



**REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS
ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON
COMPLIANCE AND OTHER MATTERS REQUIRED BY *GOVERNMENT
AUDITING STANDARDS***

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Board of Directors
Successor Agency to the
Redevelopment Agency of the City of San José
City of San José, California

We have audited, 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, the financial statements of the Successor Agency to the Redevelopment Agency of the City of San José (the “SARA”), a component of the City of San José, as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the SARA’s basic financial statements, and have issued our report thereon dated November 13, 2017.

Internal control over financial reporting

In planning and performing our audit of the financial statements, we considered the SARA’s internal control over financial reporting (“internal control”) to design audit procedures that are appropriate in the circumstances for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of internal control. Accordingly, we do not express an opinion on the effectiveness of the SARA’s internal control.

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 SARA’s financial statements will not be prevented, or detected and corrected, on a timely basis. 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.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section 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 have not been identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify certain deficiencies in internal control, described in the accompanying summary of findings as item 2017-01 that we consider to be a significant deficiency in the SARA's internal control.

Compliance and other matters

As part of obtaining reasonable assurance about whether the SARA's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Intended purpose

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the SARA's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the SARA's internal control and compliance. Accordingly, this report is not suitable for any other purpose.

Grant Thornton LLP

San José, California
November 13, 2017

CITY OF SAN JOSE
Summary of Findings
June 30, 2017

Finding 2017-01

Interest expense not recorded in the correct period (Significant Deficiency)

Criteria

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America (“US GAAP”). This includes the design, implementation, and maintenance of internal control relevant to the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Condition

We noted that the SARA recorded interest expense of \$3.4 million in FY 2017, which related to FY 16. This interest expense was related to the reinstatement of SERAF loans by the Oversight Board on May 26, 2016.

Context

Pursuant to SB 107, section 21, if the Oversight Board finds that a loan is an enforceable obligation, any interest remaining on the principal amount of the loan that was previously unpaid shall be recalculated from the origination of the loan at a simple interest rate of 3 percent. The Oversight Board approved the reinstatement of SERAF loans, identifying them as enforceable obligations, on May 26, 2016.

Cause

Management’s internal control environment did not identify the need to record the accumulated interest as a SARA obligation concurrent with recording the obligation for the reinstated principal in the year the event took place. Management identified the error in the next fiscal year and corrected it at that time.

Effect

\$3.4 million of interest expense should have been recorded in FY 16. Because the error was corrected in FY 17, expenses for FY 17 were overstated by the \$3.4 million which did not belong in that fiscal year.

Recommendation

We recommend management review and consider new legislation and other important communications related to redevelopment agency activities before closing the books for year end. Further, the supervisory review of non-routine transactions should be more robust so as to identify and correct similar errors on a timely basis.

Management Response

The SARA staff was not aware of the financial impact of SB 107 in the fiscal year 2015-16. When the information became available in fiscal year 2016-17, SARA staff corrected the interest rate. The SARA staff will consult with City Attorneys on any potential financial impact of new legislation related to redevelopment agency activities before the fiscal year closing.