CITY OF SAN JOSÉ

Deferred Compensation Plans

Report to Those Charged
with Governance

For the Year Ended
June 30, 2016

CITY OF SAN JOSÉ

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Deferred Compensation Advisory Committee
City of San José, California

Ladies and Gentlemen:

In connection with our audit of the financial statements the City of San José Deferred Compensation Plans (which include the Deferred Compensation Plan (457 Plan) and the Deferred Compensation PTC Plan ("PTC") Plan (collectively, the "Plans")), as of and for the year then ended June 30, 2016, auditing standards generally accepted in the United States of America ("US GAAS") require that we communicate the following information related to our audit to management and Deferred Compensation Advisory Committee (hereinafter referred to as "those charged with governance").

Responsibilities

Our responsibilities

We are responsible for:

- Performing audits under US GAAS of the financial statements prepared by management, with your oversight
- Forming and expressing opinions about whether the financial statements are presented fairly, in all material respects in accordance with US GAAP
- Forming and expressing an opinion about whether certain supplementary information is fairly stated in relation to the financial statements as a whole
- Communicating specific matters to you

An audit provides reasonable, not absolute, assurance that the financial statements do not contain material misstatements due to fraud or error. It does not relieve you or management of your responsibilities. Our respective responsibilities are described further in our engagement letters including communications required by US GAAS. We have also communicated information about our audit plan to the City in our communication from August 2, 2016.

Those charged with governance and management responsibilities

Those Charged with Governance (Deferred Compensation Advisory Committee):

- Overseeing the financial reporting process
- Setting a positive tone at the top and challenging the Plans' activities in the financial arena
- Discussing significant accounting and internal control matters with management
- Informing us about fraud or suspected fraud, including its views about fraud risks

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- Informing us about other matters that are relevant to our audit, such as:
  - Objectives and strategies and related business risks that may result in material misstatement
  - Matters warranting particular audit attention
  - Significant communications with regulators
  - Matters related to the effectiveness of internal control and your related oversight responsibilities
  - Your views regarding our current communications and your actions regarding previous communications

Management:

- Preparing and fairly presenting the financial statements in accordance with US GAAP
- Designing, implementing, evaluating, and maintaining effective internal control over financial reporting
- Communicating significant accounting and internal control matters to those charged with governance
- Providing us with unrestricted access to all persons and all information relevant to our audit
- Informing us about fraud, illegal acts, significant deficiencies, and material weaknesses
- Adjusting the financial statements, including disclosures, to correct material misstatements
- Informing us of subsequent events
- Providing us with certain written representations

Audit scope

Materiality

Essentially, materiality is the magnitude of an omission or misstatement that likely influences a reasonable person's judgment. It is based on a relevant financial statement benchmark. We believe that total assets is the appropriate benchmark for the Plans. Other areas less than materiality may be in scope if qualitative factors are present (for example, related party relationships or transactions and fraud risk).

Quality of accounting practices

Accounting policies

Accounting policies are consistently and appropriately applied. The significant accounting policies are disclosed in the financial statements.

Accounting estimates

We believe that the fair value of investments represents a particularly sensitive accounting estimates. We are satisfied as to the reasonableness of such estimates in the context of the financial statements taken as a whole, based on our knowledge of management's process for making such judgment, inquiry of management and others regarding such matters, and other audit procedures applied during the engagement.

Management consultation with other independent accountants

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

Difficulties encountered during the audit

During our audit we found 84 employees in the PTC Plan whose PTC contributions are or have been deposited into the investment funds associated with the 457 Plan. Management's investigation of this issue took some time and delayed completion of the audit by five months. Management ultimately concluded this practice was intentional and appropriate and has added disclosure to the financial statements to describe the practice.

Disagreements with management

For purposes of this letter, a disagreement with management is 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 no such disagreements arose during the course of our audit.

Internal control matters

In connection with our audit of the Plans' as of June 30, 2016 and for the year then ended, auditing standards generally accepted in the United States of America ("US GAAS") require that we advise Deferred Compensation Advisory Committee (hereinafter referred to as "those charged with governance") of the following internal control matters identified during our audit.

Our responsibilities

Our responsibility, as prescribed by US GAAS, is to plan and perform our audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to fraud or error. An audit includes consideration of internal control over financial reporting (hereinafter referred to as "internal control") as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Plans' internal control. Accordingly, we express no such opinion on internal control effectiveness.

Identified deficiencies in internal control

We identified the following internal control matters that are of sufficient importance to merit your attention.

Material weakness

Our consideration of internal control was also not designed to identify deficiencies in internal control that, individually or in combination, might be material weaknesses; therefore, material weaknesses may exist that were not identified. 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 Plans' financial statements will not be prevented, or detected and corrected, on a timely basis.

We consider the following identified control deficiency to be a material weakness.

During our testing of the investment portfolio and upon further inquiry with the Plan Administrator ("Voya") it was discovered that the $564 million of investments held by the 457 Plan were not direct investments in mutual funds as originally described in the financial statements but, rather, investments in pooled separate accounts (PSA's) created by Voya. PSA's are private funds comprised of mutual fund investments and can hold the invested assets of employees of several different employers. In other words, these investment were private funds and not directly traded mutual fund securities. While PSA's are common for the investment of contributions to employer-sponsored benefit plans, they do present a challenge for employers who must verify the fair value of these assets before presenting them in a financial statement prepared under US GAAP since there is no exchange to look to for evidence of active trades (and therefore, fair value) . Since PSAs are not exchange-traded funds the determination of fair value is provided, instead, by the Plan Administrator. The City is responsible for reporting these at fair value in the financial statements at June 30, 2016 yet the procedures performed by the City to verify the fair value figures computed by Voya were not robust enough to detect a material misstatement in the financial statements.

In the future, we recommend management perform additional steps to validate the fair value figures provided by Voya and ensure there is a thorough understanding of the types of investments held by the plan to facilitate accurate description of participant investments in the US GAAP financial statements. Enhanced procedures should include review of the underlying investments in the funds and recalculation of a selection of fair value calculations using the net asset value of the underlying funds as modified by the allocated cost adjustments Voya deducts from net asset value, consistent with the City's contract. We have previously provided to the City a publication authored by the AICPA's Employee Benefit Plan Quality Center which explains PSA's and other alternative investments and outlines suggested techniques for plan sponsors like the City to validate the fair value information provided by plan administrators. We would be pleased to discuss this further.

* * *

This communication is intended solely for the information and use of management and the Deferred Compensation Advisory Committee and is not intended to be and should not be used by anyone other than these specified parties.

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

Very truly yours,

GRANT THORNTON LLP

Grant Thornton LLP

March 6, 2017
San José, California

Appendix A- Proposed Disclosure Adjustments

Footnote 1 – Plans' Desciption
We suggested management add disclosure to explain how PTC Plan contributions for some current and former employees are in the 457 Plan.

Footnote Note 4 – Investments
Leveling of investments was adjusted based on testing performed by the audit team as these investments were initially all consdered to be Level 1 by management however a majority of the investments are held at Account Unit Value ("AUV") which are not required to be leveled. Additonally, we suggested updating the descriptions of the investment portfolio to clarify which investments were PSA's and not mutual funds and to add the standard disclosures required by GASB Statement No. 40.