

CITY OF SAN JOSE

Independent Accountant's Report on
Applying Agreed-Upon Procedures

As of June 30, 2019



Certified
Public
Accountants



Independent Accountant's Report on Applying Agreed-Upon Procedures

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

We have performed the procedures enumerated below, which were agreed to by the City of San José (City) Finance Department and the Office of the City Auditor (City Auditor), solely to assist these specified parties in evaluating whether the investments within the City's pooled portfolio are in compliance with the City's Investment Policy and Finance Department procedures as of June 30, 2019. The City's management is responsible for the City's compliance with those requirements. The sufficiency of these procedures is solely the responsibility of those parties specified in the report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

The procedures and associated findings are as follows:

1. We obtained a copy of the FY 2018-19 Fourth Quarter Investment Report (Investment Report) as of June 30, 2019 and agreed individual investments, which includes investment description, maturity date, CUSIP number, book and market value, to supporting documentation such as custodian/bank statements obtained from the City.

Finding: We noted there was a difference of \$10.0 million in market value representing 0.48% of the portfolio, where the custodian's statement reported a higher balance compared to the Investment Report. The difference is due to the maturity of Investment #37599 of \$10.0 million, which was reported on settlement date basis in the custodian's statement while on trade date basis in the Investment Report.

Management Response: This difference is the result of differences in the reporting basis between the custodian and the City. In conversations with Macias Gini & O'Connell, they have recommended to revisit the Agreed-Upon Procedures to exclude timing variances due to different reporting methods. The Finance Department will work with the City Auditor to make this change to the Agreed-Upon Procedures.

2. We traced total investments listed on the Investment Report as of June 30, 2019 to the City's general ledger.

Finding: We noted a net variance of \$9,960,156 between the Investment Report and the City's general ledger (FMS) as of June 30, 2019. The variance represents the maturity of Investment #37599 of \$9,960,156, the original cost of the investment. The difference is due to the timing of when the Investment Report is extracted and the posting to the FMS. The variance was resolved when the investment was settled through the City's custodian and investment staff posted the cash journal in early July 2019.

3. We verified the types of investments listed in the Investment Report as of June 30, 2019 were authorized by the City's Investment Policy dated March 9, 2019.

Finding: We noted the General Electric ("GE") Corporate Medium Term Note (Investment #37557) was downgraded on October 31, 2018 to a rating of BBB+/Baa1 by Standard & Poor's and Moody's, respectively. The Investment Policy requires ratings of A3, A-, or A- or higher by two of the three nationally recognized rating services for corporate medium term notes.

Section 9.0 of the Investment Policy states the following:

If, subsequent to purchase, securities are downgraded below the minimum acceptable ratings level (below prime for short term ratings, or below investment grade for long term ratings), the securities shall be reviewed for possible sale within a reasonable amount of time after the downgrade. In either instance listed above, the fact will be disclosed in the Quarterly Investment Report as described in Section 18.0 of this Policy.

Based on our review of the Quarterly Investment Report as of June 30, 2019, we did not observe the disclosure of the downgrade and the City's consideration of whether or not to sell the investment.

Management Response: Investment staff confirmed that the specific GE bond was purchased on June 21, 2017 when GE was rated "A1, AA-, AA-" by Moody's, S&P and Fitch respectively. When the company showed signs of financial stress in August 2018, the investment team upon consultation with the Director and the Assistant Director of Finance decided not to invest in additional GE securities and put the credit on the watch list. GE was taken off the approved credit list immediately after rating agencies announced the downgrade in October 2018. However, the investment team in consultation with the Director and Assistant Director of Finance made a collective decision to hold the security to maturity as the default probability on the bond was low and the company has been paying coupon payments as scheduled. The security is to mature on January 8, 2020.

4. We read the Investment Report as of June 30, 2019 to determine whether it contains the information/data required by the City's Investment Policy and whether it meets the timing requirements of the City's Investment Policy, as follows:
 - a. The investment quarterly report includes the type of investment, issuer, date of maturity, par and dollar amount invested on all securities, investments and monies held by the City.
 - b. The investment quarterly report includes market value (and source) as of the date of the report of all securities held by the City or under management of any outside party.
 - c. The investment quarterly report states the compliance of the portfolio to the City's Investment Policy.
 - d. The investment quarterly report includes a statement addressing the ability of the City to meet the pool's expenditure requirements for the next six months.

Finding: No exceptions were found as a result of applying the procedure.

5. We verified the investments listed in the Investment Report as of June 30, 2019 were not prohibited investments listed in the City's Investment Policy.

Finding: No exceptions were found as a result of applying the procedure.

6. We calculated the total investment amounts on a cost basis for the investment types listed in the Investment Report as of June 30, 2019, and compared those totals to the maximum portfolio limitations imposed by the City's Investment Policy for specified investment types.

Finding: No exceptions were found as a result of applying the procedure.

7. We agreed individual investment maturity dates listed in the Investment Report as of June 30, 2019, to the custodian/bank statements and determined whether they conform to the maturity requirements of the City's Investment Policy.

Finding: No exceptions were found as a result of applying the procedure.

8. We obtained and read the third party custodial agreement(s) and broker/dealer agreement(s) in effect at the date of the Investment Report to determine if the agreements contained a clause addressing delivery of securities and that the delivery method conformed to the City's Investment Policy.

Finding: No exceptions were found as a result of applying the procedure.

9. We recomputed and reviewed supporting documentation relevant to the repurchase agreements and, if applicable, the reverse repurchase agreements held by the City on June 30, 2019, to ascertain whether the investments conform to the City's Investment Policy.

Finding: Not applicable. No repurchase or reverse repurchase agreements were held by the City on June 30, 2019.

10. We determined through inquiry and observation whether the responsibilities for initiating, evaluating, and approving transactions are separate from detail accounting and general ledger functions.

Finding: No exceptions were found as a result of applying the procedure.

11. We determined through inquiry and observation whether custodial responsibility for investments is restricted to authorized personnel and separate from personnel with accounting duties.

Finding: No exceptions were found as a result of applying the procedure.

12. We determined through inquiry and observation whether responsibilities for detailed investment records in the investment system (Sympro) are separate from general ledger functions.

Finding: No exceptions were found as a result of applying the procedure.

13. We determined through inquiry and document inspection whether the City maintains authorized lists of signatures, security dealers, and counterparties and whether those lists are updated periodically.

Finding: No exceptions were found as a result of applying the procedure.

14. We determined through inquiry and document inspection whether the City counts and/or confirms its investments as transaction occurs.

Finding: No exceptions were found as a result of applying the procedure.

15. We determined through inquiry and document inspection whether counts and/or investment confirmations and detailed subsidiary records are prepared by Accounting Technician and reviewed by the Assistant Director of Finance.

Finding: No exceptions were found as a result of applying the procedure.

16. We determined through inquiry and document inspection whether investment income is periodically reviewed for accuracy by the Assistant Director of Finance and the Deputy Director of Accounting.

Finding: No exceptions were found as a result of applying the procedure.

17. We determined through inquiry and document inspection whether reconciliations between detailed subsidiary records and general ledger control accounts are prepared by an Accountant I and reviewed by a Supervising Accountant.

Finding: No exceptions were found as a result of applying the procedure.

18. We determined through inquiry and document inspection whether the Assistant Director of Finance assesses the classification and valuation of its investments at acquisition and at the end of the quarter.

Finding: No exceptions were found as a result of applying the procedure.

This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. We were not engaged to and did not conduct an examination or review, the objective of which would be the expression of an opinion or conclusion, respectively, on whether the City's investments within the City's pooled portfolio are in compliance with the City's Investment Policy and Finance Department procedures as of June 30, 2019. Accordingly, we do not express such an opinion or conclusion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the City Council, the Public Safety, Finance & Strategic Support Committee, the City Auditor, and Finance Department and is not intended to be and should not be used by anyone other than these specified parties.



Walnut Creek, California
September 24, 2019