CITY OF SAN JOSE

Report to Those Charged With Governance

For the Year Ended June 30, 2023

MGO. Certified Public Accountants

November 17, 2023

Honorable Mayor and City Council
City of José, California

We are pleased to present this report related to our audit of the basic financial statements of the City of San José, California (City) as of and for the year ended June 30, 2023. This report summarizes certain matters required by professional standards to be communicated to you in your oversight responsibility for the City's financial reporting process.

In addition to the City's basic financial statements, we audit and separately report on the following financial statements as of and for the year ended June 30, 2023. These entities are included in the City's basic financial statements:

- Successor Agency to the Redevelopment Agency of the City of San José;
- San José Mineta International Airport;
- Parks and Recreation Bond Projects Fund;
- Branch Library Bond Projects Fund;
- Library Parcel Tax Special Revenue Fund;
- Pedestrian/Bicycle Facilities Grant;
- Public Safety and Infrastructure Bond Projects Fund;
- San José Clean Energy Enterprise Fund;
- South Bay Water Recycling Program and System;
- Wastewater Treatment System Enterprise Fund; and
- City of San José Deferred Compensation Plans.

We also audit the financial statements of the City sponsored retirement plans, the Federated City Employees' Retirement System and the Police and Fire Department Retirement Plan, collectively, the Retirement Systems. We issue a separate communications report to the respective Boards of the Retirement Systems.

This report is intended solely for the information and use of the Mayor, City Council and management, and is not intended to be, and should not be, used by anyone other than these specified parties. It will be our pleasure to respond to any questions you have about this report. We appreciate the opportunity to continue to be of service to the City.

Macias Gini & O'Connell LLP

Walnut Creek, California

TABLE OF CONTENTS

REQUIRED COMMUNICATIONS

Auditing standards generally accepted in the United States of America (AU-C 260, *The Auditor's Communication With Those Charged With Governance*) require the auditor to promote effective two-way communication between the auditor and those charged with governance. Consistent with this requirement, the following summarizes our responsibilities regarding the financial statement audits as well as observations arising from our audits that are significant and relevant to your responsibility to oversee the financial reporting process.

Our Responsibilities With Regard to the Financial Statement Audits

Our responsibilities under auditing standards generally accepted in the United States of America and *Government Auditing Standards* have been described to you in our engagement letter dated August 20, 2023. Our audit of the City's financial statements does not relieve management or those charged with governance of their responsibilities, which are also described in that letter.

Overview of the Planned Scope and Timing of the Financial Statement Audits

We conducted our audits consistent with the planned scope and timing in our engagement letter dated August 20, 2023.

Accounting Policies and Practices

Preferability of Accounting Policies and Practices
Under accounting principles generally accepted in the United States of America, in certain circumstances, management may select among alternative accounting practices. In our view, in such circumstances, management has selected the preferable accounting practice.

Adoption of, or Change in, Accounting Policies
Management has the ultimate responsibility for the appropriateness of the accounting policies used by the City. A summary of the significant policies adopted by the City is included in Note I to the financial statements. As described in Note I.E. to the financial statements, the following is a description of Governmental Accounting Standards board (GASB) Statements that the City implemented during the year:

- **GASB Statement No. 91 – Conduit Debt Obligations**
  This statement provides a single method of reporting conduit debt obligations by issuers and eliminates diversity in practice associated with (1) commitments extended by issuers, (2) arrangements associated with conduit debt obligations, and (3) related note disclosures. This statement achieves those objectives by clarifying the existing definition of a conduit debt obligation; establishing that a conduit debt obligation is not a liability of the issuer; establishing standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations; and improving required note disclosures. The statement did not have any effect on the City's financial statements.

- **GASB Statement No. 94 - Public-Private and Public-Public Partnerships and Availability Payment Arrangements**
  This statement is to improve financial reporting by addressing issues related to public-private and public-public partnership arrangements (PPPs). As used in this statement, a PPP is an arrangement in which a government (the transferor) contracts with an operator (a governmental or nongovernmental entity) to provide public services by conveying control of the right to operate or use a nonfinancial asset, such as infrastructure or other capital asset (the underlying PPP asset), for a period of time in an

exchange or exchange-like transaction. Some PPPs meet the definition of a service concession arrangement (SCA), which the Board defines in this statement as a PPP in which (1) the operator collects and is compensated by fees from third parties; (2) the transferor determines or has the ability to modify or approve which services the operator is required to provide, to whom the operator is required to provide the services, and the prices or rates that can be charged for the services; and (3) the transferor is entitled to significant residual interest in the service utility of the underlying PPP asset at the end of the arrangement. This statement also provides guidance for accounting and financial reporting for availability payment arrangements (APAs). As defined in this statement, an APA is an arrangement in which a government compensates an operator for services that may include designing, constructing, financing, maintaining, or operating an underlying nonfinancial asset for a period of time in an exchange or exchange-like transaction. This statement was implemented for FY 2023 reporting purposes. The required changes are reflected in the City's financial statements and notes to the statements. The City has identified qualified PPP. As a result, it recorded a PPP receivable of $102.6 million and deferred inflow of resources related to PPP of $97.3 million on governmental fund statements and the Statement of Net Position under governmental activities.

- **GASB Statement No. 96 – Subscription-Based Information Technology Arrangements**
  This statement provides guidance on the accounting and financial reporting for subscription-based information technology arrangements (SBITAs) for government end users (governments). This statement (1) defines a SBITA; (2) establishes that a SBITA results in a right-to-use subscription asset—an intangible asset—and a corresponding subscription liability; (3) provides the capitalization criteria for outlays other than subscription payments, including implementation costs of a SBITA; and (4) requires note disclosures regarding a SBITA. To the extent relevant, the standards for SBITAs are based on the standards established in Statement No. 87, *Leases*, as amended. A SBITA is defined as a contract that conveys control of the right to use another party's (a SBITA vendor's) information technology (IT) software, alone or in combination with tangible capital assets (the underlying IT assets), as specified in the contract for a period of time in an exchange or exchange-like transaction. The subscription term includes the period during which a government has a noncancelable right to use the underlying IT assets. The subscription term also includes periods covered by an option to extend (if it is reasonably certain that the government or SBITA vendor will exercise that option) or to terminate (if it is reasonably certain that the government or SBITA vendor will not exercise that option). Under this statement, a government generally should recognize a right-to-use subscription asset—an intangible asset—and a corresponding subscription liability. This statement was implemented for FY 2023 reporting purposes. The required changes are reflected in the City's financial statements and notes to the statements. The adoption of this new standard led to the restatement of net position by $42,000 in the San José Mineta International Airport fund, which falls under Business-type Activities Enterprise fund. For more detailed information on the current impact, please refer to Notes III.D and III.F.

- **GASB Statement No. 99 – Omnibus 2022**
  The objectives of this statement are to enhance comparability in accounting and financial reporting and to improve the consistency of authoritative literature by addressing: (1) Classification and reporting of derivative instruments within the scope of Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, that do not meet the definition of either an investment derivative instrument or a hedging derivative instrument; (2) Clarification of provisions in Statement No. 87, *Leases*, as amended, related to the determination of the lease term, classification of a lease as a short-term lease, recognition and measurement of a lease liability and a lease asset, and identification of lease incentives; (3) Clarification of provisions in Statement No. 94, *Public-Private and Public-Public Partnerships and Availability Payment Arrangements*, related to (a) the determination of the public-private and public-public partnership (PPP) term and (b) recognition and measurement of installment payments and the transfer of the underlying PPP asset; (4) Clarification of provisions in Statement No. 96, *Subscription-Based Information Technology Arrangements*, related to the subscription-based information technology

arrangement (SBITA) term, classification of a SBITA as a short-term SBITA, and recognition and measurement of a subscription liability; (5) Extension of the period during which the London Interbank Offered Rate (LIBOR) is considered an appropriate benchmark interest rate for the qualitative evaluation of the effectiveness of an interest rate swap that hedges the interest rate risk of taxable debt; (6) Accounting for the distribution of benefits as part of the Supplemental Nutrition Assistance Program (SNAP); (7) Disclosures related to nonmonetary transactions; (8) Pledges of future revenues when resources are not received by the pledging government; (9) Clarification of provisions in Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, as amended, related to the focus of the government-wide financial statements; (10) Terminology updates related to certain provisions of Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*; and (11) Terminology used in Statement 53 to refer to resource flows statements.

The requirements of this statement that are effective as follows: Items (5), (6), (7), (8), (9), (10), and (11) were implemented starting FY 2022; items (2), (3), and (4) related to leases, PPPs, and SBITAs were implemented for FY 2023 reporting purposes. The required changes are reflected in the City's financial statements and notes to the statements. Item (1), which is related to financial guarantees and the classification and reporting of derivative instruments within the scope of Statement No. 53 will take effect for financial statements starting with the fiscal year that ends June 30, 2024.

Significant Accounting Policies
We did not identify any significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.

Significant Unusual Transactions
We did not identify any significant unusual transactions.

Management's Judgments and Accounting Estimates
Accounting estimates are an integral part of the preparation of financial statements and are based upon management's current judgment. The process used by management encompasses their knowledge and experience about past and current events, and certain assumptions about future events. You may wish to monitor throughout the year the process used to determine and record these accounting estimates.

The following is summary information about the process used by management in formulating particularly sensitive accounting estimates and about our conclusions regarding the reasonableness of those estimates:

Significant Accounting Estimates	
Measurement of investments at fair value	The City's investments are accounted for in accordance with the provisions of GASB Statement No. 72, *Fair Value Measurement and Application*, and accordingly, its fair value measurements are categorized within the fair value hierarchy established by the standard. The following levels indicate the hierarchy of inputs used to measure fair value and the primary valuation methodologies used for financial instruments measured at fair value on a recurring basis: o Level 1 – Investments whose values are based on quoted prices (unadjusted) for identical assets in active markets that a government can access at the measurement date.

Significant Accounting Estimates	
	o Level 2 – Investments whose values are based on inputs – other than quoted prices including prices included within level 1 – that are observable for an asset, either directly or indirectly. o Level 3 – Investments whose values are based on unobservable inputs for an asset and may require a degree of professional judgment. MGO compared investment values from quoted market information and using pricing applications and models obtained from custodian bank, fiscal agents or other sources and determined that they were reasonable.
Estimated allowance for losses on accounts receivable	Estimated allowance for losses on accounts receivable was based on historical experience. MGO evaluated the methodologies and assumptions used in make the estimated allowance for losses and tested subsequent cash receipts of significant accounts receivable.
Estimated allowance for losses on loans receivable	Estimated allowance for loans receivable is comprised of an allowance for risk and an allowance for present value discount. The allowance for risk was based on the consideration of the changes in the portfolio character, evaluation of current economic conditions and such other factors that, in management's judgment, deserve recognition in estimating potential loan losses. The allowance for risk takes into consideration maturity dates, interest rates, and other relevant factors. The allowance for present value discount gives recognition to the economic cost of providing loans at interest rates below market and represents management's estimate of the present value of projected net cash flows to the City from the loan portfolio. MGO evaluated the methodologies and assumptions used in making the accounting estimate and determined whether they are consistent with the City's Loan Loss Reserve Policies and Procedures and performed analytical procedures to determine the estimated allowance for losses was reasonable.
Depreciation and amortization of capital assets, including depreciation/amortization methods and useful lives assigned to depreciable/amortizable property	Useful lives, or in the case of intangible right-to-use lease and SBITA assets, the shorter of useful lives or the lease/subscription term, for depreciable/amortizable capital assets were determined by management based on the nature of the capital asset. Depreciation/amortization was calculated based on the straight-line method. MGO assessed the reasonableness of the useful lives based on the nature of the capital assets and performed substantive analytical procedures on depreciation/amortization expense and determined the estimates were reasonable.

Significant Accounting Estimates	
Accrual of compensated absences	Accrual of compensated absences was based on accrued eligible hours of vacation, sick leave and other compensatory time at current pay rates for eligible employees. MGO agreed the unused hours and pay rates at year-end to payroll reports and recalculated the reported balances to determine they were reasonable.
Accrual and disclosure of self-insurance claims liabilities	Estimated liabilities for workers' compensation claims were based on management's estimate obtained from information derived from Intercare's (a third-party administrator) claims database system adjusted for a discounted projection of the ultimate cost of known claims and unreported claims at 1.5%. Estimated liabilities for general liability and other claims were determined by the City Attorney's judgment about the ultimate outcome of the claims. MGO evaluated the methodologies and assumptions used to develop the workers' compensation claims estimate through data testing. For general liability and other claims, MGO obtained legal confirmation and obtained evidence relevant to the period in which the underlying cause for legal action occurred, the degree of probability of an unfavorable outcome and the amount or range of potential loss.
Accrual and disclosure of pollution remediation obligations	Accrual and disclosures of pollution remediation obligations were determined by the City's engineers and its environmental consultants' judgments about the ultimate outcome of the obligations. MGO evaluated the methodologies and assumptions used to develop the obligations, reviewed the assumptions used for reasonableness, and determined whether the estimate is supported and reasonable.
Measurement of the pension contributions, net pension liability, pension expense, and pension-related deferred outflows and inflows of resources	Pension plans' employer and employee contributions requirements, net pension liability, and related deferred outflows and inflows of resources were based on actuarial valuations prepared by the City's Retirement Systems and CalPERS. MGO agreed the calculations to actuarial valuations prepared by the Retirement Systems and CalPERS and tested the reasonableness of allocations to various City funds.
Measurement of the other postemployment benefits (OPEB) contributions, net OPEB liability, OPEB expense and OPEB-related deferred outflows and inflows of resources	OPEB plans' employer and employee contributions requirements, net OPEB liability, and related deferred outflows and inflows of resources were based on actuarial valuations prepared by the City's Retirement Systems. MGO agreed the calculations to actuarial valuations prepared by the City's Retirement Systems and tested for reasonableness the allocations to various City funds.
Measurement of the lease and PPP receivables, and	The discount rate used for the calculation of the lease and PPP receivables, and the lease and subscription liabilities are based on the

Significant Accounting Estimates	
the lease and subscription liabilities	City's estimated incremental borrowing rate using the national average fixed-rate loan index on the either the implementation date or on the date of commencement thereafter.

Audit Adjustments and Uncorrected Misstatements

There were no corrected misstatements that were material to the financial statements.

Uncorrected misstatements are summarized in the accompanying list of Uncorrected Misstatements in Exhibit B. Uncorrected misstatements or matters underlying these uncorrected misstatements could potentially cause future-period financial statements to be materially misstated, even if we have concluded that the uncorrected misstatements are immaterial to the financial statements under audit.

Departure From the Auditor's Standard Report

Expected Emphasis of Matter Paragraph
As noted above, the City adopted the provisions of GASB Statements No. 94 and No. 96, effective July 1, 2022. In light of this matter, we included an emphasis of matter paragraph in the auditor's report. Below is the paragraph included in the auditor's report for the City's basic financial statements.

> **Emphasis of Matter**
> As discussed in Note 1.E. to the financial statements, effective as of July 1, 2022, the City adopted the provisions of Governmental Accounting Standards Board Statements No. 94, *Public-Private and Public-Public Partnerships and Availability Payment Arrangements* and No. 96, *Subscription-Based Information Technology Arrangements*. Our opinions are not modified with respect to this matter.

Other Information Included in Annual Comprehensive Financial Report

Our responsibility for other information included in the annual comprehensive financial report is to read the information and consider whether its content or the manner of its presentation is materially inconsistent with the basic financial information covered by our auditor's report, whether it contains a material misstatement of fact or whether the other information is otherwise misleading. We read the City's introductory and statistical sections. We did not identify material inconsistencies with the audited basic financial statements.

Observations About the Audit Process

Disagreements With Management
We encountered no disagreements with management over the application of significant accounting principles, the basis for management's judgments on any significant matters, the scope of the audit or significant disclosures to be included in the City's financial statements.

Consultations With Other Accountants
We are not aware of any consultations management had with other accountants about accounting or auditing matters.

Significant Issues Discussed With Management
No significant issues arising from the audit were discussed or were the subject of correspondence with management.

Significant Difficulties Encountered in Performing the Audit
We did not encounter any significant difficulties in dealing with management during the audit.

Shared Responsibilities for Independence

Independence is a joint responsibility and is managed most effectively when management, audit committees (or their equivalents), and audit firms work together in considering compliance with American Institute of Certified Public Accountants (AICPA) and *Government Accountability Office* (GAO) independence rules. For MGO to fulfill its professional responsibility to maintain and monitor independence, management, the Mayor and City Council, and MGO each play an important role.

Our Responsibilities

1. AICPA and GAO rules require independence both of mind and in appearance when providing audit and other attestation services. MGO is to ensure that the AICPA and GAO's General Requirements for performing non-attest services are adhered to and included in all letters of engagement.
2. Maintain a system of quality management over compliance with independence rules and firm policies.

The City's Responsibilities

1. Timely inform MGO, before the effective date of transactions or other business changes, of the following:
    a. New affiliates, directors, or officers.
    b. Changes in the organizational structure or the reporting entity impacting affiliates such as subsidiaries, partnerships, related entities, investments, joint ventures, component units, and jointly governed organizations.
2. Provide necessary affiliate information such as new or updated structure charts, as well as financial information required to perform materiality calculations needed for making affiliate determinations.
3. Understand and conclude on the permissibility, prior to the City and its affiliates, officers, directors, or persons in a decision-making capacity, engaging in business relationships with MGO.
4. Not entering into arrangements of nonaudit services resulting in MGO being involved in making management decisions on behalf of the City.
5. Not entering into relationships resulting in close family members of MGO covered persons, temporarily or permanently acting as an officer, director, or person in an accounting, financial reporting or compliance oversight role at the City.

EXHIBIT A

Recent Accounting Pronouncements

RECENT ACCOUNTING PRONOUNCEMENTS

The following accounting pronouncements have been issued as of the date of this communication but are not yet effective and may affect the future financial reporting by the City.

Pronouncement	Summary
GASB Statement No. 99, *Omnibus 2022*	The objectives of this statement are to enhance comparability in accounting and financial reporting and to improve the consistency of authoritative literature by addressing (1) practice issues that have been identified during implementation and application of certain GASB Statements and (2) accounting and financial reporting for financial guarantees. The requirements related to financial guarantees and the classification and reporting of derivative instruments within the scope of Statement 53 are effective for the City's fiscal year ending June 30, 2024.
GASB Statement No. 100, *Accounting Changes and Error Corrections—an amendment of GASB Statement No. 62*	The primary objective of this statement is to enhance accounting and financial reporting requirements for accounting changes and error corrections to provide more understandable, reliable, relevant, consistent, and comparable information for making decisions or assessing accountability. Statement No. 100 is effective for the City's fiscal year ending June 30, 2024.
GASB Statement No. 101, *Compensated Absences*	The objective of this statement is to better meet the information needs of financial statement users by updating the recognition and measurement guidance for compensated absences. That objective is achieved by aligning the recognition and measurement guidance under a unified model and by amending certain previously required disclosures. Statement No. 101 is effective for the City's fiscal year ending June 30, 2025.

EXHIBIT B

Schedule of Uncorrected Misstatements

SUMMARY OF UNCORRECTED FINANCIAL STATEMENT MISSTATEMENTS

		Account / Adjustment Description	Debit (Dollars in thousands)	Credit (Dollars in thousands)
1	Business-Type Activities	Expenses	$ 270	
	Business-Type Activities	Accounts Payable		$ 270
	Parking System	Expenses	$ 270	
	Parking System	Accounts Payable		$ 270
	To adjust the accounts payable balance for services performed in the fiscal			
2	Aggregate Remaining Funds	Revenue	$ 20,410	
	Aggregate Remaining Funds	Unavailable Revenue		$ 20,410
	To adjust the accrued revenue for receipts after the period of availability.			
3	Governmental Activities	Accounts Receivable	$ 7,884	
	Governmental Activities	Accounts Payable		$ 7,884
	General Fund	Accounts Receivable	$ 7,884	
	General Fund	Accounts Payable		$ 7,884
	To recognize a payable and to restore sales tax receivable relating to a revenue capture agreement.			