

# Planning the 2020 Audit

Presentation to the Audit Committees and Management of (“the Plans”):

*City of San José Federated City Employees' Retirement System*  
*City of San José Police and Fire Department Retirement Plan*

Audits for the Year-ending June 30, 2020

**May 21, 2020**

# Our Responsibilities

## We are responsible for:

- Performing an audit under:
  - Auditing standards generally accepted in the United States of America ("US GAAS") of the financial statements prepared by management, with your oversight and
  - Applicable standards contained in Governmental Auditing Standards issued by the Comptroller General of the United States of the financial statements, prepared by management with your oversight, of the following:
    1. Federated City Employees' Retirement System ("the System")
    2. Police and Fire Department Retirement Plan ("P&F Plan") (collectively, the "Plans")
- Forming and expressing an opinion, by auditing the form and content of the information included therein, that the financial statements are presented fairly, in all material respects in accordance with US GAAP – Governmental Accounting Standards Board ("GASB")
- We disclaim an opinion on the required supplemental information and information contained elsewhere in the comprehensive annual financial reports, indicate that other supplemental information provided is fairly stated in relation to the financial statements as a whole, and make reference to our separate report on internal control.
- Reading other information and considering whether it is materially inconsistent with the financial statements.
- Communicating specific matters to you on a timely basis; we do not design our audit for this purpose.

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 letter.

# Those Charged with Governance and Management responsibilities

Those Charged with Governance	Management
<p>Those Charged with Governance (the Audit Committees) are responsible for:</p> <ul style="list-style-type: none"><li>• Overseeing the financial reporting process</li><li>• Setting a positive tone at the top and challenging the management's activities in the financial arena</li><li>• Discussing significant accounting and internal control matters with management</li><li>• Informing us about fraud or suspected fraud, including its views about fraud risks</li><li>• Informing us about other matters that are relevant to our audit, such as:<ul style="list-style-type: none"><li>– Objectives and strategies and related business risks that may result in material misstatement</li><li>– Matters warranting particular audit attention</li><li>– Significant communications with regulators</li><li>– Matters related to the effectiveness of internal control and your related oversight responsibilities</li><li>– Your views regarding our current communications and your actions regarding previous communications</li></ul></li></ul>	<p>Management is responsible for:</p> <ul style="list-style-type: none"><li>• Designing, implementing, evaluating, and maintaining effective internal control over financial reporting</li><li>• Communicating significant accounting and internal control matters to those charged with governance</li><li>• Providing us with unrestricted access to all persons and all information relevant to our audit</li><li>• Informing us about fraud, illegal acts, significant deficiencies, and material weaknesses</li><li>• Adjusting the financial statements, including disclosures, to correct material misstatements</li><li>• Informing us of subsequent events</li><li>• Providing us with certain written representations</li></ul>

# Audit timeline

## Client re-acceptance

- January 2020

## Planning and preliminary risk assessment

- April/May 2020
- Engagement letter
- Discussions with management
- Interims sample selections

## Interim audit fieldwork

- May-June 2020
- Planning discussions and preparation for year-end audit
- Finalize benefits and contributions testing

## Final Fieldwork

- August – October 2020
- Final audit testing

## Final deliverables

- Audit committee date: October 15, 2020
- City auditor target date: November 17, 2020
- Target issuance dates:
  - Federated: November 5, 2020
  - P&F: November 5, 2020

# Deliverables

## Our deliverables include the following.

Report on the June 30, 2020 financial statements and related reporting required by Government Auditing Standards and U.S. GAAS

Communicate relevant technical audit, accounting, internal control, and tax-related matters

Communicate any significant deficiencies or material weaknesses

Communicate periodically to understand the entity's adoption and implementation of new accounting standards

Periodic consultations with management as necessary

# 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 **Net Assets** is the appropriate benchmark for the Plans, applied to each trust/plan presented in the financial statements.**

Financial statement items greater than materiality are in scope. Other areas less than materiality may be in scope if qualitative factors are present (for example, related party relationships or transactions and fraud risk areas).

# Risk assessment overview

The following provides an overview of our audit areas of focus based on our risk assessment procedures.

Areas of focus	Planned audit response
Investments	GT will confirm 100% of the investment balance for both plans, perform cut-off testing and test valuation on a scope basis.
Significant Estimates (including fair value measurements)	GT will evaluate management's assumptions used in determining these estimates.
Actuarial Information	GT will review actuarial reports prepared by independent actuary including assessment of key assumptions, and reconciliation to inputs tested elsewhere in the audit, as well as to the information provided in the notes to financial statements and RSI.
Contributions & Benefit Information	GT will test eligibility and recalculate pensionable pay for a sample of plan participants.
Benefit Payments	GT will sample test the benefit payments for pension eligibility, accuracy of pension calculation and reconciliation between the pension payment and the bank statement.
Cash Disbursements	GT will scan the disbursement detail for unusual items, or significant amounts in the Benefit Payments module.
Manual Adjustments	GT will test a sample of manual adjusting or topside entries made and agree them to related support.
Going Concern	GT will review managements ongoing assessment on contemporary issues that may arise from the COVID-19 pandemic.

# Fraud risks

Nature of identified fraud risk	Planned audit response
Significant estimates and/or judgements surrounding fair value measurements	GT will test investment valuations and associated unrealized gains on investments by independently verifying the valuation data sources.
Presumed fraud risk in revenue recognition	GT will test investment valuations and associated unrealized gains on investments by independently verifying the valuation data sources. Any realized gains, interest income, distributions or dividend income will be tested directed to net proceeds on exchange.
Management override	GT will test completeness of all journal entries and will perform extractions to test the entries using criteria judgmentally selected by risk criteria designed by the engagement team.

## Fraud risk discussion

- Views about the risks of fraud
- Awareness of fraud or suspected fraud
- Oversight over management's fraud risk assessment
- Awareness of tips or complaints regarding the Company's financial reporting
- Knowledge of violations or possible violations of laws or regulations
- Views on other matters relevant to the audit, such as risks of material misstatement



# COVID-19 pandemic

## Accounting considerations

Management considerations on the following:

1. Effect on market actuarial estimates and assumptions on actuarial liabilities
2. Effect on market rate changes in determining fair value of the Plan's investment portfolio
3. Other, if any, financial statement impact of the COVID-19 pandemic, such as accruals, severance liabilities etc.

## Audit considerations

Grant Thornton will:

1. Seek to be provided with management's assessment of the above considerations
2. Where significant observable and unobservable assumptions are utilized, we will seek to corroborate these assumptions by obtaining management's sources and independently verifying against our observations
3. Assess the adequacy of management's considerations, and documentation of such considerations.

# Use of the work of others

## Auditor Specialists and those with specialized skill or knowledge:

### **Harvest**

GT will engage Harvest for the limited scope of valuing the investment assets. Harvest is used regularly by GT for investment valuation services.

### **Grant Thornton Business Advisory Services Information Technology Group**

GT will review the design effectiveness of the Company's IT entity level control environment.

### **Grant Thornton Actuarial Group**

GT will review the actuarial valuation of the retirement and OPEB liabilities and related disclosures.

## Management Specialists and those with specialized skill or knowledge

### **Managements' Investment Team and Advisors**

GT will require the assistance of any investment valuation experts White Oak and/or other advisors utilized by management in developing its fair value estimates to reproduce valuation information and data sets to support management's valuation assumptions and methodologies.

### **Managements' Actuarial Report**

GT will obtain managements' annual actuarial reports from Cheiron. GT will require supporting documentation of assumptions, changes in assumptions and other data points utilized by managements' experts.

# Related parties

The following related parties were identified while planning the audit.

The following related parties have been identified:	
• Trustee	• Fund Managers
• Plan Custodian	• Investment Advisor(s)
• Plan Record-keeper	• External Auditors
• Plan Sponsor	• Legal Counsel
• Plan Administrator	• Those Charged With Governance
• Plan Participant	• Close relatives of Plan Sponsor's employees providing services to the Plan

# Internal Controls Matters

## Responsibility

We are responsible for obtaining reasonable assurance about whether the financial statements are free of material misstatement. Our audit will include consideration of internal control over financial reporting 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 will express no such opinion. Control deficiencies that are of a lesser magnitude than a significant deficiency will be communicated to management.

## Definitions

- A deficiency in internal control ("control deficiency") 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, misstatements 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 responsible for oversight of an entity's financial reporting.
- 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 an entities annual or interim financial statements will not be prevented or detected on a timely basis.

# Internal control matters (continued)

The following is a list of internal control matters from the FY19 audit communicated to those charged with governance and management in our letters dated November 12, 2019 (Police and Fire Plan) and November 12, 2019 (Federated Plan):

Finding	Control Rating	Plan(s) Affected
2019-001   IT: City-Wide Direct Data Changes and Audit Logging / Monitoring	Significant Deficiency	Federated and Police & Fire Plans
2019-002   GASB No. 72 Fair Value Measurement Disclosure	Significant Deficiency	Federated and Police & Fire Plans

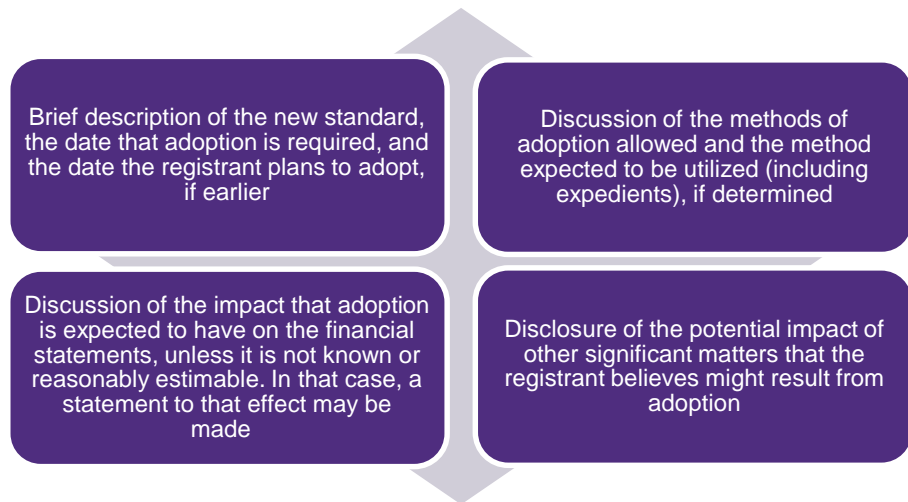
# GASB 87 Leases Implementation Progress

The requirements of this Statement are effective for reporting periods beginning after December 15, 2019:

Implementation will generally address the following key activities	Status		
	Not started	In progress	Complete
Understand the impact of the new standard on current accounting policies and the implications of the accounting changes on reporting and disclosure requirements		✓	
Establish an implementation team, identify necessary resources (internal and external) and develop internal resources		✓	
Analyze all contracts to identify leases, including reviewing service contracts to identify <b>embedded leases</b>		✓	
Assess and update accounting policies / positions and the processes and controls to support those policies		✓	
Determine and implement appropriate interim and/or ongoing technology solutions based on current organizational and information technology (IT) environment		✓	
Determine and formalize the appropriate accounting and transition approach for existing leases, including <b>practical expedients and transition method selected</b>		✓	
Document assumptions required for calculating lease values and formalize the process to calculate the impact of the change		✓	
Define processes for identifying future leases and develop a plan to periodically review the processes, controls, and systems implemented to properly account for leases under the new standard		✓	
Calculate transition adjustments based upon assumptions made / practical expedient(s) chosen and draft transition disclosures		✓	

**Keys to successful implementation:** Involve all stakeholders; Identify and commit appropriate resources; Focus on implementation now

# GASB 87 Leases Disclosures



## SAB 74 Overview

## Each Subsequent Period Presented

### Qualitative disclosures

- General description of lease
- Basis and terms and conditions of variable lease payments, extension and termination options, and residual value guarantees
- Restrictions or covenants imposed by leases
- Significant assumptions and judgments made in identifying a lease, allocation of lease consideration, lease term, and discount rate
- Significant rights and obligations for leases not yet commenced

### Quantitative disclosures

- Finance lease cost (separating amortization and interest cost)
- Operating lease cost
- Short-term lease cost
- Variable lease cost
- Separately for finance and operating leases: cash paid, weighted-average remaining lease term, weighted-average discount rate, supplemental noncash information about lease liabilities recognized from obtaining ROU assets, maturity analysis of undiscounted lease cash flows and a reconciliation of undiscounted cash flows to lease liabilities

---

## Technical Update - GASB





# Selected pronouncements effective for the year ending June 30, 2020 or subsequent periods - GASB

Title	Effective date	
GASB 84- <i>Fiduciary Activities</i>	Periods beginning after December 15, 2018 (postponed 12 months)	<i>N/A to the Plans</i>
GASB 87- <i>Leases</i>	Periods beginning after December 15, 2019 (postponed 18 months to June 15, 2021)	<i>Applicable to the Plans</i>
GASB 89- <i>Accounting for Interest Cost Incurred before the end of a Construction Period</i>	Periods beginning after December 15, 2019 (postponed 12 months)	<i>N/A to the Plans</i>
GASB 90 – <i>Majority Equity Interests – an amendment of GASB Statements No. 14 and No. 61</i>	Periods beginning after December 15, 2018 (postponed 12 months)	<i>N/A to the Plans</i>
GASB 91 – <i>Conduit Debt Obligations</i>	Periods beginning after December 15, 2020 (postponed 12 months)	<i>N/A to the Plans</i>
GASB 92 – <i>Omnibus 2020</i>	Periods beginning after June 15, 2020* (postponed 12 months)	<i>N/A to the Plans</i>

# GASB Statement 87, Leases

## Summary

- The GASB issued guidance which resembles the FASB guidance on leases
- To determine whether a lease exists, a government should assess whether it has both:
  - 1) The right to obtain the present service capacity from use of the underlying asset as specified in the contract, and
  - 2) The right to determine the nature and manner of use of the underlying asset as specified in the contract
- For Lessees:
  - In general, all leases will be reported on the statement of net position (the distinction between operating and capital leases is no longer relevant) as a "right of use" intangible asset and a corresponding lease liability within long term debt
  - On the statement of changes, rent expense will be replaced by amortization expense of the right-of-use asset as well as interest expense on the lease liability (thus accelerating expenses in the beginning years of the lease term)
  - There is an exemption for short term leases (those with a term of 12 months or less, including extension options) as well as leases that transfer ownership at the end of the term
  - Disclosures regarding matters such as total leased assets by major class of underlying assets and related accumulated amortization (in total), principal and interest payments for each of the five subsequent fiscal years and in five year increments thereafter and commitments under leases before a lease commencement period, among other items

# GASB Statement 87, *Leases (continued)*

## Summary, continued

- For Lessors:
  - Record a lease receivable and a deferred inflow of resources equal to the present value of future lease payments (which should generally equal the amount recorded as a liability by the lessee), and also continue to report the leased asset
  - The receivable will be reduced as cash is received, the asset will be depreciated (generally) and the deferred inflow will be recognized over the lease term
  - Disclosures include matters such as general description of leasing arrangements, total amount of inflows of resources, and those related to variable payments, residual guarantees, etc., and the existence, terms and conditions of options by the lessee to terminate the lease or abate payments in certain circumstances, among other disclosures
- Effective for periods beginning after December 15, 2019, with early adoption encouraged. Existing leases will be adjusted based on the remaining lease payments as of the beginning of the period of adoption or beginning of any earlier periods restated (for example, for June 30 year ends, adoption is June 30, 2021 so the beginning period is July 1, 2020). Under GASB Statement No. 95, a number of standards effective dates have been delayed. GASB 87 has been delayed 18 months, with new effective date June 15, 2021.

## Potential Impact

For those which use operating leases to finance certain capital activities, this standard could have a significant impact on the financial statements upon adoption. Management should consider the impact on financial covenants, as well as ensuring a complete inventory of existing leases that will be subject to the new accounting and disclosures.

# GASB projects

Project	Timing
Public-private partnerships, including reexamination of Statement 60	Final statement expected March 2020
Secured overnight financing rate – London Interbank Offered Rate	Final statement expected March 2020
Implementation guidance – 2020 update	Final implementation guide expected April 2020
Subscription-based information technology arrangements	Final statement expected May 2020
Recognition (conceptual framework)	Final Concepts Statement expected 2022
Certain component unit criteria, and accounting and financial reporting for Section 457 plans	Exposure draft expected March 2020
Financial Reporting Model- Reexamination of Statements 34, 35, 37, 41 and 46, and Interpretation 6	Exposure draft expected July 2020
Compensated absences – reexamination of Statement 16	Exposure draft expected February 2021
Prior-period adjustments, accounting changes, and error corrections – a reexamination of Statement 62	Exposure draft expected February 2021
Disclosure framework (conceptual framework)	Preliminary views expected Spring 2020
Revenue and expense recognition	Preliminary Views expected in June 2020

# GASB major project – Financial Reporting Model

## Summary

- GASB is revisiting its reporting model established in GASB 34 and 35, as well as other GASB standards, following the FASB project to revisit the reporting model of NFP entities.
- Although there is general consensus that most of the components of the financial reporting model are effective, the Board determined that there is a need to update guidance related to several categories, focusing on the following:
  - MD&A
  - Government-wide financial statements
  - Major funds
  - Governmental fund financial statements
  - Proprietary fund and business-type activity financial statements
  - Fiduciary fund financial statements
  - Budgetary comparisons
- Preliminary Views of note (Preliminary Views was issued in September 2018):
  - Definition of non-operating activities includes i) subsidies received and provided, ii) revenues and expenses of financing, iii) resources from the disposal of capital assets and inventory and iv) investment income and expenses
  - A subtotal for "operating income/(loss) and noncapital subsidies"
  - Government-wide schedule of natural classification of expenses would be presented as supplementary information (BTA activities by segment)

# GASB major project – Financial Reporting Model, continued

## Potential impact

Similar to the significant impact on reporting and disclosures when GASB 34 and 35 were issued, this proposed guidance could have sweeping effects on the reporting and disclosures. Depending on how much the GASB looks to what was done by the FASB on the NFP reporting model, there could be an increase in comparability between the two types of entities that currently use very different reporting models.

Three of the business type activities issues that the GASB is considering that are particularly relevant are guidance on the operating indicator, MD&A and extraordinary and special items. Based on comments made by GASB representatives, one of the preliminary views is to present a subtotal for "operating income/loss and noncapital subsidies", which includes state appropriations. This is an accommodation to the request by many constituents to include state appropriations as an operating revenue, which will not be changed based on preliminary views. In addition, the addition of a separate schedule of expenses by natural classification will highlight certain expenses that may receive additional scrutiny such as salary/compensation expense. Depending on the ultimate guidance, management may want to think about how the reporting of these expenses will be captured to be accurately reported in the financial statements.

# GASB major project – Revenue and Expense Recognition

Summary	Potential impact
<ul style="list-style-type: none"><li>• Three primary areas of focus of the project are as follows:<ol style="list-style-type: none"><li>1. Common exchange transactions not specifically addressed in existing GASB guidance<ul style="list-style-type: none"><li>➤ Project plans to develop guidance or improve existing guidance regarding<ol style="list-style-type: none"><li>i. Exchange and exchange-like transactions having single elements</li><li>ii. Exchange and exchange-like transactions having multiple elements</li><li>iii. The differentiation between exchange-like and non-exchange transactions</li></ol></li></ul></li><li>2. Post-implementation review of GASB 33 and 36<ul style="list-style-type: none"><li>➤ Areas to be considered include:<ol style="list-style-type: none"><li>i. Distinguishing between eligibility requirements and purpose restrictions</li><li>ii. Determining when a transaction is an exchange or a non-exchange transaction</li><li>iii. Using the availability period concept consistently across governments</li><li>iv. Applying time and contingency requirements</li></ol></li></ul></li><li>3. Development of GASB conceptual framework<ul style="list-style-type: none"><li>➤ GASB 33 and 36 were developed prior to key parts of the conceptual framework, such as defining deferred inflows and outflows</li><li>➤ An evaluation of the recognition of non-exchange transactions against the conceptual framework is necessary</li></ul></li></ol></li><li>• <u>Currently in redeliberations</u>, with Preliminary Views expected in June 2020.</li></ul>	<p>As it relates to recognition of exchange and non-exchange transactions such as grants vs gifts vs contracts, there continues to be an element of judgment and interpretation of existing GASB and FASB guidance. This project could impact the current practices of higher education institutions as it relates to revenue recognition.</p>

# GASB pre-agenda research

## Topics

- Going concern disclosures
- Capital assets
- Interim financial reporting
- Investment fees



# GASB Considers Extensions in Response to COVID-19

## Summary

- GASB has added a project to its current technical agenda to consider postponing all Statement and Implementation Guide provisions with an effective date that begins on or after reporting periods beginning after June 15, 2018.
- GASB has received numerous requests from state and local government officials and public accounting firms regarding postponing the upcoming effective dates of pronouncements.
- Most notably, those pronouncements include GASB Statement No. 84, *Fiduciary Activities*, and GASB Statement No. 87, *Leases*, as well as their related Implementation Guides.
- An exposure draft is expected in April 2020 and a final standard in May 2020. The GAQC will provide updates on this project as it progresses.

# Commitment to promote ethical and professional excellence

We are committed to promoting ethical and professional excellence. To advance this commitment, we have put in place a phone and Internet-based hotline system.

The Ethics Hotline (1.866.739.4134) provides individuals with a means to call and report ethical concerns

The EthicsPoint URL link can be found on our internal website or from our external website ([https://secure.ethicspoint.com/domain/en/report\\_custom.asp?clientid=15191](https://secure.ethicspoint.com/domain/en/report_custom.asp?clientid=15191))

Disclaimer: EthicsPoint is not meant to act as a substitute for a company's "whistleblower" obligations.