PORT OF OAKLAND

Report to Board of Port Commissioners
Year ended June 30, 2018

MGO Certified Public Accountants

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Public
Accountants

Board of Port Commissioners
of the Port of Oakland, California
Oakland, California

In planning and performing our audit of the financial statements of the Port of Oakland, California (Port) as of and for the year ended June 30, 2018, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, we considered the Port's internal control over financial reporting (internal control) 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 Port's internal control. Accordingly, we do not express an opinion on the effectiveness of the Port's internal control.

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 and correct, misstatements on a timely basis. 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 the entity's financial statements will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses. Given these limitations during our audit, we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Professional standards also require that we communicate to you the information related to our audit that is included in the Required Communications section of this report. The Current Year Comments and Responses section includes pronouncements issued by the Governmental Accounting Standards Board (GASB) that may have significant impacts to the Port's financial statements in future years. We have also provided a status of our prior year comments in the Status of Prior Year Comments section.

The Port's responses to the comments identified in our audit are described in the accompanying schedule of current year comments and responses. We did not audit the Port's responses and, accordingly, we express no opinion on them. We will review the status of the comments during our next audit engagement. We have already discussed the comments and suggestions with various Port personnel, and we will be pleased to discuss them in further detail at your convenience, to perform any additional study of the matter, or to assist you in implementing the suggestions.

This communication is intended solely for the information and use of the Board of Port Commissioners, management, and others within the Port, and is not intended to be, and should not be, used by anyone other than these specified parties.

Macias Gini & O'Connell LLP
Walnut Creek, California
December 7, 2018

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Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards, *Government Auditing Standards*, and the Uniform Guidance, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our FY 2018 Audit Service Plan dated July 9, 2018. Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Matters

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the Port are described in Note 2 to the financial statements. As described in Note 2 to the financial statements, the Port changed accounting policies related to other postemployment benefits (OPEB), debt, and interest costs by adopting Statement of Governmental Accounting Standards (GASB Statement) No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, No. 85, *Omnibus 2017*, No. 86, *Certain Debt Extinguishment Issues*, and No. 89, *Accounting for Interest Cost Incurred before the End of the Construction Period*. The implementation of the provisions of GASB Statement No. 75 resulted in the Port restating and reducing its net position on July 1, 2017 by $84,505,000 to record the beginning net OPEB liability of $109,884,000, the beginning deferred outflows of resources of $15,400,000, and reverse the previously recognized OPEB liability of $9,979,000. The adoption of the other GASB Statements did not have a significant impact on the Port's financial statements.

We noted no transactions entered into by the Port during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the Port's financial statements and management's bases for the estimates are listed below.

1. Fair value measurements of investments were based on quoted prices in active markets or other observable market or industry inputs.
2. Allowance for losses on customer accounts receivable is based on historical collection activity.
3. Depreciation estimates for capital assets are calculated under the straight-line method using estimated useful lives of the assets based on the nature of the depreciable assets.
4. Estimated claims liabilities and pollution remediation costs are based on valuations from Port personnel and external consultants.
5. Workers' compensation liability is based on an actuarial valuation using historical loss and other data.
6. The net pension and OPEB liabilities, contributions, expenses, and other related balances are based on actuarial information provided by the California Public Employees' Retirement System (CalPERS) and actuarial valuations performed by the Port's actuaries.

7. Allocation of costs to construction projects is based on a methodology developed in accordance with the Code of Federal Regulations Title 2 Part 200 *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance).

We evaluated the key factors and assumptions used to develop these estimates in determining that it is reasonable in relation to the financial statements taken as a whole.

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the financial statements and the related notes to the financial statements were:

1. Fair value measurements of investments are disclosed in Note 3.
2. Estimated claims liabilities and pollution remediation costs are disclosed in Note 13.
3. Workers' compensation liability is disclosed in Note 14.
4. Net pension and OPEB liabilities are disclosed in Notes 9 and 10, respectively.

The financial statement disclosures are neutral, consistent, and clear.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to the Port's financial statements taken as a whole.

Disagreements with Management

For purposes of this letter, a disagreement with management is a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated December 7, 2018.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a “second opinion” on certain situations. If a consultation involves application of an accounting principle to the Port’s financial statements or a determination of the type of auditor’s opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Port’s auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Other Matters

We applied certain limited procedures to management’s discussion and analysis, the schedule of proportionate share of the net pension liability, the schedule of pension contributions, the schedule of changes in the net OPEB liability and related ratios, the schedule of OPEB contributions, and the schedule of funding progress – other postemployment benefits, which are required supplementary information (RSI) that supplements the basic financial statements. Our procedures consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management’s responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We did not audit the RSI and do not express an opinion or provide any assurance on the RSI.

We were engaged to report on the schedule of revenues and expenses by business line, the schedule of expenditures of federal awards, the passenger facility charge cash receipts, cash disbursements, and interest by quarter, and the schedule of customer facility charge cash receipts and cash disbursements, which either accompany the financial statements or are separately presented, but are not RSI. With respect to this supplementary information, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

We were not engaged to report on the introductory and statistical sections, which accompany the financial statements but are not RSI. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

2018-001 GASB Statement No. 84 *Fiduciary Activities*
Informational Comment

Fiduciary activities involve a government taking care of assets that belong to individuals or other entities outside of the government itself. GASB Statement No. 84, *Fiduciary Activities*, establishes guidance regarding what constitutes fiduciary activities for accounting and financial reporting purposes, the recognition of liabilities to beneficiaries, and how fiduciary activities should be reported.

For activities that are not pension plans or OPEB plans, the focus of the criteria generally is on (1) whether a government is controlling the assets of the fiduciary activity and (2) the beneficiaries with whom a fiduciary relationship exists. The activity must meet all of the following criteria to be considered a fiduciary activity:

1. The assets are controlled by the government.
2. The assets are not derived solely from the government's own-source revenues or from government-mandated nonexchange transactions, or voluntary nonexchange transactions.
3. The assets have one or more of the following characteristics:
    a. The assets are (a) administered through a trust in which the government itself is not a beneficiary, (b) dedicated to providing benefits to recipients in accordance with the benefit terms, and (c) legally protected from the creditors of the government.
    b. The assets are for the benefit of individuals and the government does not have administrative involvement with the assets or direct financial involvement with the assets. In addition, the assets are not derived from the government's provision of goods or services to those individuals.
    c. The assets are for the benefit of organizations or other governments that are not part of the financial reporting entity. In addition, the assets are not derived from the government's provision of goods or services to those organizations or other governments.

Separate criteria are included to identify fiduciary component units and postemployment benefit arrangements that are fiduciary activities.

The statement is effective for fiscal years beginning after December 15, 2018.

Management Response:
Port staff are currently evaluating the provisions of GASB Statement No. 84, *Fiduciary Activities* (GASB 84) for applicability to the Port's deferred compensation plan and will review other financial arrangements that GASB 84 could impact. At this time, Port staff does not feel GASB 84 will have an impact on the Port's financial statement reporting requirements, but will make a final determination after GASB publishes its implementation guide.

2017-001 GASB Statement No., 87 *Leases*
Informational Comment

In June 2017, GASB issued Statement No. 87, *Leases* (GASB 87). The objective of GASB 87 is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. This statement increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities.

The requirements of this statement are effective for reporting periods beginning after December 15, 2019. Application of this statement is effective for the Port's fiscal year ending June 30, 2021. This new standard represents a significant change to the accounting and financial reporting of certain types of leases. We recommend the Port identify all of its lease contracts and assess the impact of the required accounting and reporting changes.

Status:
Port staff will begin evaluating lease contracts for applicability of GASB 87 this calendar year 2019 and plan to prepare a draft analysis of the expected impact on the Port's financial statement reporting by the end of the calendar year 2019. The analysis is expected to be completed prior to the development of the Port's fiscal year 2021 budget and will provide Port staff with ample time to implement procedures for collecting information necessary for the implementation of GASB 87 for the Port's June 30, 2021 financial statements.

2017-002 Risk Assessment
Informational Comment

With potential changes in business processes and controls resulting from the significant system upgrades, as well as new federal grant compliance requirements under the Uniform Guidance, continuing legislative and funding changes, current economic conditions, and future GASB implementations, the Port is exposed to various risks in operational effectiveness and efficiency, accurate financial reporting and compliance with laws and regulations.

We recommend that the Port perform an updated risk assessment considering the objectives of the COSO *Internal Control-Integrated Framework* (Framework), which is the common framework against which internal control systems can be assessed and improved. The Framework establishes five elements of internal control that the Port should consider at the entity-wide level identifying the pervasive risks affecting the Port: (1) Control Environment; (2) Risk Assessment; (3) Control Activities; (4) Information and Communication; and (5) Monitoring. These risks may include the Port's financial reporting information system and related subsidiary systems, changes in fiscal policies and federal and state regulations. The Port should also inventory and evaluate each of its critical business cycles/processes (e.g. revenue/cash receipts, expenses/cash disbursements, grants management, etc.) under the element of Control Activities and consider risks related to staff turn-over and institutional knowledge loss, adequacy of staffing levels to mitigate errors in financial reporting and noncompliance, and efficiency and effectiveness of processes due to changes in laws, regulations and technology.

Status:
Port staff agrees with this recommendation. In March 2018 the Port completed an upgrade of the Port's Enterprise Resource Planning (ERP) system and implemented process changes identified to increase internal controls or improve efficiency. In December 2018 the Port substantially completed a transition to a new banking provider, which also resulted in minor process changes. Therefore, Port staff feel that calendar year 2019 is the appropriate time to perform an updated risk assessment and inventory critical business processes.

2015-002 New Other Postemployment Benefits Accounting Standard
Informational Comment

Postemployment benefits other than pensions (OPEB) principally involve health care benefits, but also may include life insurance, disability, legal and other services. In June 2015, the GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, which is effective for the fiscal year ended June 30, 2018.

The Port should begin assessing the impacts of the new OPEB standards and develop a plan to implement the new accounting and financial reporting requirements. In addition, the Port should work closely with its OPEB administrator, actuaries, and auditors to ensure that all relevant parties are involved in the process that ultimately affect its successful implementation.

Status:
The Port adopted the provisions of this statement as of July 1, 2017.