



PRESENTATION TO THE AUDIT COMMITTEES AND MANAGEMENT OF (THE PLANS")

# Planning the 2021 Audit

City of San Jose Federated City Employee's Retirement System  
City of San Jose Police and Fire Department Retirement Plan

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**May 20, 2021**

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



# 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 contract and/or our engagement letter.

# Those Charged With Governance and Management Responsibilities

## Those Charged with Governance are responsible for:

- Overseeing the financial reporting process
- Setting a positive tone at the top and challenging the Agency's 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
- Informing us about other matters that are relevant to our audit, such as:
  - Agency strategies and related business risks that may result in heightened risks of material misstatement
  - Matters warranting particular audit attention
  - Significant communications with regulators
  - Matters related to the effectiveness of internal control and your oversight responsibilities
  - Your views regarding our current communications and your actions regarding previous communications

## Management is responsible for:

- Preparing and fairly presenting the financial statements **including supplementary information and required supplementary information** in accordance with US GAAP
- Designing, implementing, evaluating, and maintaining effective internal control over financial reporting and compliance
- 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 written representations

# Audit timeline & scope

January-February 2021	Client re-acceptance	<ul style="list-style-type: none"><li>• Independence</li></ul>
May 2021	Planning and Preliminary risk assessment	<ul style="list-style-type: none"><li>• Engagement letter</li><li>• Discussions with management</li><li>• Interim sample selections</li></ul>
July-August 2021	Interim Audit fieldwork	<ul style="list-style-type: none"><li>• Planning discussions and preparation for year-end audit</li><li>• Finalize benefits and contributions testing</li></ul>
August- October 2021	Final fieldwork	<ul style="list-style-type: none"><li>• Final audit testing</li></ul>
November 2021	Final deliverables	<ul style="list-style-type: none"><li>• Audit committee date: October 21, 2021</li><li>• City auditor target date: November 17, 2021 <b>[TBD]</b></li><li>• Target issuance dates:<ul style="list-style-type: none"><li>• Federated: November 4, 2021</li><li>• P&amp;F: November 4, 2021</li></ul></li></ul>

# Deliverables

## Our deliverables include the following.

Report on the June 30, 2021 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).

# Significant risks

The following provides an overview of the areas of significant audit focus based on our risk assessments.

Area of focus	Planned Audit response
Investments	GT will confirm 100% of the investment balances 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.

# Other areas of focus

Area of focus	Planned Audit response
Benefit Payments	<ul style="list-style-type: none"><li>GT will sample test the benefit payments for pension eligibility, accuracy of pension calculation and reconciliation between the pension payment and the bank statement.</li></ul>
Cash Disbursements	<ul style="list-style-type: none"><li>GT will scan the disbursement detail for unusual items, or significant amounts in the Benefit Payments module.</li></ul>
Manual Adjustments	<ul style="list-style-type: none"><li>GT will test a sample of manual adjusting or topside entries made and agree them to related support.</li></ul>
Going Concern	<ul style="list-style-type: none"><li>GT will review managements ongoing assessment on contemporary issues that may arise from the ongoing potential impacts of COVID-19 pandemic.</li></ul>



# Fraud risks

## Nature of identified fraud risk

## Results

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

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

## Fraud risk discussion

Views about the risks of fraud

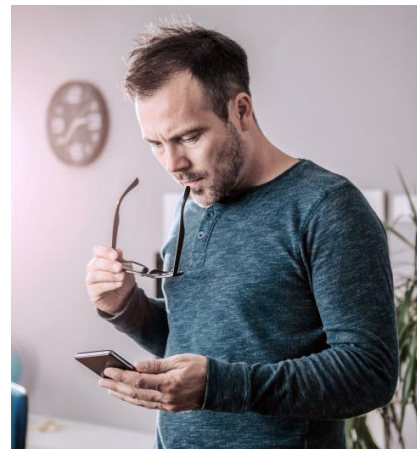
Awareness of fraud or suspected fraud

Oversight over management's fraud risk assessment

Awareness of tips or complaints regarding the Agency'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

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Management considerations on the following:

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

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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.
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# 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 may require the assistance of any investment valuation experts utilized by management in developing its fair value estimates for any significant Level 3 investments 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 control matters

## Responsibility

We are responsible for obtaining reasonable assurance about whether the financial statements are free of material misstatement. Our audit included 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 Plan's internal control. Accordingly, we express no such opinion. Control deficiencies that are of a lesser magnitude than a significant deficiency will be communicated to management.



# Internal control matters (continued)



## Control deficiency

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 misstatements on a timely basis



## Significant deficiency

A deficiency, or 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 the agency's financial reporting.



## Material weakness

A deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the agency's 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 FY20 audit communicated to those charged with governance and management in our letters dated November 5, 2020 (both Police and Fire Plan and Federated Plan):

Finding	Control Rating	Plan(s) Affected
2020-001   IT: City-Wide Direct Data Changes and Audit Logging / Monitoring	Significant Deficiency	Federated and Police & Fire Plans
2020-002   GASB No. 72 Fair Value Measurement Disclosure	Significant Deficiency	Federated and Police & Fire Plans

# Other considerations

Cybersecurity

Internal controls  
(systems)

Segregation of  
duties







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## Technical updates - GASB

# Selected pronouncements effective for the year ending June 30, 2021 or subsequent periods - GASB

Title	Effective date	
GASB 87– Leases	Periods beginning after June 15, 2021**	<i>Applicable to the Plans – not material.</i>
GASB 89 – Accounting for Interest Cost Incurred before the end of a Construction Period	Periods beginning after December 15, 2020**	<i>N/A to the Plans</i>
GASB 90 – Majority Equity Interests – an amendment of GASB Statements No. 14 and No. 61	Periods beginning after December 15, 2019**	<i>N/A to the Plans</i>
GASB 91 – Conduit Debt Obligations	Periods beginning after December 15, 2021**	<i>N/A to the Plans</i>
GASB 92 – Omnibus 2020	Periods beginning after June 15, 2021*	<i>N/A to the Plans</i>

\* Effective dates vary by topic.

\*\* Reflective of effective date deferrals under GASB 95.

# Selected pronouncements effective for the year ending June 30, 2021 or subsequent periods – GASB – continued

Title	Effective date	
GASB 93 – Replacement of Interbank Offered Rates	Periods beginning after June 15, 2020	<i>Applicable to the Plans</i>
GASB 94 – Public-Private and Public-Public Partnerships and Availability Payment Arrangements	Periods beginning after June 15, 2022	<i>N/A to the Plans</i>
GASB 96 – Subscription-Based Information Technology Arrangements	Periods beginning after June 15, 2022	<i>Applicable to the Plans</i>
GASB 97 – Certain Component Unit Criteria, and Accounting and Financial Reporting for IRC Section 457 Deferred Compensation Plans – an amendment of GASB Statements 14 and 84 (Supersedes GASB Statement 32)	Periods beginning after June 15, 2021*	<i>Applicable to the Plans</i>

\* Effective dates vary by topic.

# GASB Statement 87, Leases

## Summary

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- 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
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# 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 June 15, 2021, 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 15, 2022 so the beginning period is July 1, 2021).

## Potential Impact

- For those entities which use operating leases to finance certain capital activities, this standard could have a significant impact on the financial statements of the entities 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 Statement 93, *Replacement of Interbank Offered Rates*

## Summary

- Addresses accounting and financial reporting implications that result from the replacement of LIBOR
  - Provides exceptions for certain hedging derivative instruments to the hedge accounting termination provisions when an IBOR is replaced as the reference rate of the hedging derivative instrument's variable payment
  - Clarifies the hedge accounting termination provisions when a hedged item is amended to replace the reference rate
  - Clarifies that the uncertainty related to the continued availability of IBORs does not, by itself, affect the assessment of whether the occurrence of a hedged expected transaction is probable
  - Removes LIBOR as an appropriate benchmark interest rate for the qualitative evaluation of the effectiveness of an interest rate swap
  - Identifies a Secured Overnight Financing Rate and the Effective Federal Funds Rate as appropriate benchmark interest rates for the qualitative evaluation of the effectiveness of an interest rate swap
  - Provides an exception to the lease modifications guidance in Statement 87, as amended, for certain lease contractions that are amended solely to replace an IBOR as the rate upon which variable rates depend
- The removal of LIBOR as an appropriate benchmark interest rate is effective for reporting periods ending after December 31, 2021.
- All other requirements are effective for periods beginning after June 15, 2021, with early adoption encouraged.

## Potential Impact

- LIBOR has historically been a common benchmark for debt, hedging and other agreements with some fashion of variable rate. Entities should inventory agreements to identify which, if any, include current references to LIBOR
- For agreements with current LIBOR references, entities should coordinate with lenders and other counterparties to identify a replacement benchmark interest rate, and update agreements and footnote disclosures as needed

# GASB Statement 96, *Subscription-Based Information Technology Arrangements*

## Summary

- Defines subscription-based information technology arrangements (SBITA) as a contract that conveys control of the right to use another party's IT software,
  - alone or with underlying tangible IT assets,
  - For a period of time (noncancelable period, plus options to extend),
  - In an exchange or exchange-like transaction.
- Government should recognize a right-to-use subscription asset and a corresponding subscription liability
  - Measured as the present value of expected subscription payments
  - Discounted using the rate the SBITA vendor charges, or the incremental borrowing rate
- Subscription asset to be amortized over the subscription term
- Activities associated with a SBITA, other than subscription payments, should be grouped into the following three stages and costs accounted for accordingly:
  - Preliminary project stage – expensed as incurred
  - Initial implementation stage – capitalized as an addition to the subscription asset
  - Operation and additional implementation stage – expensed as incurred, unless they meet specific capitalization criteria
- Effective for fiscal years beginning after June 15, 2022, with early adoption encouraged.

## Potential Impact

- For those entities using subscription-based IT arrangements, this standard could have a significant impact on the financial statements of the entities upon adoption. As with the new lease standard, management should consider the impact on financial covenants, as well as ensuring a complete inventory of existing agreements that will be subject to the new accounting and disclosures.

# GASB projects

Project	Timing
Recognition (conceptual framework)	Final Concepts Statement expected 2022
Financial Reporting Model - Reexamination of Statements 34, 35, 37, 41 and 46, and Interpretation 6	Final Statement expected 2022
Compensated absences – reexamination of Statement 16	Exposure draft expected early 2021
Prior-period adjustments, accounting changes, and error corrections – a reexamination of Statement 62	Exposure draft expected May 2021
Disclosure framework (conceptual framework)	Final Concepts Statement expected Spring 2021
Revenue and expense recognition	Exposure draft expected 2023
Risks and Uncertainties Disclosures	Exposure draft expected November 2021
Implementation Guidance – 2021 Update	Final Implementation Guide expected Spring 2021
Omnibus	Exposure draft expected August 2021
Renaming the Comprehensive Annual Financial Report	Final Statement expected October 2021



# GASB major project – Financial Reporting Model

## Summary

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- 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
  - Exposure Draft elements of note for entities (Preliminary Views was issued in June 2020):
    - 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"
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# GASB major project – Financial Reporting Model, continued

## Potential impact

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- Proposed guidance could have sweeping effects on the reporting and disclosures by entities.
  - 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 to entities are:
    - Guidance on the operating indicator
    - MD&A
    - Extraordinary and special items
  - Depending on the ultimate guidance, entities may want to think about how the reporting of these expenses will be captured to be accurately reported in the financial statements.
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# GASB major project – Revenue and Expense Recognition

## Summary

- Three primary areas of focus of the project are as follows:
  1. Common exchange transactions not specifically addressed in existing GASB guidance
    - Project plans to develop guidance or improve existing guidance regarding
      1. Exchange and exchange-like transactions having single elements
      2. Exchange and exchange-like transactions having multiple elements
      3. The differentiation between exchange-like and non-exchange transactions
  2. Post-implementation review of GASB 33 and 36
    - Areas to be considered include:
      1. Distinguishing between eligibility requirements and purpose restrictions
      2. Determining when a transaction is an exchange or a non-exchange transaction
      3. Using the availability period concept consistently across governments
      4. Applying time and contingency requirements
  3. Development of GASB conceptual framework
    - GASB 33 and 36 were developed prior to key parts of the conceptual framework, such as defining deferred inflows and outflows
    - An evaluation of the recognition of non-exchange transactions against the conceptual framework is necessary
- Currently in public hearings and redeliberations, with Exposure Draft expected in June 2023.

## Potential Impact

- 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.

# GASB pre-agenda research

## Topics

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- Going concern disclosures
  - Capital assets
  - Interim financial reporting
  - Investment fees
  - Nonfinancial assets
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# 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 a means to call and report ethical concerns.

The EthicsPoint URL link can be accessed from our external website or through this link:

[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 intended to act as a substitute for a agency's "whistleblower" obligations.