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PRESENTATION TO THE AUDIT COMMITTEE'S

2021 Annual Audit Presentation

City of San Jose

Federated City Employees' Retirement System; and Police and Fire Department Retirement Plan (collectively, "the Plans")

June 30, 2021

--- DRAFT 10/14/2021 ---

October 21, 2021 Meeting

This communication is intended solely for the information and use of management and the Audit Committees of the Federated City Employees' Retirement System and the Police and Fire Department Retirement Plan and is not intended to be and should not be used by anyone other than these specified parties.

Our Values are CLEARR

To achieve our global vision, we capitalize on our strengths by embracing the following values:

- Unite through global **Collaboration**
- Demonstrate **Leadership** in all we do
- Promote a consistent culture of **Excellence**
- Act with **Agility**
- Ensure deep **Respect** for people
- Take **Responsibility** for our actions

Our values serve as the foundation of each step we take toward achieving our vision.

They guide our decision-making and provide a framework for our people to make correct and appropriate choices.

Audit timeline & scope

April/May2021	Client continuance	▪ Independence ▪ Discuss with management any major changes in FY2021 ▪ Issue engagement letters ▪ Developed PBC list, project timelines, etc.
May 2021	Planning	▪ Materiality Determination ▪ Held planning meetings with management to further discuss the timing to fieldwork and considerations for the audits ▪ Presented audit plan to the Joint Audit Committee on May 21
May/June 2021	Preliminary risk assessment procedures	▪ Significant Risks Identified ▪ Develop audit plan that addresses risk areas ▪ Assessed financial reporting risk related to the Plans
July/September 2021	Interim fieldwork	▪ Perform walk-throughs of business processes and controls ▪ Performed interim testing on contributions, eligibility, benefit payments and census data ▪ Performed interim testing on investment purchases and sales
September/October 2021	Final fieldwork	▪ Performed testing on investments portfolios including fair value ▪ Performed remaining testing on contributions, eligibility, benefit payments and census data ▪ Reviewed financial statements
Sign Off Date	Deliverables	Financial Statements, Misstatements, Disclosures – issued opinions and other communications (target November 4, 2021)

Areas of audit focus

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

Areas of focus	Results
Fair value measurements of investments and related disclosures	▪ Confirmed investments held by the Plans with BNYM as of year end. ▪ Tested fair values at the end of the year. ▪ Performed analytics on investment income ▪ Reviewed fair value measurement for disclosure purposes. ▪ Reviewed SOC1 reports for State Street and BNYM as well as management's complementary user controls. ▪ Reviewed management's process for assessing fair value provided by investment manager's and the custodian ▪ No significant issues noted
Actuarial amounts not determined properly	▪ Obtained census data and compared to the data maintained by management. ▪ Performed testing around census data movement. ▪ Engaged our Human Capital Resources Group to review the Cheiron actuarial valuation report and evaluate the underlying assumptions for reasonableness for both the pension and OPEB plans ▪ No significant issues noted.
Benefits payments improperly computed	▪ Tested eligibility requirements for the benefit payments ▪ Recalculated the distributions to ensure they were allowable per the municipal code and that the amounts distributed were accurate. ▪ No significant issues noted

Areas of audit focus (continued)

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

Areas of focus	Results
Participant data and eligibility	▪ Selected a sample of participants and tested for eligibility and recalculated contributions (both employee and employer). ▪ Selected a sample of remittances during the year and agreed them to transmittal support to the custodian. ▪ We randomly selected three employees and tested for proper exclusion. ▪ No significant issues noted.
Fraud related to journal entries	▪ Auditing standards suggest that an auditor's identification of fraud risks should include the risk of management override of controls. ▪ We made inquiries of management. ▪ We obtained an understanding of management's process relating to Plans' reporting. ▪ We tested journal entries based on specific criteria ▪ No significant issues noted.
Financial statement presentation and disclosure	▪ Verified disclosures related newly implemented GASB Statements were included ▪ No significant issues noted.
Change in custodian	▪ Reviewed management’s testing of the new system implementation and data conversion. ▪ Reviewed SOC1 reports for State Street and BNYM as well as management's complementary user controls.

COVID-19 pandemic

Accounting considerations

- Fair value measurements and impairment of financial assets.
- Disclosures regarding risks and uncertainties
- Accounting estimates rely on an entity's judgmental assumptions, which must be based on a reasonable interpretation of conditions or events that are either known or knowable as of the reporting date.

Audit considerations

Our audit procedures included the review of valuation assumptions of financial assets and liabilities. Management has included its analysis of the on-going impact of COVID-19 through its MD&A. The reports of the investment advisors also include consideration of the effects of the pandemic on the investment portfolio and the Plans as it relates to the reported value of investments at June 30, 2021. Management is conducting an ongoing evaluation of the continuing impact of the pandemic on the portfolio. We note that the complete impact of the COVID-19 pandemic on the wider financial markets as a whole and as it relates to the valuations represented in the June 30, 2021 financial statements is unknown. The valuation of certain types of investments, such as those measured at NAV, may not reflect the impacts of events such as the pandemic as quickly as those that are measured routinely in liquid markets.

Summary of misstatements – the Federated System

Description	Increase (Decrease) to: Assets	Liabilities	Equity	Net Income
Uncorrected misstatements DB				
None noted.				
Net impact	$ -	$ -	$ -	$ -
Uncorrected misstatements HCT				
Cash and Securities - HCT	2,847,627			
Accounts Payable - HCT		2,847,627		
To reclass negative cash balance to liability				
Net impact	$ 2,847,627	$ 2,847,627	$ -	$ -

Management believes the uncorrected misstatements are immaterial to the financial statements.

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Summary of misstatements – the P&F Plan

Description	Increase (Decrease) to: Assets	Liabilities	Equity	Net Income
Uncorrected misstatements DB				
None noted.				
Net impact	$ -	$ -	$ -	$ -
Uncorrected misstatements HCT				
Cash and Securities - HCT	252,663			
Accounts Payable - HCT		252,663		
To reclass negative cash balance to liability				
Net impact	$ 252,663	$ 252,663	$ -	$ -

Management believes the uncorrected misstatements are immaterial to the financial statements.

Disclosure Adjustments –the System & Plan

Recorded disclosure adjustments	Unrecorded disclosure adjustments
The following is a description of adjustments to disclosures identified during the audit that were made by the Plans: ▪ None noted.	The following is a description of omitted, incomplete or inaccurate disclosures identified during the audit that were not made by the Plans: ▪ None noted.

Other required communications

Professional standards require that we communicate the following matters to you, as applicable.

Going concern matters **– *No issues noted***
Fraud and noncompliance with laws and regulations **– *No issues noted***
Significant deficiencies and material weaknesses in internal control over financial reporting **– *See following slides***
Use of other auditors **– *N/A***
Use of internal audit **– *No issues noted***
Related parties and related party transactions **– *City of San Jose***
Significant unusual transactions **– *None noted***
Disagreements with management **– *No issues noted***
Management's consultations with other accountants **– *N/A***
Significant issues discussed with management **– *No issues noted***
Significant difficulties encountered during the audit **– *No issues noted***
Other significant findings or issues that are relevant to you and your oversight responsibilities **– *No issues noted***
Modifications to the auditor's report **– *N/A***
Other information in documents containing audited financial statements **– *Required Supplementary Information and Other Supplementary Information reviewed as part of the holistic financial statement review process.***

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Quality of accounting practices

Accounting policies

- The significant accounting policies used by the Plans are disclosed in the notes to the financial statements.
- Accounting policies and their application were appropriate and consistently applied.
- There were no changes in significant accounting policies.
- There were no accounting policies unique to the industry.
- We noted no significant unusual transactions, or other significant transactions in controversial or emerging areas of which there is a lack of authoritative accounting guidance or consensus.
- There were no effects of the timing of transactions in relation to the period in which they are recorded.

Accounting estimates

Fair value measurement

The Plans' assets are held by the Custodian - BNYM and management relies on the Custodian (quarterly and annually) as well as the various investment managers' reports in determining fair value of the Plans' investments.

Management has assessed the valuation techniques employed by the Custodian and the investment managers and determined them to be in accordance with GASB Statement No. 72.

Actuarial assumptions

Management makes significant estimates related to the actuarial valuations of the Plans. These valuations are completed by Cheiron and reviewed by management. There are inherent complexities surrounding the inputs, methods, and assumptions to the actuarial valuations of the Plans.

Management has assessed the methods and assumptions employed by Cheiron in the valuation of the pension and OPEB reports and determined them to be in accordance with GASB Statements No. 67/68 and 74/75.

Quality of accounting practices (continued)

Disclosures	▪ We noted completeness of financial statements and disclosures. ▪ We noted overall neutrality and consistency.
Other related matters	None Noted

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 Company'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)

Definitions

The objective of the audit was to report on the financial statements as a whole and not to provide assurance on internal control over financial reporting.

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 entity’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 Company's annual or interim financial statements will not be prevented or detected on a timely basis.

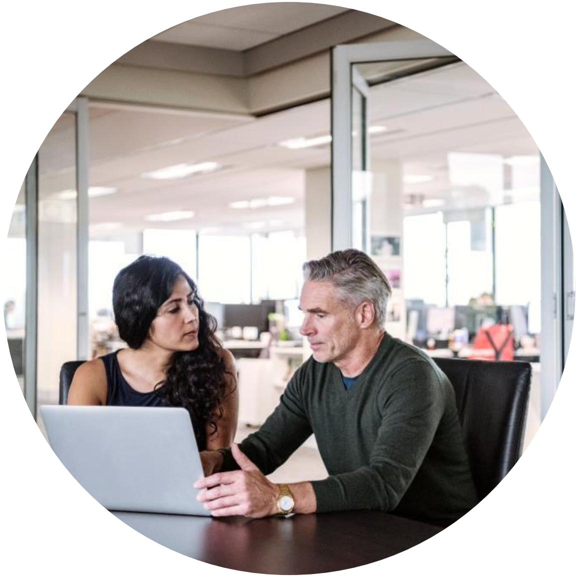
Control deficiencies that are of a lesser magnitude than a significant deficiency will be communicated to management.

Other considerations

Cybersecurity

Internal controls (systems)

Segregation of duties



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Open items as of October 14, 2021

The following items remain open for completion as of October [14], 2021:

Deliverable	Expected date - Federated	Expected date – Police & Fire
Audit Committee presentation	October 21, 2021	October 21, 2021
Management Representation letter	November 4, 2021	November 4, 2021
Issuance of Internal control report	November 4, 2021	November 4, 2021
Issuance of Audit Report	November 4, 2021	November 4, 2021

Other open areas of the audit:

1. Completion of Investment’s testing: Pending Partner/EQR review
2. Completion of Contribution & Benefits Testing : Pending Partner/EQR review
3. Receipt of legal letter
4. Review of actuarial assumptions
5. Completion of detail tie-out of financial statements
6. Review of the City financial statements

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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**
GASB 92 – Omnibus 2020	Periods beginning after June 15, 2021*
GASB 93 – Replacement of Interbank Offered Rates	Periods beginning after June 15, 2020
GASB 96 – Subscription-Based Information Technology Arrangements	Periods beginning after June 15, 2022

* Effective dates vary by topic.

** Reflective of effective date deferrals under GASB 95.

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	Potential Impact

• 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 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).
	• 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 Statement 92, *Omnibus 2020*

Summary	Potential Impact

• Addresses practice issues that have been identified during implementation and application of certain GASB Statements
    • Effective date of GASB 87 and Implementation Guide 2019-3 clarified as fiscal years beginning after December 15, 2019, and all reporting periods thereafter (subsequently updated to periods beginning after June 15, 2021 with GASB 95)
    • Presentation of transfers of capital or financial assets under GASB 48 updated to be consistent with the provisions of GASB 67 and 74, as applicable
    • Modifies the requirements of Statements 73 and 74 to remove the liability recognition provisions
    • Provides exception to the use of acquisition value for AROs in a government acquisition
    • Clarifies that recoveries from reinsurers may, but are not required to be, reported as a reduction of expenses
    • The terms derivative and derivatives in National Council on Government Accounting and GASB pronouncements are replaced with derivative instrument and derivative instruments, respectively
• Effective upon issuance for requirements related to the effective date of GASB 87 and reinsurance recoveries.
• Effective for periods beginning after June 15, 2021, for all other topics, with early adoption encouraged and permitted by topic.
	• The practice issues addressed within this Omnibus are very narrow. Review the clarifications provided for applicability, and update presentation and disclosures, as needed.

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	**Potential Impact**

• 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.
	• For those entities using subscription-based IT arrangements, this standard could have a significant impact on the financial statements of the entity 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
Renaming the Comprehensive Annual Financial Report	Final Statement expected October 2021
Compensated absences – reexamination of Statement 16	Final Statement expected December 2021
Financial Reporting Model - Reexamination of Statements 34, 35, 37, 41 and 46, and Interpretation 6	Final Statement expected 2022
Recognition (conceptual framework)	Final Concepts Statement expected 2022
Prior-period adjustments, accounting changes, and error corrections – a reexamination of Statement 62	Exposure Draft released May 2021: comment period open through August 2021
Disclosure framework (conceptual framework)	Revised Exposure Draft released June 2021: comment period open through October 2021
Omnibus	Exposure Draft released July 2021: comment period open through October 2021
Risks and Uncertainties Disclosures	Exposure Draft expected November 2021
Revenue and Expense Recognition	Exposure Draft expected June 2023

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
- Exposure Draft elements of note (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

- 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.

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 re-deliberations, 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
• Going concern disclosures • Capital assets • Interim financial reporting • Nonfinancial assets

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

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