

**CITY OF SAN JOSE**

Public Safety, Finance &  
Strategic Support Committee

Report to Management

For the Year Ended  
June 30, 2013



**Certified Public Accountants.**

**CITY OF SAN JOSE**

Public Safety, Finance & Strategic Support Committee  
For the Year Ended June 30, 2013

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To Members of the Public Safety, Finance &  
Strategic Support Committee and  
San José City Council  
San José, California

In planning and performing our audit of the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of San Jose (City) as of and for the year ended June 30, 2013, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, we considered the City's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

In addition to the City's basic financial statements, we audited and separately reported on the financial statements of the Successor Agency to the Redevelopment Agency of the City of San José (Successor Agency); the Norman Y. Mineta San José International Airport, the Police and Fire Department Retirement Plan, the Federated City Employees' Retirement System, the San José-Santa Clara Clean Water Financing Authority, the Pedestrian/Bicycle Facilities Grant, the Parks and Recreation Bond Projects Fund, the Branch Libraries Bond Projects Fund, the Neighborhood Security Bond Projects Fund, the Library Parcel Tax Special Revenue Fund, the City of San José Deferred Compensation Plan, and the Diridon Development Authority as of and for the year ended June 30, 2013.

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

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. We did not identify any deficiencies in internal control that we consider to be material weaknesses.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We considered items 2013-001 and 2013-002 in the accompanying Schedule of Comments and Responses to be significant deficiencies.

The City's written responses to the recommendations identified are described in the Schedule of Comments and Responses section. We did not audit the City's responses and, accordingly, we express no opinion on them. In addition, we would be pleased to discuss the recommendations in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing these recommendations.

Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards, *Government Auditing Standards* and OMB Circular A-133, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated June 28, 2013. Professional standards also require that we communicate to you the information related to our audits discussed on pages 1 through 6.

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

This communication is intended solely for the information and use of the Public Safety, Finance & Strategic Support Committee, 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 & Counsel LLP

Walnut Creek, California  
November 12, 2013

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**REQUIRED COMMUNICATIONS**

**I. Significant Audit Findings**

*Qualitative Aspects of Accounting Practices*

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City are described in Note 1 to the City's basic financial statements. As described in Note 1 to the financial statements, the City changed accounting policies related to the following:

- **GASB Statement No. 60 – Accounting and Financial Reporting for Service Concession Arrangements (SCA)**  
This statement requires disclosures about an SCA including a general description of the arrangement and information about the associated assets, liabilities, and deferred inflows, the rights granted and retained, and guarantees and commitments. This statement did not have any effect on the City's financial statements.
- **GASB Statement No. 61 – Financial Reporting Entity: Omnibus – an amendment of GASB Statements No. 14 and No. 34**  
The requirements of this statement result in financial reporting entity financial statements being more relevant by improving guidance for including, presenting and disclosing information about component units and equity interest transactions of a financial reporting entity. This statement did not have any effect on the City's financial statements.
- **GASB Statement No. 62 – Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements**  
This statement incorporates into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins of the AICPA Committee on Accounting Procedures, which do not conflict with or contradict other GASB pronouncements. This statement did not have a significant effect on the City's financial statements.
- **GASB Statement No. 63 – Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position**  
This statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. This statement also amends the net asset reporting requirements in Statement No. 34 – *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets.
- **GASB Statement No. 65 – Items Previously Reported as Assets and Liabilities**  
This statement establishes accounting and financial reporting standards that reclassify certain items (that were previously reported as assets and liabilities) as deferred outflows of resources or deferred inflows of resources, and recognizes certain items (that were previously reported as assets and liabilities) as outflows of resources or inflows of resources. As of July 1, 2012, the City implemented this statement and restated the beginning net position by \$6.1 million for governmental activities, \$1.3 million for business-type activities and

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enterprise funds, and \$(2.1) million for the Successor Agency private-purpose trust fund to write off the unamortized bond issuance costs that were previously reported as assets or as part of the unamortized loss and gain on refunding debt. Furthermore, the unamortized loss on refunding of debt was reclassified from a contra-liability to deferred outflows of resources and the unamortized gain on refunding debt was reclassified from a liability to deferred inflows of resources in the government-wide, proprietary funds, and the Successor Agency private-purpose trust fund statements of net position.

We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected.

The most sensitive estimates affecting the financial statements were:

- Fair value of investments
- Estimated allowance for losses on accounts receivable
- Estimated valuation allowance for loans receivable
- Estimated valuation of property held for resale
- Accrual and disclosure of self-insurance claims liabilities
- Depreciation estimates for capital assets, including depreciation methods and useful lives assigned to depreciable property
- Accrual and disclosure of compensated absences
- Pension and other postemployment benefit plans' employer and employee contribution requirements and funded status of the plans
- Accrual and disclosure of pollution remediation obligations

Management's estimates were based on the following:

- Fair values of investments traded on a national or international exchange were based on quoted sales prices reported on the last business day of the fiscal year at current exchange rates, if applicable. Investments that do not have an established market, such as private equity, commingled real estate funds and certain pooled fund investments are reported at estimated fair value based on the most recently available investor reports or audited financial statements issued by the manager of those funds. The fund manager provides an estimated unrealized gain/loss of the fund based on the most recently available audited financial statements and other fund information. The fair value of the separate real estate properties are based on independent appraisals.
- Estimated allowance for losses on accounts receivable was based on historical experience.
- Estimated valuation 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 management's estimate regarding the likelihood of collectability based on

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loan provisions and collateral. The allowance for present value discount was based on management's estimate of the present value of projected net cash flows to the City from the loan portfolio.

- Estimated valuation of property held for resale was based on the most recently available consultant analysis of estimated values performed at the request of a creditor and sales prices previously received from recent solicitations that resulted in purchase and sale agreements.
- Estimated liabilities for workers' compensation claims were based on management's estimate obtained from information derived from the City's claims database system adjusted for a discounted projection of unreported claims at 3.1%. Estimated liabilities for general liability and other claims were determined by the City Attorney's judgment about the ultimate outcome of the claim.
- Useful lives for depreciable property were determined by management based on the nature of the capital asset. Depreciation was calculated based on the straight-line method.
- Accrual and disclosures of compensated absences were based on accrued eligible hours of vacation, sick leave and other compensatory time at current pay rates for eligible employees.
- Pension and other postemployment benefit plans' employer and employee contributions requirements and funded status were based on actuarial valuations.
- Accrual and disclosures of pollution remediation obligations were determined by the City's Environmental Compliance Officers and its environmental consultants' judgments about the ultimate outcome of the obligations.

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

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the financial statements were as follows:

- The City's Employee Defined Benefit Retirement Plans described in Note IV. A.
- Commitments and contingencies related to the Successor Agency described in Note IV.C.5.

The financial statement disclosures are neutral, consistent and clear.

***Difficulties Encountered in Performing the Audit***

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

***Corrected and Uncorrected Misstatements***

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. The attached schedule summarizes uncorrected misstatements of the financial statements. Management has determined that their effects are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. In addition, none of the

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misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to each opinion unit's financial statements taken as a whole.

***Disagreements with Management***

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

***Management Representations***

We have requested certain representations from management that are included in the management representation letter with dates ranging from October 4, 2013 through November 21, 2013.

***Management Consultation with Other Independent Accountants***

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the City's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

***Other Audit Findings or Issues***

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the City's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

**II. Other Information in Documents Containing Audited Financial Statements**

During the year, the City included audited financial statements in various debt offering documents (e.g., Official Statements). We do not have an obligation to perform any procedures to corroborate other information contained in such debt offering documents. We were not associated with and did not have any involvement with such documents. Accordingly, we did not perform any procedures on these documents and provide no assurance as to the other information contained in the debt offering documents.

With respect to the supplementary information accompanying the financial statements, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.



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**SCHEDULE OF COMMENTS AND RESPONSES**

**Item 2013-001 – Significant Deficiency**  
**Risk Assessment of Internal Controls Over the Financial Reporting Process**

As discussed in the prior year, internal control is an integral process that is affected by the City's governing body, management and personnel and is designed to address risks and to provide reasonable assurance that in pursuit of the organization's goals, the following general objectives are being achieved:

- Executing orderly, ethical, economical, efficient and effective operations;
- Fulfilling accountability obligations;
- Complying with applicable laws and regulations; and
- Safeguarding resources against loss, misuse and damage.

Internal control is a dynamic integral process that should be continuously adapting to the changes the City is facing. Prior to 2013, the City has cut 28 percent of budgeted positions over the past decade. As noted in last year's Report to Management, the widespread reduction and displacement of staff through the Civil Service Rules resulted in a significant disruption in the City's ability to maintain appropriate financial internal controls. As the City incorporates new personnel into its organization, the City should ensure that while new personnel acquire on-the-job training and experience, adequate supervision and review processes are in place to mitigate errors such as the following that were noted:

- Under-reporting of accounts payable liabilities at year-end totaling \$1.2 million.
- Lack of review and approval of the Notice of Separation Form for 2 out of 40 employees' terminated or separated.
- Insufficient review and approval of 2 out of 40 workers compensation reserve computation worksheets tested for reserve amounts in excess of \$75 thousand.
- Insufficient review of complex government-wide reconciling journal entries resulting in post-closing adjusting and reclassification entries.

The City is sensitive to these observations and continues to work its way out of its personnel vacancies challenges and providing on-the-job training to its new personnel. Over the past year, the City developed a work plan and started to stabilize the Finance Department to address control deficiencies identified in prior years. The City's appointment of the Director of Finance position in December 2012 and the hiring of three senior accountants and two accountants to fill open positions that were vacant during the economic downturn helped steady the department.

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*Recommendation*

As a result of the recent organizational changes, the City should continue to review the experience of professionals throughout the City assigned to key roles in the preparation of the annual financial statements to ensure that the most experienced professionals are responsible for the higher risk areas of the financial statements and that there is a robust supervision and review process over those professionals with developing experience. A professional development plan should be created for those individuals who are new to the process, which includes a training plan. In addition, the City should assess the magnitude of any deficiencies in the internal control over financial reporting as it continues to identify and quantify the risks of any significant internal control weaknesses that have not yet been addressed. The City should also develop a robust succession plan to prepare for planned and unplanned absences of key finance professionals throughout the City.

*Management Response*

Management acknowledges the impact on the organization of the deficiencies in formalized roles and responsibilities in City departments and the impact it may have on the quality and consistency of financial reporting. The decentralization of finance functions to other City departments has made each department responsible for establishing and maintaining specific and defined roles and responsibilities to assure a seamless transition during staffing changes. Due to the reduction and turnover in City staffing, consistencies in establishment and maintenance of roles and responsibilities within departments and with the Finance Department has diminished.

During FY 2012-13, the Finance Department worked with City departments to identify the changes in all finance related positions and assess current staffing levels on a Citywide basis. In addition, the Finance Department obtained documentation from City departments to assist in evaluating documentation of financial operations to ensure consistency and continuity throughout the organization. A Request for Proposals (“RFP”) is currently being developed for the purpose of retaining a consultant to conduct a comprehensive study of the City’s organizational structure for finance functions and ultimately recommend and aid in the facilitation of actions that will improve the effectiveness and efficiency of the City’s internal controls. The work product from the consultant will also include recommendations that will assist City management in addressing the City’s need to maintain quality internal controls and sound accounting practices. The expected release date of the RFP is late February 2014.

The City’s appointment of the Director of Finance position in December 2012 and the hiring of three senior accountants and two accountants to fill vacant positions did assist in stabilizing the Finance Department especially with regard to the completion of the fiscal year 2013 CAFR and the fiscal year 2014 cost allocation plans. However, the Finance Department remains challenged with retaining knowledgeable and experienced staff, which is illustrated by five vacant senior accountant positions; recruitment for these positions is in process. As the City begins planning for the preparation of the fiscal year 2014 CAFR, the Finance Department is making a concerted effort to assemble the strongest team possible, which will involve more closely aligning staff skills with job duties and responsibilities. Additionally, the City has contracted with a firm to provide a financial reporting solution package that will streamline the CAFR process and provide more time for analytical reviews of data. The City is working to have this solution implemented to assist in the preparation of the fiscal year 2014 CAFR.

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**SCHEDULE OF COMMENTS AND RESPONSES (Continued)**

**Item 2013-002 – Cost Allocation Plans**

It is the City's policy to identify and allocate appropriate General Fund and certain other central service program costs that indirectly benefit the Airport Department. The Finance Department develops an Airport Cost Allocation Plan (ACAP) using actual allowable costs from the prior two fiscal years. In addition, allocations of these allowable costs are based on various nonfinancial factors such as number of purchase orders processed and number of full-time equivalents (FTE) budgeted.

During our audit, we noted that the fiscal year 2013 ACAP used a factor of 205 FTEs. However, the Airport has approximately 187 FTEs at June 30, 2013. Unlike expenditures, the City does not adjust nonfinancial factors such as FTEs to actual results. As such, the Airport may be burdened with a disproportionate share of overhead costs when they experience dramatic changes in FTEs and other nonfinancial measurements. In addition, we noted in the ACAP that the former Redevelopment Agency (Agency) had costs allocated to the Agency as a service department and user department. The Agency was dissolved as of February 1, 2012. The costs that were being allocated to the Agency as user department went unallocated since the Agency is no longer active in 2013. As a result, these unallocated central service costs are not recovered.

*Recommendation*

The City should update its procedures in order to develop a more equitable cost allocation methodology that measures and allocates the relative benefit of administrative efforts received by City departments during a given fiscal year. As part of updating its procedures, the City should also review, communicate with central service departments, and revise its lists of allocated and unallocated costs. This will ensure that allocation bases reflect actual workload and take into account organizational changes.

*Management Response*

The City utilizes budgeted FTEs for indirect cost allocation purposes as it considers the budgeted FTE data as more reflective of recent activity levels of departments rather than using actual FTE data from two years prior. Using the actual FTEs reported at year-end may not necessarily depict a true level of use of services as the actual FTE counts do not remain the same throughout a fiscal year due to changes in staffing levels. The City consistently applies the budgeted FTE allocation methodology to all City departments. Therefore, the City believes that the allocation bases currently in place do not result in a disproportionate share of overhead costs to either the Airport or any other City department. However, the City will continue to monitor and evaluate the cost allocation bases to ensure fair share distribution of indirect costs to all City departments.

Additionally, the City has revised its current cost allocation plan procedures to include meetings with key central service departments including, but not limited to, Finance, Public Works, City Manager's Budget Office, and Information Technology to review and analyze the allocable costs and the cost allocation bases prior to completion of the fiscal year 2015 CAP. The City is in the process of reviewing and updating its current cost allocation plan procedures to address organizational changes, specifically ensuring the exclusion of allocated costs to the former Redevelopment Agency as a user department in the cost allocation plan. The revised procedures will be reflected in the fiscal year 2015 cost allocation plan.

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**STATUS OF PRIOR YEAR'S SIGNIFICANT AND CONTROL DEFICIENCY COMMENTS**

2012 Comment:	<b><i>2012-1 – Internal Control Over Financial Reporting – Preparation of Financial Statements</i></b>
Condition/Effect:	The dissolution of the Redevelopment Agency (Agency) of the City severely impacted the organization's internal controls over financial reporting of the Agency and the Successor Agency to the Redevelopment Agency of the City (Successor Agency). During our audit, we noted that the staffing complement is not configured to adequately support the Successory Agency's financial reporting responsibilities and other increasing audit requests related to the Successor Agency's activities.
Recommendation:	We recommend the Successor Agency obtain additional assistance from the City to reduce the likelihood that errors may occur and not be detected or corrected on a timely basis and therefore improve internal controls over financial reporting.
Status:	In progress. The Successor Agency and the City began the interface and transfer of the financial operations, including financial reporting, to the City's Finance Department. A complete transition is expected by the end of fiscal year 2014-2015.
2012 Comment:	<b><i>2012-2 – Risk Assessment of Internal Controls</i></b>
Condition/Effect:	Internal controls should be continuously monitored in order to adapt to the City's recent organizational changes, changes in its operating environment and reduced resources available for internal controls. The City has been going through a profound change especially in the number of personnel and the experience level of its finance and accounting personnel since the end of fiscal year 2009.
Recommendation:	The City should identify and quantify the risks of any significant internal control weaknesses that have not been addressed because of insufficient resources or staff capabilities. The City should also develop a work plan to mitigate these risks in internal controls.
Status:	In progress. See current year comment 2013-001.

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2012 Comment: ***2012-3 Housing Department Budgetary Controls***

Condition/Effect: Under the Redevelopment Dissolution Law, the Redevelopment Agency of the City of San José (Agency) and the Successor Agency to the Redevelopment Agency of the City of San José (Successor Agency) were no longer required to set-aside 20% of property tax revenues to the City's Housing Department for low and moderate income housing activities. In fiscal year 2010-2011, the last full fiscal year of this source of funds, the Housing Activities Fund received \$34.8 million from this revenue source. Commencing February 1, 2012, the Housing Activities Fund's primary sources of revenues will be limited to grant funds from the U.S. Department of Housing and Urban Development and repayments on loans from its loan portfolio. In fiscal year 2011-2012, the Housing Activities Fund final budgeted revenues and other financing sources reported a total \$78.4 million and final budgeted expenditures and other financing uses reported a total \$145.3 million or a deficiency of \$66.9 million. On a budgetary basis, the Housing Activities Fund reported a deficiency of funding sources under its funding uses of \$44.4 million and a deficit fund balance of \$15.2 million.

During our audit, we made inquiries regarding the nature of these budgetary deficits and noted that the primary cause was due to the decrease in the 20% set-aside of property tax revenues. Additionally, upon inquiry, it was noted that there is not a plan in place to remedy the fund deficit on a budgetary basis as all available funding sources are budgeted for current projects. As such, the City may not be properly analyzing the Fund's available funding sources and budgetary accounts.

Recommendation: The City should improve monitoring of its Housing budget as compared to actual amounts so that a fund does not close the year in a deficit position.

Status: Substantially implemented. Per review of the budgetary statement for the year ended June 30, 2013, the final budget has a net positive change of \$13.1 million. The beginning fund deficit was (\$15.2) million, therefore, the final budget ending fund deficit was (\$1.9) million, resulting in a reduced deficit in the Housing Activities Fund. The City continues to monitor the Housing budget to ensure the fund does not close the year in a deficit position.

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2012 Comment: ***2012-4 – Accounting for Housing Loans Reserves***

Condition/Effect: Each year for preparation of the City’s basic financial statements, the City’s Housing Department conducts an analysis of its loan portfolio. The analysis includes a calculation of loan loss reserves to fairly state the value of reserves as of the balance sheet date of June 30 for the City’s Major Housing, Community Development Block Grant (CDBG), and HOME loans. From the analysis, an adjustment is recorded to the general ledger to fairly state the value of loan loss reserves for the City’s basic financial statements.

During the year, the City implemented a new customer relationship management (CRM) system to track outstanding loans and to compute the present value of the loan loss reserves. This computation is extracted to an excel spreadsheet for further analysis. We noted that the CRM system had a formula error in the calculation of the reserve, which resulted in the understatement of the allowance on the City’s loans receivable by \$19.3 million at June 30, 2012. The City subsequently corrected this error in its financial statements.

Recommendation: We recommend that the Housing Department develop procedures to review its CRM database and system computations in order to ensure that accurate financial information is available to management for analysis of its loan portfolio.

Status: Implemented.

2012 Comment: ***2012-5 – Successor Agency’s Investment Policy Compliance***

Condition/Effect: The Successor Agency follows the investment policy of the City, which is governed by provisions of the California Government Code and the City’s Municipal Code. The Successor Agency also has investments subject to provisions of the bond indentures of the former Agency’s various bond issues. City of San Jose Investment Policy Section 9.10 Money Market Mutual Fund states that, *No more than 20% of the portfolio shall be invested in money market mutual funds.* The City’s policy does have exceptions for investments of bond proceeds and bond reserve accounts. However, it currently does not have an exception for investments held for a short duration to pay upcoming debt service payments.

During our audit, we noted that the former Agency and the Successor Agency were not in compliance with the City’s Investment Policy by investing more than 20% of their portfolios in money market mutual funds. As of January 31, 2012, the former Agency invested \$80.6 million in money market mutual funds out of its total investment portfolio of \$130.7 million (61% of the portfolio). As of June 30, 2012, the Successor Agency invested \$95.7 million of the total investment portfolio of \$161.0 million in money market mutual funds (59% of the portfolio).

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Recommendation: We recommend the Successor Agency work with the City in updating its investment policy to consider its short-term investment needs.

Status: Implemented.

2012 Comment: ***2012-6 – New Pension Accounting Standards***

Condition/Effect: The City will be required to implement GASB Statement No. 67 and 68 in fiscal years 2014 and 2015.

Recommendation: It is likely that these new accounting and reporting standards will dramatically change the City’s financial statements and disclosures and will result in the recognition of net pension liability. We recommend consulting with the San José Police and Fire Department Retirement Plan (PFDRP) and the City of San José Federated City Employees Retirement System’s (FCERS) actuaries to develop a better understanding of and to quantify the impact of these new accounting and reporting on the City’s current financial statements.

Status: In progress. The City will be implementing the above GASBs in fiscal years 2014 and 2015.

2011 Comment: 2011-1 - Risk Assessment of Internal Controls

Condition/Effect: Internal controls should be continuously monitored in order to adapt to the City’s recent organizational changes, changes in its operating environment and reduced resources available for internal controls. The City has been going through a profound change especially in the number of personnel and the experience level of its finance and accounting personnel since the end of fiscal year 2009.

In general, we observed that staff is facing additional pressures to maintain service levels with fewer resources and the City has not adequately assessed the necessary changes in processes to mitigate risk associated with reduced resources in the City’s financial reporting and accounting processes.

Recommendation: The City should update its documentation, test its internal controls, assess the magnitude of any deficiencies identified and develop a work plan to re-structure the organization to ensure that its internal controls are adequate for its changed environment and reduced workforce.

Status: In progress. See current year comment 2013-001.

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2011 Comment:	<b><i>2011-2 - Airport Cost Allocation Plan</i></b>
Condition/Effect:	During our audit, we noted that the fiscal year 2011 Airport Cost Allocation Plan (ACAP) used a factor of 400 full-time equivalents (FTEs). However, the Airport has approximately 206 FTEs at June 30, 2011. Unlike expenditures, the City does not adjust nonfinancial factors such as FTEs to actual results. As such, the Airport may be burdened with a disproportionate share of overhead costs when they experience dramatic changes in FTEs and other nonfinancial measurements.
Recommendation:	We recommend the City develop a more equitable cost allocation methodology that measures and allocates the relative benefit of administrative efforts received by the Airport during a given fiscal year.
Status:	In progress. The City maintained the same methodology in allocating central service program costs. The ACAP used 205 FTEs compared to the approximate actual of 187 FTEs as of June 30, 2013, and thus the Airport may still be burdened with a disproportionate share of overhead costs. See current year comment 2013-002.



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**SUMMARY OF UNCORRECTED FINANCIAL STATEMENT MISSTATEMENTS**

Adjustment Number	Account / Adjustment Description	Debit (Dollars in thousands)	Credit
<b>General Fund/Governmental Activities</b>			
1	Sales Taxes Receivable - General Fund	\$ 302	
	Sales Taxes Revenue - General Fund		3,486
	Deferred Inflow of Resources - General Fund		\$ 3,788
	<i>To adjust sales taxes receivable based on actual receipts after year-end and deferred sales taxes revenue not collected within the period of availability.</i>		
2	Expenditure - General Government	\$ 10,788	
	Unrestricted cash and investments		\$ 10,788
	<i>To adjust the ending book balance of the City's operating account to the actual balance at June 30, 2013.</i>		
<b>Muni-Water Major Enterprise Fund/Business-Type Activities</b>			
3	Accounts Receivable - Muni Water	\$ 1,651	
	Charges for Services - Muni Water		\$ 1,651
	<i>To recognize revenue for current year unbilled services.</i>		
	Charges for Services - Muni Water	\$ 1,455	
	Unrestricted Net Position - Muni Water		\$ 1,455
	<i>To reverse impact of prior year passed proposed adjustment.</i>		
<b>Governmental Activities</b>			
4	Governmental Activities - Various Expense Accounts	\$ 9,021	
	General Liabilities - Worker's Compensation		\$ 9,021
	<i>To adjust the worker's compensation liability based on actuarial valuation at June 30, 2013.</i>		
5	Expenses - General Government	\$ 3,640	
	Claims Liabilities		\$ 3,640
	<i>To increase the claims liability balance at June 30, 2013.</i>		
<b>Private Purpose Trust Funds (SARA)</b>			
6	Prepaid bond insurance	\$ 7,881	
	Net position		\$ 7,881
	<i>To adjust prepaid bond insurance beginning balance written off during the GASB 65 early implementation.</i>		

**CITY OF SAN JOSE**  
Public Safety, Finance & Strategic Support Committee  
For the Year Ended June 30, 2013

Adjustment Number	Account / Adjustment Description	Debit (Dollars in thousands)	Credit
<b>Neighborhood Security Bond Projects Fund</b>			
7	Expenditures	\$ 33	
	Accounts payable		\$ 33
	<i>To adjust accounts payable for cost incurred, but not accrued as of June 30, 2013.</i>		
8	Expenditures	\$ 4	
	Accounts payable		\$ 4
	<i>To adjust accounts payable for cost incurred, but not accrued as of June 30, 2013.</i>		
9	Expenditures	\$ 5	
	Accounts payable		\$ 5
	<i>To adjust accounts payable for cost incurred, but not accrued as of June 30, 2013.</i>		
10	Expenditures	\$ 7	
	Accounts payable		\$ 7
	<i>To adjust accounts payable for cost incurred, but not accrued as of June 30, 2013.</i>		