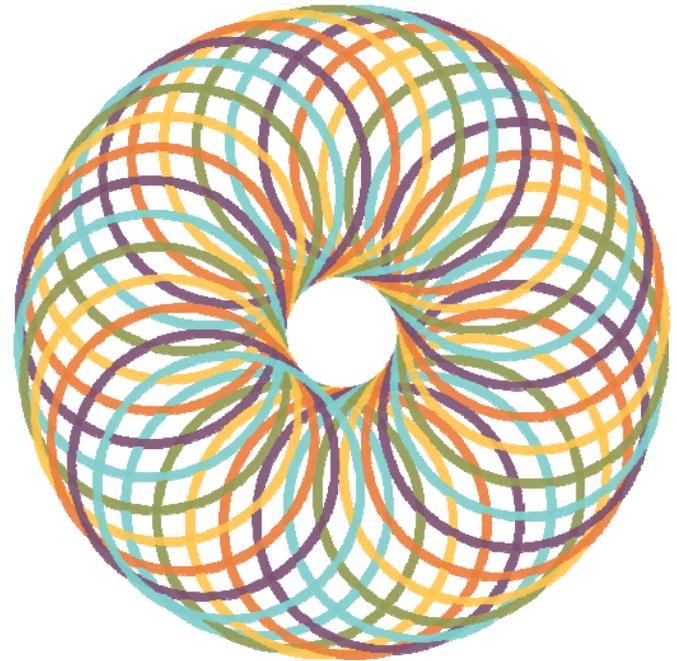


# Deloitte.

City of Austin, Texas —  
Report to the Audit and Finance  
Committee for the year ended  
September 30, 2016

Deloitte & Touche LLP  
March 29, 2017



This report is intended solely for the information and use of the Audit and Finance Committee of the City Council, management, and others in the City. It is not intended to be and should not be used by anyone other than these specified parties.

# Contents

Report on the Basic Financial Statements	3
Other Reports Issued	8
Required Communications	10
Significant Accounting Policies	13
Accounting Estimates	15
Material Audit Adjustments, Uncorrected Misstatements, and Disclosure Items Passed	17
Control-Related Matters	19
Additional Matters	22
Appendices	24

# Report on the Basic Financial Statements

# Report on the Basic Financial Statements

- We have performed an audit of the Comprehensive Annual Financial Report (“CAFR”) of the City of Austin, Texas (the “City”), as of and for the year ended September 30, 2016, in accordance with auditing standards generally accepted in the United States of America (“GAAS”) and *Government Auditing Standards* (“GAS”).
- As a part of this audit process, we have issued an unmodified (clean) opinion, dated March 10, 2017, on the FY 2016 CAFR.
- We have prepared the following comments to assist you in fulfilling your obligation to oversee the financial reporting and disclosure process for which management of the City is responsible.

# Audit Scope

- Our responsibilities under GAAS are outlined in our contract dated June 5, 2013 (renewed on June 1, 2016) and were not restricted in any manner.
- No significant changes resulted from the execution of the external audit plan
- Our auditing procedures addressed the areas of focus identified in our external audit plan dated February 1, 2017; these areas included:
  - Calculations of deferred depreciation and deferred contributions as well as the effect of any changes in the rate-setting process for regulated operations accounting (*Governmental Accounting Standards Board (“GASB”) Statement No. 62, formerly Financial Accounting Standards Board (“FASB”) Statement No. 71*)
  - Management override of controls (*American Institute of Certified Public Accountants (“AICPA”) AU-C 240*)

## Audit Scope (continued)

- We did not audit the financial statements of certain discretely presented component units (Austin Bergstrom Landhost Enterprises, Inc. and Austin Convention Enterprises, Inc.)
  - Represents 100% of the assets and net position, and 99.8% of revenues of the discretely presented component units
  - Those statements were audited by other auditors whose reports, one of which (Austin Bergstrom Landhost Enterprises) contains an emphasis of matter paragraph related to a going concern issue, have been furnished to us, and our opinion, insofar as it relates to the amounts included for the discretely presented component units, is based solely on the reports of the other auditors

# Unaudited Information

- When audited financial statements are included in documents containing other unaudited information such as certain information in the City's CAFR, we read the unaudited information and consider whether it, or the manner of its presentation, is materially inconsistent with the information in the financial statements audited by us.
- We have read the other information in the City's CAFR and inquired as to the methods of measurement and presentation of such information. We did not note any material inconsistencies or obtain knowledge of a material misstatement of fact in the other information.

# Other Reports Issued

# Other Reports Issued

## Issued reports

- Texas Commission on Environmental Quality (“TCEQ”) Agreed-Upon Procedures report

## To be issued – April 2017

- Report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with GAS
- Single Audit Report, which includes:
  - A report on compliance with requirements that could have a direct and material effect on each major federal program and on internal control over compliance in accordance with Uniform Grant Guidance (“UGG”)
  - A report on compliance with requirements that could have a direct and material effect on each major state program and on internal control over compliance in accordance with and State of Texas Uniform Grants Management Standards (“UGMS”)
- Report on compliance with requirements applicable to the Passenger Facility Charge program and internal control over compliance in accordance with requirements issued by the Federal Aviation Administration

# Required Communications

# Required Communications

Generally accepted auditing standards require that certain additional matters be communicated to an entity's audit committee in connection with the performance of an audit:

- **Auditor's responsibility under GAAS and GAS** – The objective of a financial statement audit is to express an opinion on the fairness of the presentation of the City's financial statements for the year ended September 30, 2016, in conformity with accounting principles generally accepted in the United States of America ("generally accepted accounting principles"), in all material respects. Our responsibilities under GAAS and GAS include forming and expressing an opinion about whether the financial statements that have been prepared by management with the oversight of the Audit Committee are presented fairly, in all material respects, in conformity with generally accepted accounting principles.
- **The audit of the financial statements does not relieve management or the Audit and Finance Committee of their responsibilities.**

*(continued on next slide)*

## Required Communications (continued)

Generally accepted auditing standards require that certain additional matters be communicated to an entity's audit committee in connection with the performance of an audit (continued):

- **An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements.** The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether caused by fraud or error. In making those risk assessments, we considered internal control over financial reporting relevant to the City's preparation and fair presentation of the financial statements in order to design audit procedures that were appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting.
- **Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.** Our consideration of internal control over financial reporting was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses.

# Significant Accounting Policies

# Significant Accounting Policies

- The City's significant accounting policies are set forth in Note 1 to the City's FY 2016 CAFR.
- We are not aware of any significant changes in previously adopted accounting policies or their application during the year ended September 30, 2016.
- We have evaluated the significant qualitative aspects of the City's accounting practices, including accounting policies, accounting estimates and financial statement disclosures and concluded that these practices are appropriate, adequately disclosed, and consistently applied by management.

# Accounting Estimates

# Accounting Estimates

- Accounting estimates are an integral part of the financial statements prepared by management and are based on management's current judgments.
  - Those judgments are ordinarily based on knowledge and experience about past and current events and on assumptions about future events.
- Our assessment of the significant qualitative aspects of the City's particularly sensitive accounting estimates has been attached to this presentation as Appendix A
  - Annual required contribution to the City's other postemployment benefit plan
  - Net pension liabilities and related balances
  - Nuclear decommissioning liability
  - Fair value of derivatives
  - Deferred amounts related to accounting for regulated operations

Material Audit Adjustments,  
Uncorrected Misstatements, and  
Disclosure Items Passed

## Material Audit Adjustments, Uncorrected Misstatements, and Disclosure Items Passed

- Our audit of the financial statements was designed to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud.
- The following material misstatements were brought to the attention of management as a result of our audit procedures and were corrected by management during the current period:
  - The City did not record an asset and a related deferred inflow of resources for the annual installment payments as part of the Consolidated Rent-A-Car Center (“CONRAC”) service concession arrangement (\$12.6M). There was no impact on net position.
  - The City did not properly reflect the deferred inflow of resources related to CONRAC as "related debt" in the Net Investment in Capital Assets calculation (\$146.5M). There was no impact on total net position.
- We have attached to this presentation, as Appendix B, a summary of uncorrected misstatements that we presented to management during the current audit engagement that were determined by management to be immaterial, both individually and in the aggregate, to the financial statements taken as a whole.
- There were no passed disclosure items noted in the current year.

# Control-Related Matters

# Definitions of a deficiency, significant deficiency, and material weakness

<b>Deficiency</b>	<p><i>A deficiency in internal control over financial reporting</i> exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A deficiency in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in operation exists when a properly designed control does not operate as designed, or when the person performing the control does not possess the necessary authority or competence to perform the control effectively.</p>
<b>Significant deficiency</b>	<p><i>A significant deficiency</i> is a deficiency, or combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.</p>
<b>Material weakness</b>	<p><i>A material weakness</i> is a deficiency, or combination of deficiencies, in internal control over financial reporting, 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.</p>

# Internal Controls

- No material weaknesses noted in connection with our audit of the CAFR as of and for the year ended September 30, 2016.
- We have identified the following matters involving the City's internal control over financial reporting that we consider to be significant deficiencies under generally accepted auditing standards:
  - Management did not properly apply all aspects of GASB Statement No. 60 for the City's service concession arrangement entered into for the purpose of building the CONRAC.
  - Management's review of the calculation of deferred depreciation for Austin Water Utility was not performed in sufficient detail to identify errors in the calculation.
- Management concurs with the recommendations related to the findings above.
- Note that the audit of federal and state awards is on-going, therefore, this listing does not include any potential findings Deloitte & Touche LLP may have in connection with the Single Audit report.

# Additional Matters

# Upcoming GASB Statements

## Effective for fiscal year 2017

- GASB Statement No. 74, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans
- GASB Statement No. 77, Tax Abatement Disclosures
- GASB Statement No. 78, Pensions Provided through Certain Multiple Employer Defined Benefit Pension Plans
- GASB Statement No. 80, Blending Requirements for Certain Component Units – An Amendment of GASB Statement No. 14

## Effective for future years

- GASB Statement No. 75, Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions, effective 2018
- GASB Statement No. 81, Irrevocable Split-Interest Agreements, effective 2018
- GASB Statement No. 83, Certain Asset Retirement Obligations, effective 2019
- GASB Statement No. 84, Fiduciary Activities, effective 2020
- GASB Statement No. 85, Omnibus 2017, effective 2018

# Appendices

# Appendices

A. Audit procedures related to significant judgments and estimates

B. Summary of Uncorrected Misstatements

C. Representations from Management

# Appendix A — Significant Judgments and Estimates

## Annual required contribution to City's other postemployment benefit plan

Management's methodology	Audit procedures
<ul style="list-style-type: none"><li>• Management engages an actuary to perform a valuation with the objective of estimating the unfunded actuarial accrued liability (UAAL) and the annual required contribution (ARC) for the City's other postemployment benefit plan.</li><li>• With data provided by the City on the plan participants and with management's oversight, the actuary makes certain assumptions about the plan participants, discount rate, mortality, rate of salary increases, inflation rate, and healthcare costs trends to develop the estimated UAAL and ARC.</li><li>• This valuation is performed biennially and projected forward to the off years as permitted by GAAP. A new valuation dated October 1, 2014 was performed for fiscal year 2015. An updated valuation was not done for fiscal year 2016.</li></ul>	<ul style="list-style-type: none"><li>• Performed data analysis procedures and testing of the census data used by the actuary to develop the assumptions and estimates</li><li>• Involved Deloitte actuarial specialists in the evaluation of the City's actuarial valuation, including the calculations and the reasonableness of assumptions</li><li>• Tested a sample of claims expenses to determine if they were for eligible plan participants</li><li>• Reviewed the related disclosures of the assumptions and the estimated UAAL and ARC for accuracy and consistency with the actuarial study and GAAP requirements</li><li>• Management's methodology and resulting amounts were deemed reasonable.</li></ul>

# Appendix A — Significant Judgments and Estimates

## Net pension liability and related balances for City's participation in three pension plans

### Management's methodology

- Management obtained information from the three pension plans including actuarial valuations, audited plan financial statements, and census data.
- After evaluating the information received from the three plans, management used the information to calculate the balances that needed to be recorded in the current year based on a measurement date of December 31, 2015.
- The net pension liability, pension expense, and the related balances were allocated to the funds using annual contributions made by each fund during the measurement period.

### Audit procedures

- Agreed the total pension liability and fiduciary net position as well as certain disclosures from the audited plan financial statements to the City's disclosures
- Involved Deloitte actuarial specialists in the evaluation of the plans' actuarial valuations, including the calculations and the reasonableness of assumptions
- Tested a sample of employer contributions to determine if they were properly calculated and for eligible plan participants. Also, tested management's allocation of the pension balances to the funds, which was based on contributions
- Either analyzed and tested the census data used by the plans' actuaries or obtained an audited schedule of pension amounts from the respective plan to gain sufficient audit evidence of the accuracy and completeness of the census data used in the valuation
- Management's methodology and resulting amounts were deemed reasonable.

# Appendix A — Significant Judgments and Estimates

## Nuclear decommissioning liability

Management's methodology	Audit procedures
<ul style="list-style-type: none"><li>• Management developed the estimated decommissioning liability by applying the latest escalation factors (specifically energy, waste burial, and public utility employee inflation rates) to the costs first estimated in 2008 and updated annually.</li></ul>	<ul style="list-style-type: none"><li>• Recalculated management's application of the latest escalation factors to the cost estimates.</li><li>• Agreed the escalation factors used to the third-party sources.</li><li>• Understood the qualifications of and evaluated whether there are any conflicts with the company performing decommissioning cost estimates and the time period that the nuclear power plant is expected to operate (rollforward procedure as no new study performed for FY16).</li><li>• Management's methodology and resulting amounts were deemed reasonable.</li></ul>

# Appendix A — Significant Judgments and Estimates

## Fair value of derivatives

Management's methodology	Audit procedures
<ul style="list-style-type: none"><li>• Management determined the fair value of natural gas derivatives using NYMEX closing settlement prices or Black/Scholes valuation method using implied volatility based on NYMEX closing settlement prices and various other factors.</li><li>• Management determined the fair value of congestion revenue rights is determined using the implied market value (difference between future proxy sink price and source price).</li><li>• Management determined the fair value of interest rate swaps using independent pricing services.</li><li>• All methods include adjustments for the risk of non-performance by either the City of the counterparty to the derivative.</li></ul>	<ul style="list-style-type: none"><li>• Obtained the valuations performed by specialists for a sample of natural gas, congestion revenue rights, and interest rate swaps and agreed the amount determined by management's specialist to the amount recorded.</li><li>• Involve our own pricing specialists to perform a valuation of a sample of these derivatives to determine a reasonable range for the fair value as of the balance sheet date.</li><li>• Management's methodology and resulting amounts were deemed reasonable.</li></ul>

# Appendix A — Significant Judgments and Estimates

## Deferred amounts related to accounting for regulated operations

### Management's methodology

- Management considers the rate setting process and estimates the amount of costs that will be recovered in the future and costs that have been collected in advance through calculations that compare debt outstanding to the net book value of depreciable capital assets purchased with debt.
- In addition, management evaluates certain costs that have not been included in the rate setting process. This includes other key estimates such as nuclear decommissioning, pensions and other post employment benefits costs, and unrealized gains and losses on investments and derivatives.
- Management evaluates certain estimates by projecting them forward to determine if the amounts will amortize to zero over time if no other transactions that affected the deferred amounts occurred.

### Audit procedures

- Understood any changes to management's rate setting process and tested that the City continued to meet the criteria defined by GAAP
- Gained an understanding of the costs that will be recovered in the future and costs recovered in advance and tested the completeness of management's identification of such costs
- Tested the amortization period of deferred regulatory costs model
- Tested estimates that were significant to the calculation, specifically nuclear decommissioning, pensions and other post employment benefits costs, and investments and derivatives
- Considered the consistency of the application of GAAP, as applicable to the City
- Management's methodology and resulting amounts were deemed reasonable, except for the Austin Water Utility adjustment noted in Appendix B.

# Appendix B — Uncorrected Misstatements

## Governmental Activities

City of Austin, Texas  
 Summary of Uncorrected Misstatements  
 Year Ended September 30, 2016

### Impact of Uncorrected Misstatements on Financial Statements

Only items that meet the materiality threshold for this fund are included on this schedule.

Governmental Activities (in 000's)	As Reported at 9/30/2016	Fiscal Year 2016 Adjustments	If Adjusted at 9/30/2016
Assets and Deferred Outflows	\$ 4,050,641	1,535	\$ 4,052,176
Liabilities and Deferred Inflows	3,417,737		3,417,737
Net Position	632,904	1,535	634,439
Total Liabilities and Net Position	\$ 4,050,641	1,535	\$ 4,052,176
Revenues	\$ 1,238,870	-	\$ 1,238,870
Expenses	(1,389,854)	3,810	(1,386,044)
Transfers In (Out) - net	121,838	-	121,838
Change in Net Position	(29,146)	3,810	(25,336)
Beginning Net Position	662,050	(2,275)	659,775
Ending Net Position	\$ 632,904	1,535	\$ 634,439

### Uncorrected Misstatements Related to Current Year

	Debit	Credit
Known		
Beginning Net Position	\$ 2,275	
Deferred outflows of resources	\$ 1,535	
Pension Expense		\$ (3,810)
<i>To correct pension expense for prior year allocation error and for the effect of change in proportionate share between funds</i>		

# Appendix B — Uncorrected Misstatements

## Austin Water Utility

City of Austin, Texas  
 Summary of Uncorrected Misstatements  
 Year Ended September 30, 2016

### Impact of Uncorrected Misstatements on Financial Statements

Only items that meet the materiality threshold for this fund are included on this schedule.

Austin Water (in 000's)	As Reported at 9/30/2016	Fiscal Year 2016 Adjustments	If Adjusted at 9/30/2016
Assets and Deferred Outflows	\$ 4,467,030		\$ 4,467,030
Liabilities and Deferred Inflows	3,676,704	(2,974)	3,673,730
Net Position	790,326	2,974	793,300
Total Liabilities and Net Position	\$ 4,467,030	-	\$ 4,467,030
Operating Revenues	\$ 561,834		\$ 561,834
Operating Expenses	(352,390)		(352,390)
Other Revenue/Expense (Net)	(95,318)	2,974	(92,344)
Change in Net Position	114,126	2,974	117,100
Beginning Net Position	676,200		676,200
Ending Net Position	\$ 790,326	2,974	\$ 793,300

### Uncorrected Misstatements Related to Current Year

		Debit	Credit
Known	Deferred inflow of resources - regulatory balances	\$ 2,974	
	Costs to be recovered		\$ (2,974)
	<i>To correct the balance of deferred depreciation related to regulatory accounting</i>		
Known	Capital appreciation bond interest payable (noncurrent)	\$ 2,571	
	Accrued interest payable (current)		\$ (2,571)
	<i>To reclassify an additional portion of the capital appreciation bond payments to current liabilities</i>		

# Appendix B — Uncorrected Misstatements

## Airport

City of Austin, Texas  
 Summary of Uncorrected Misstatements  
 Year Ended September 30, 2016

### Impact of Uncorrected Misstatements on Financial Statements

Only items that meet the materiality threshold for this fund are included on this schedule.

Airport (in 000's)	As Reported at 9/30/2016	Fiscal Year 2016 Adjustments	If Adjusted at 9/30/2016
Assets and Deferred Outflows	\$ 1,406,303	845	\$ 1,407,148
Liabilities and Deferred Inflows	827,905		827,905
Net Position	578,398	845	579,243
Total Liabilities and Net Position	\$ 1,406,303	845	\$ 1,407,148
Operating Revenues	\$ 135,765	(418)	\$ 135,347
Operating Expenses	(116,349)	1,263	(115,086)
Other Revenue/Expense (Net)	9,229		9,229
Change in Net Position	28,645	845	29,490
Beginning Net Position	549,753		549,753
Ending Net Position	\$ 578,398	845	\$ 579,243

### Uncorrected Misstatements Related to Current Year

		Debit	Credit
Known	Accumulated Depreciation	\$ 1,263	
	Depreciation expense		\$ (1,263)
	User fees and rentals	\$ 418	
	Other assets		\$ (418)
	<i>To correct depreciation expense and base rent other asset related to the CONRAC facility</i>		

# Appendix B — Uncorrected Misstatements

## Nonmajor Enterprise Funds

City of Austin, Texas  
 Summary of Uncorrected Misstatements  
 Year Ended September 30, 2016

### Impact of Uncorrected Misstatements on Financial Statements

Only items that meet the materiality threshold for this fund are included on this schedule.

Nonmajor Enterprise Funds (in 000's)	As Reported at 9/30/2016	Fiscal Year 2016 Adjustments	If Adjusted at 9/30/2016
Assets and Deferred Outflows	\$ 1,066,929		\$ 1,066,929
Liabilities and Deferred Inflows	622,895	2,621	625,516
Net Position	444,034	(2,621)	441,413
Total Liabilities and Net Position	\$ 1,066,929	-	\$ 1,066,929
Operating Revenues	\$ 319,284		\$ 319,284
Operating Expenses	(331,298)	(4,293)	(335,591)
Other Revenue/Expense (Net)	41,358	-	41,358
Change in Net Position	29,344	(4,293)	25,051
Beginning Net Position	414,690	1,672	416,362
Ending Net Position	\$ 444,034	(2,621)	\$ 441,413

### Uncorrected Misstatements Related to Current Year

Other Funds (Nonmajor Enterprise)		Debit	Credit
Known	Pension expense	\$ 4,293	
	Beginning Net Position		\$ (1,672)
	Deferred inflows of resources		\$ (2,621)
<i>To correct pension expense for prior year allocation error and for the effect of change in proportionate share between funds</i>			

## Appendix C — Management Representation Letter

- We have made specific inquiries of the City's management about the representations embodied in the financial statements.
- Additionally, we have requested that management provide to us the written representations the City is required to provide to its independent auditors under GAAS.
- We have attached to this presentation, as part of this Appendix, a copy of the representation letter we obtained from management.

Questions?

# Deloitte.



Official Professional Services Sponsor

Professional Services means audit, tax, consulting, and advisory.

#### About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. Please see [www.deloitte.com/about](http://www.deloitte.com/about) for a detailed description of DTTL and its member firms. Please see [www.deloitte.com/us/about](http://www.deloitte.com/us/about) for a detailed description of the legal structure of Deloitte LLP and its subsidiaries. Certain services may not be available to attest clients under the rules and regulations of public accounting.

Copyright © 2017 Deloitte Development LLC. All rights reserved.