May 2, 2003. We have not considered internal control since the date of our report.

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May 2, 2003
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Our audit procedures are designed primarily to enable us to form an opinion on the basic financial statements, and therefore may not bring to light all weaknesses in policies or procedures that may exist. We are, however, to use our knowledge of the City gained during our work to make comments and suggestions that we hope will be useful to you.

We would be pleased to discuss these comments and recommendations with you at any time.

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

Very truly yours,

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ORA/Council
July 15, 2003

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Three Embarcadero Center
San Francisco, CA 94111

May 5, 2003

The Finance and Management Committee
City of Oakland
Oakland, California

Members of the Finance and Management Committee:

We have audited the basic financial statements of the City of Oakland (the City) for the year ended June 30, 2002, and have issued our report thereon dated May 2, 2003. We did not audit the financial statements of the Oakland Redevelopment Agency, the Oakland Municipal Employees' Retirement System, the Police and Fire Retirement System, the Port of Oakland, and the City of Oakland Housing Finance Revenue Bonds Issue D1 and D2. Those statements were audited by other auditors whose reports have been furnished to us. Under generally accepted auditing standards, we are providing you with the following information related to the conduct of our audit.

Our Responsibility Under Generally Accepted Auditing Standards

We have a responsibility to conduct our audit in accordance with auditing standards generally accepted in the United States of America. In carrying out this responsibility, we planned and performed the audit to obtain reasonable assurance about whether the basic financial statements are free of material misstatement, whether caused by error or fraud. Because of the nature of audit evidence and the characteristics of fraud, we are unable to obtain reasonable, not absolute, assurance that material misstatements are detected. We have no responsibility to plan and perform the audit to obtain reasonable assurance that misstatements, whether caused by error or fraud, that are not material to the financial statements are detected.

In addition, in planning and performing our audit, we considered internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements. Our audit does not include an examination of the effectiveness of internal control and does not provide assurance on internal control.

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The Finance and Management Committee
City of Oakland
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Significant Accounting Policies

The significant accounting policies used by the City are described in note 2 to the basic financial statements. As described in note 2, the City has implemented a new financial reporting model, as required by Governmental Accounting Standards Board (GASB) Statement No. 34, Basic Financial Statements - and Management's Discussion and Analysis -for State and Local Governments, as of July 1, 2001. The City has also adopted the provisions of GASB Statement No. 37, Basic Financial Statements - and Management's Discussion and Analysis -for State and Local Governments: Omnibus, GASB Statement No. 38, Certain Financial Statement Note Disclosures and GASB Interpretation No. 6, Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements, as of July 1, 2001.

Management Judgments and Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's current judgments. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affect them - they may differ markedly from management's current judgments.

Management's estimate of accrued workers' compensation is based on an analysis of historical trends. The City also contracted to have an actuarial study performed with respect to the sufficiency of the reserve. We compared the reserve amount to the amount actuarially determined in order to evaluate the reasonableness of the reserve in relation to the basic financial statements of the City taken as a whole.

Management's estimate of estimated litigation reserves is based upon the individual case reserves proposed by the City Attorney's Office. The City also contracted to have an actuarial study performed with respect to the sufficiency of the reserve. We discussed significant cases with the City's attorneys and compared the reserve amount to the amount actuarially determined in order to evaluate the reasonableness of the reserve in relation to the basic financial statements of the City taken as a whole.

Management's estimate of the reserve for uncollectible loan receivables is based on the

repayment terms of the loan agreements, and an analysis of historical trends. We evaluated the
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key factors and assumptions used to develop the reserves, and discussed significant loan
reserves with management in order to evaluate the reasonableness of the reserve in relation to
the basic financial statements of the City taken as a whole.

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The Finance and Management Committee
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Management's estimates of the useful lives and capitalization criteria pertaining to capital assets
are based on prior experience with similar assets and industry standards. We evaluated the key
factors and assumptions used to determine the expected useful lives and develop capitalization
criteria in order to evaluate the reasonableness of the underlying capital assets in relation to the
basic financial statements of the City taken as a whole.

Receipts from federal and state grants and other similar programs are subject to audit to
determine if the funds were expended in accordance with appropriate statutes, grant terms, and
regulations. Management records receivables based on an estimate of what will ultimately be
recoverable. Our procedures include evaluating the reasonableness of management's estimates.

Audit Adjustments

We proposed corrections relating to debt issuance costs, debt service expenditures, long-term
debt, interest expenses and accrued interest on long-term debt, cash, the valuation of
investments, the deferral of property tax revenues, the valuation of long-term loan receivables,
the valuation of grant receivables, and net asset classification. These corrections were
considered material to the basic financial statements and appear to have been caused by the
implementation of several new and complex accounting standards in the current year.

In connection with our audit of your basic financial statements, we have discussed with
management certain financial statement misstatements that have not been accounted for in your
books and records as of and for the year ended June 30, 2002. We have reported such
misstatements to management on a Summary of Uncorrected Misstatements and have received
written representations from management that management believes the effects of the
uncorrected financial statement misstatements are immaterial, both individually and in the
aggregate, to the basic financial statements taken as a whole. Attached is a copy of the summary
that has been provided to, and discussed with, management.

Other Information in Documents Containing Audited Financial Statements

Our responsibility for other information in documents containing the City's basic financial
statements and our report thereon does not extend beyond the financial information identified in
Our report, and we have no obligation to perform any procedures to corroborate other
information contained in these documents. We have, however, read the other information

included in the City's Comprehensive Annual Financial Report, and no matters came to our attention that cause 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.

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The Finance and Management Committee
City of Oakland
May 8, 2003
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Disagreements with Management

There were no disagreements with management on financial accounting and reporting matters that, if not satisfactorily resolved, would have caused a modification of our report on the City's basic financial statements.

Consultation with Other Accountants

To the best of our knowledge, management has not consulted with or obtained opinions, written or oral, from other independent accountants during the past year that were subject to the requirements of AU 625, "Reports on the Application of Accounting Principles."

Major Issues Discussed with Management Prior to Retention

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.

Difficulties Encountered in Performing the Audit

Our audit of the City's basic Financial statements was not completed in our expected timeframe. This delay was caused by the City's implementation of several new and complex accounting standards for the year ended June 30, 2002.

This report is intended solely for the information and use of the Finance and Management Committee and is not intended to be and should not be used by anyone other than this specified party.

Very truly yours,

O&M, LLP

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SUPPORTING DOCUMENTATION FOR
FISCAL YEAR 2001-2002
COMPREHENSIVE ANNUAL
FINANCIAL REPORT AND
OAKLAND REDEVELOPMENT
AGENCY FINANCIALS

THIS DOCUMENT IS ON FILE AND
AVAILABLE FOR REVIEW AT THE
OFFICE OF THE CITY CLERK.

Location of Office:

Office of the City Clerk
15t Floor, Records Section
One Frank Ogawa Plaza
Oakland, Ca. 94612

Office Hours 8:30 A.M. - 5:00 P.M.
Closed During Lunch Hour (12:00 P.M. - 1:00 P.M.)

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ORA/Council
July 15, 2003