

CITY OF SAN JOSE

Report to Those Charged With Governance

For the Year Ended June 30, 2024



November 22, 2024

Honorable Mayor and City Council
City of José, California

We are pleased to present this report related to our audit of the basic financial statements of the City of San José, California (City) as of and for the year ended June 30, 2024. This report summarizes certain matters required by professional standards to be communicated to you in your oversight responsibility for the City's financial reporting process.

In addition to the City's basic financial statements, we audit and separately report on the following financial statements as of and for the year ended June 30, 2024. These entities are included in the City's basic financial statements:

- Successor Agency to the Redevelopment Agency of the City of San José;
- San José Mineta International Airport;
- Parks and Recreation Bond Projects Fund;
- Branch Library Bond Projects Fund;
- Library Parcel Tax Special Revenue Fund;
- Pedestrian/Bicycle Facilities Grant;
- Public Safety and Infrastructure Bond Projects Fund;
- San José Clean Energy Enterprise Fund;
- South Bay Water Recycling Program and System;
- Wastewater Treatment System Enterprise Fund; and
- City of San José Deferred Compensation Plans.

We also audit the financial statements of the City sponsored retirement plans, the Federated City Employees' Retirement System and the Police and Fire Department Retirement Plan, collectively, the Retirement Systems. We issue a separate communications report to the respective Boards of the Retirement Systems.

This report is intended solely for the information and use of the Mayor, City Council and management, and is not intended to be, and should not be, used by anyone other than these specified parties. It will be our pleasure to respond to any questions you have about this report. We appreciate the opportunity to continue to be of service to the City.



Walnut Creek, California

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REQUIRED COMMUNICATIONS

Auditing standards generally accepted in the United States of America (AU-C 260, *The Auditor's Communication With Those Charged With Governance*) require the auditor to promote effective two-way communication between the auditor and those charged with governance. Consistent with this requirement, the following summarizes our responsibilities regarding the financial statement audits as well as observations arising from our audits that are significant and relevant to your responsibility to oversee the financial and related compliance reporting process.

Our Responsibilities With Regard to the Financial Statement Audits

Our responsibilities under auditing standards generally accepted in the United States of America and *Government Auditing Standards* have been described to you in our engagement letter dated July 1, 2024. Our audit of the City's financial statements does not relieve management or those charged with governance of their responsibilities, which are also described in that letter.

Overview of the Planned Scope and Timing of the Financial Statement Audits

We conducted our audits consistent with the planned scope and timing in our engagement letter dated July 1, 2024.

Accounting Policies and Practices

Preferability of Accounting Policies and Practices

Under accounting principles generally accepted in the United States of America, in certain circumstances, management may select among alternative accounting practices. In our view, in such circumstances, management has selected the preferable accounting practice.

Adoption of, or Change in, Accounting Policies

Management has the ultimate responsibility for the appropriateness of the accounting policies used by the City. A summary of the significant policies adopted by the City is included in Note I to the financial statements. As described in Note I.E. to the financial statements, the City implemented the Governmental Accounting Standards Board (GASB) Statement No. 100, *Accounting Changes and Error Corrections—an amendment of GASB Statement No. 62*, and requirements of GASB Statement No. 99, *Omnibus 2022*, related to financial guarantees and the classification and reporting of derivative instruments within the scope of GASB Statement No. 53. The implementation of these statements did not have a significant impact on the City's financial statements for the year ended June 30, 2024.

During the year ended June 30, 2024, the City adopted a policy for the establishment of a rate stabilization reserve to allow San José Clean Energy to defer revenues to future years in accordance with GASB Statement No. 62. At June 30, 2024, the deferred inflows of resources - rate stabilization reserve is \$50.0 million.

Significant Accounting Policies

We did not identify any significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.

Significant Unusual Transactions

We did not identify any significant unusual transactions.

Management’s Judgments and Accounting Estimates

Accounting estimates are an integral part of the preparation of financial statements and are based upon management’s current judgment. The process used by management encompasses their knowledge and experience about past and current events, and certain assumptions about future events. You may wish to monitor throughout the year the process used to determine and record these accounting estimates.

The following is summary information about the process used by management in formulating particularly sensitive accounting estimates and about our conclusions regarding the reasonableness of those estimates:

Significant Accounting Estimates	
Measurement of investments at fair value	<p>The City’s investments are accounted for in accordance with the provisions of GASB Statement No. 72, <i>Fair Value Measurement and Application</i>, and accordingly, its fair value measurements are categorized within the fair value hierarchy established by the standard. The following levels indicate the hierarchy of inputs used to measure fair value and the primary valuation methodologies used for financial instruments measured at fair value on a recurring basis:</p> <ul style="list-style-type: none"> ○ Level 1 – Investments whose values are based on quoted prices (unadjusted) for identical assets in active markets that a government can access at the measurement date. ○ Level 2 – Investments whose values are based on inputs – other than quoted prices including prices included within level 1 – that are observable for an asset, either directly or indirectly. ○ Level 3 – Investments whose values are based on unobservable inputs for an asset and may require a degree of professional judgment. <p>MGO compared investment values from quoted market information and using pricing applications and models obtained from the custodian bank, fiscal agents or other sources and determined that they were reasonable.</p>
Estimated allowance for losses on accounts receivable	<p>Estimated allowance for losses on accounts receivable was based on historical experience.</p> <p>MGO evaluated the methodologies and assumptions used in estimating the allowance for losses and tested subsequent cash receipts of significant accounts receivable.</p>
Estimated allowance for losses on loans receivable	<p>Estimated allowance for loans receivable is comprised of an allowance for risk and an allowance for present value discount. The allowance for risk was based on the consideration of the changes in the portfolio character, evaluation of current economic conditions and such other factors that, in management’s judgment, deserve recognition in estimating potential loan losses. The allowance for risk takes into consideration maturity dates, interest rates, and other relevant factors. The allowance for present value discount gives recognition to the economic cost of providing loans at interest rates below market and</p>

	<p>represents management’s estimate of the present value of projected net cash flows to the City from the loan portfolio.</p> <p>MGO evaluated the methodologies and assumptions used in estimating the allowance and determined whether they are consistent with the City’s Loan Loss Reserve Policies and Procedures and performed analytical procedures to determine the estimated allowance for losses was reasonable.</p>
Depreciation and amortization of capital assets, including depreciation/amortization methods and useful lives assigned to depreciable/amortizable property	<p>Useful lives, or in the case of intangible right-to-use lease and subscription-based information technology arrangement assets, the shorter of useful lives or the lease/subscription term, for depreciable/amortizable capital assets were determined by management based on the nature of the capital asset. Depreciation/amortization was calculated based on the straight-line method.</p> <p>MGO assessed the reasonableness of the useful lives based on the nature of the capital assets and performed substantive analytical procedures on depreciation/amortization expense and determined the estimates were reasonable.</p>
Accrual of compensated absences	<p>Accrual of compensated absences was based on accrued eligible hours of vacation, sick leave and other compensatory time at current pay rates for eligible employees.</p> <p>MGO agreed the unused hours and pay rates at year-end to payroll reports and recalculated the reported balances to determine they were reasonable.</p>
Accrual and disclosure of self-insurance claims liabilities	<p>Estimated liabilities for workers’ compensation claims were based on management’s estimate obtained from information derived from Intercare’s (a third-party administrator) claims database system adjusted for a discounted projection of the ultimate cost of known claims and unreported claims at 1.5%. Estimated liabilities for general liability and other claims were determined by the City Attorney’s judgment about the ultimate outcome of the claims.</p> <p>MGO evaluated the methodologies and assumptions used to develop the workers’ compensation claims estimate through data testing. For general liability and other claims, MGO obtained legal confirmation and obtained evidence relevant to the period in which the underlying cause for legal action occurred, the degree of probability of an unfavorable outcome and the amount or range of potential loss.</p>
Accrual and disclosure of pollution remediation obligations	<p>Accrual and disclosures of pollution remediation obligations were determined by the City’s engineers and its environmental consultants’ judgments about the ultimate outcome of the obligations.</p> <p>MGO evaluated the methodologies and assumptions used to develop the obligations, reviewed the assumptions used for reasonableness, and determined whether the estimate is supported and reasonable.</p>
Measurement of the pension contributions, net	<p>Pension plans’ employer and employee contributions requirements, net pension liability, and related deferred outflows and inflows of resources</p>

<p>pension liability, pension expense, and pension-related deferred outflows and inflows of resources</p>	<p>were based on actuarial valuations prepared by the City’s Retirement Systems and CalPERS.</p> <p>MGO agreed the calculations to actuarial valuations prepared by the Retirement Systems and CalPERS and tested the reasonableness of allocations to various City funds.</p>
<p>Measurement of the other postemployment benefits (OPEB) contributions, net OPEB liability, OPEB expense and OPEB-related deferred outflows and inflows of resources</p>	<p>OPEB plans’ employer and employee contributions requirements, net OPEB liability, and related deferred outflows and inflows of resources were based on actuarial valuations prepared by the City’s Retirement Systems.</p> <p>MGO agreed the calculations to actuarial valuations prepared by the City’s Retirement Systems and tested for reasonableness the allocations to various City funds</p>
<p>Discount rate used for the calculation of the lease and PPP receivables, and the lease and subscription liabilities</p>	<p>The discount rate used for the calculation of the lease and PPP receivables, and the lease and subscription liabilities are based on the City’s estimated incremental borrowing rate using the national average fixed-rate loan index on the date of commencement</p> <p>MGO evaluated the methodologies and assumptions used in making the accounting estimate and performed substantive procedures to determine that the discounted value was reasonable.</p>
<p>Rate stabilization reserve deferral for San José Clean Energy</p>	<p>The City adopted a policy for the establishment of a rate stabilization reserve to allow San José Clean Energy to defer revenues to future years in accordance with GASB Statement No. 62. The reserve is funded and a matching amount of cash is restricted. The reserve amount may periodically be adjusted based on the criteria stated in the policy.</p> <p>MGO evaluated the methodologies and assumptions used in estimating the reserve amount and determined whether they are consistent with the City’s reserve policy and performed analytical procedures to determine whether the estimate is supported, reasonable, and calculated in accordance with the City’s reserve policy.</p>

Audit Adjustments and Uncorrected Misstatements

Professional standards require us to communicate to you all material, corrected misstatements that were brought to the attention of management as a result of our audit procedures. There were no corrected misstatements identified by us as a result of our audit procedures.

Uncorrected misstatements or matters underlying these uncorrected misstatements could potentially cause future-period financial statements to be materially misstated, even if we have concluded that the uncorrected misstatements are immaterial to the financial statements under audit. We are not aware of any uncorrected misstatements other than misstatements that are clearly trivial.

Other Information Included in Annual Comprehensive Financial Report

Our responsibility for other information included in the annual comprehensive financial report is to read the information and consider whether its content or the manner of its presentation is materially inconsistent with the basic financial information covered by our auditor's report, whether it contains a material misstatement of fact or whether the other information is otherwise misleading. We read the City's introductory and statistical sections. We did not identify material inconsistencies with the audited basic financial statements.

Observations About the Audit Process

Disagreements With Management

We encountered no disagreements with management over the application of significant accounting principles, the basis for management's judgments on any significant matters, the scope of the audit or significant disclosures to be included in the City's financial statements.

Consultations With Other Accountants

We are not aware of any consultations management had with other accountants about accounting or auditing matters.

Significant Issues Discussed With Management

No significant issues arising from the audit were discussed or were the subject of correspondence with management.

Significant Difficulties Encountered in Performing the Audit

We did not encounter any significant difficulties in dealing with management during the audit.

Difficult or Contentious Matters That Required Consultation

We did not encounter any significant and difficult or contentious matters that required consultation outside the engagement team.

Shared Responsibilities for Independence

Independence is a joint responsibility and is managed most effectively when management, audit committees (or their equivalents), and audit firms work together in considering compliance with American Institute of Certified Public Accountants (AICPA) and *Government Accountability Office* (GAO) independence rules. For MGO to fulfill its professional responsibility to maintain and monitor independence, management, the Mayor and City Council, and MGO each play an important role.

Our Responsibilities

1. AICPA and GAO rules require independence both of mind and in appearance when providing audit and other attestation services. MGO is to ensure that the AICPA and GAO's General Requirements for performing non-attest services are adhered to and included in all letters of engagement.
2. Maintain a system of quality management over compliance with independence rules and firm policies.

The City's Responsibilities

1. Timely inform MGO, before the effective date of transactions or other business changes, of the following:
 - a. New affiliates, directors, or officers.
 - b. Changes in the organizational structure or the reporting entity impacting affiliates such as subsidiaries, partnerships, related entities, investments, joint ventures, component units, and jointly governed organizations.
2. Provide necessary affiliate information such as new or updated structure charts, as well as financial information required to perform materiality calculations needed for making affiliate determinations.
3. Understand and conclude on the permissibility, prior to the City and its affiliates, officers, directors, or persons in a decision-making capacity, engaging in business relationships with MGO.
4. Not entering into arrangements of nonaudit services resulting in MGO being involved in making management decisions on behalf of the City.
5. Not entering into relationships resulting in close family members of MGO covered persons, temporarily or permanently acting as an officer, director, or person in an accounting, financial reporting or compliance oversight role at the City.

Management Representations

We have requested certain written representations from management, which are included in the management representation letter dated November 22, 2024.

Internal Control and Compliance Matters

We have separately communicated on internal control and compliance over financial reporting identified during our audit of the financial statements, as required by *Government Auditing Standards*.

The financial and compliance audit of the City's major federal awards in accordance with the *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards at 2 CFR 200* (Uniform Guidance) is in process and will be issued no later than March 31, 2025.

EXHIBIT A

Recent Accounting Pronouncements

RECENT ACCOUNTING PRONOUNCEMENTS

The following accounting pronouncements have been issued as of the date of this communication but are not yet effective and may affect the future financial reporting by the City.

Pronouncement	Summary
<p>GASB Statement No. 101, <i>Compensated Absences</i></p>	<p>The objective of this statement is to better meet the information needs of financial statement users by updating the recognition and measurement guidance for compensated absences. That objective is achieved by aligning the recognition and measurement guidance under a unified model and by amending certain previously required disclosures.</p> <p>Statement No. 101 is effective for the City’s financial statements for the year ending June 30, 2025.</p>
<p>GASB Statement No. 102, <i>Certain Risk Disclosures</i></p>	<p>The objective of this statement is to provide users of government financial statements with essential information about risks related to a government’s vulnerabilities due to certain concentrations or constraints.</p> <p>Statement No. 102 is effective for the City’s financial statements for the year ending June 30, 2025.</p>
<p>GASB Statement No. 103, <i>Financial Reporting Model Improvements</i></p>	<p>The objective of this statement is to improve key components of the financial reporting model to enhance its effectiveness in providing information that is essential for decision making and assessing a government’s accountability. This statement also addresses certain application issues.</p> <p>Statement No. 103 are effective for the City’s financial statements for the year ending June 30, 2026.</p>
<p>GASB Statement No. 104, <i>Disclosure of Certain Capital Assets</i></p>	<p>The objective of this statement is to establish requirements for certain types of capital assets to be disclosed separately for purposes of note disclosures, and to establish requirements for capital assets held for sale and note disclosures for those capital assets.</p> <p>Statement No. 104 are effective for the City’s financial statements for the year ending June 30, 2026.</p>