

CITY OF SACRAMENTO

Report to the City Council

For the Fiscal Year Ended June 30, 2012

CITY OF SACRAMENTO
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For the Fiscal Year Ended June 30, 2012

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Walnut Creek

Oakland

LA/Century City

Newport Beach

San Diego

Seattle

Honorable Members of the
City Council of the City of Sacramento

We have audited the financial statements of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Sacramento, California (City), as of and for the fiscal year ended June 30, 2012, in accordance with auditing standards generally accepted in the United States of America, and have issued our report thereon dated December 28, 2012.

In planning and performing our audit in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, 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.

A deficiency in internal control over financial reporting 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 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 over financial reporting was for the limited purpose described in the second paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses, and therefore, there can be no assurance that all such deficiencies have been identified. In addition, because of inherent limitations in internal control over financial reporting, including the possibility of management override of controls, misstatements due to error or fraud may occur and not be detected by such controls. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses. However we have reported on the status of a matter previously reported to management in the Status of Prior Year's Comment and Recommendation.

We previously reported on the City's internal control over financial reporting in our report dated December 28, 2012.

This letter does not affect our report dated December 28, 2012, on the financial statements of the City.

Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards, *Government Auditing Standards*, and OMB Circular A-133, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated July 9, 2012. Professional standards also require that we communicate to you information related to our audit as discussed in required communications section of this report.

We would like to thank the City's management and staff for the courtesy and cooperation extended to us during the course of our engagement.

This report is intended solely for the information and use of the City Council and management of the City and is not intended to be and should not be used by anyone other than these specified parties.

Maciel Mini & O'Connell LLP

Sacramento, California

December 28, 2012

CITY OF SACRAMENTO

Report to the City Council
Required Communications
For the Fiscal Year Ended June 30, 2012

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during fiscal year ended June 30, 2012. We noted no transactions entered into by the City during the fiscal 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 financial statements were:

- Depreciation estimates for capital assets
- Self-funded insurance liabilities
- Actuarial valuations of pension and other postemployment benefit obligations and required contributions
- Landfill postclosure care costs

Depreciation expense is based on management's estimate of the useful lives of the related capital assets. Management's estimate of the City's self-funded insurance liabilities is actuarially determined based on the City's loss history. The actuarial pension data contained in Note 8 to the financial statements and required supplementary information (unaudited) is based on actuarial calculations performed in accordance with the parameters set forth in GASB Statement No. 50, *Pension Disclosures (an amendment of GASB Statements No. 25 and 27)* and GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*. The actuarial data for other postemployment benefit obligations contained in Note 9 to the financial statements and required supplementary information is based on actuarial calculations performed in accordance with the parameters set forth in GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. Management's estimate of its landfill postclosure care costs is determined using methods and assumptions consistent with GASB Statement No. 18, *Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs*. We evaluated the key factors and assumptions used to develop these estimates in determining that they are reasonable in relation to each opinion unit's financial statements taken as a whole.

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Report to the City Council
Required Communications (Continued)
For the Fiscal Year Ended June 30, 2012

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 trivial, and communicate them to the appropriate level of management. The attached schedule summarizes an uncorrected misstatement of the financial statements. Management has determined that its effect is immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as 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 28, 2012.

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 governmental unit'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 governmental unit's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

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Report to the City Council
Required Communications (Continued)
For the Fiscal Year Ended June 30, 2012

Other Information in Documents Containing Audited Financial Statements

With respect to the supplementary information accompanying the financial statements, 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.

CITY OF SACRAMENTO

Report to the City Council Status of Prior Year's Comment and Recommendation For the Fiscal Year Ended June 30, 2012

I. OUT-OF-CLASS WORK ASSIGNMENTS

In accordance with Section 3.12(e) of the City of Sacramento Salary Administration Policy and Section 13.1(a) of the labor agreement with the International Union of Operating Engineers, Stationary Local 39, AFL-CIO, (Local 39 Labor Agreement), out-of-class work assignments are required to be documented in writing. During our testing of employees who earned out-of-class pay during the fiscal year ended June 30, 2010, there was no evidence of written notification of the employee's out-of-class work assignment for 5 of the 8 employee files reviewed.

We recommend the City implement procedures to properly document and communicate out-of-class work assignments in writing as required by the Salary Administration Policy and the Local 39 Labor Agreement.

Status 2011

Not implemented. We selected 8 employee files for testing during the fiscal year ended June 30, 2011 and noted that there was no evidence of written notification of the employee's out-of-class work assignment for 5 of the 8 employee files reviewed.

Management Response

The City agrees with the recommendation and will strengthen procedures performed by departments to comply with the City's Salary Administration Policy and labor bargaining agreements. In addition, the Human Resources Department will adopt and implement a new Out of Class Pay policy.

The Human Resources Department presented a draft Out of Class Pay policy to the Executive Team in April 2009. The item was placed on hold during the transition of the City Manager to the Interim City Manager. During the Interim's tenure the primary focus was the adoption of the fiscal year budgets and the recruitment of a new City Manager. With the hiring of the new City Manager completed, Human Resources can now redirect its focus and make this item a priority.

Status 2012

Not implemented. Instead, the City modified its Local 39 labor agreement and approved and passed Motion No. 2012-160 on June 26, 2012, to be consistent with other labor agreements, to no longer require written documentation of out-of-class assignments.

CITY OF SACRAMENTO

Report to the City Council General Information Regarding New Accounting Standard For the Fiscal Year Ended June 30, 2012

GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*

On June 25, 2012, GASB approved Statement No. 68, *Accounting and Financial Reporting for Pensions*. Statement No. 68, which primarily relates to reporting by governments that provide pensions to their employees, is effective for fiscal years beginning after June 15, 2014.

Key changes include:

- Separating how the accounting and financial reporting is determined from how pensions are funded.
- Employers with defined benefit pension plans will recognize a net pension liability, as defined by the standard, in their government-wide, proprietary and fiduciary fund financial statements.
- Incorporating ad hoc cost-of-living adjustments and other ad hoc postemployment benefit changes into projections of benefit payments, if an employer's past practice and future expectations of granting them indicate they are essentially automatic.
- Using a discount rate that applies (a) the expected long-term rate of return on pension plan investments for which plan assets are expected to be available to make projected benefit payments, and (b) the interest rate on a tax-exempt 20-year AA- or higher rated municipal bond index to projected benefit payments for which plan assets are not expected to be available for long-term investment in a qualified trust.
- Adopting a single actuarial cost allocation method – entry age normal – rather than the current choice among six actuarial cost methods.
- Requiring more extensive note disclosures and required supplementary information.

As an employer, the City will be subject to the provisions of Statement No. 68 beginning with the fiscal year ending June 30, 2015. Statement No. 68 replaces the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers* and Statement No. 50, *Pension Disclosures*, as they relate to governments that provide pensions through pension plans administered as trusts or similar arrangements that meet certain criteria.

The Statement requires governments that participate in defined benefit pension plans to report in their statement of net position a net pension liability. The net pension liability is the difference between the total pension liability (the present value of projected benefit payments to employees based on their past service) and the assets (mostly investments reported at fair value) set aside in a trust and restricted to paying benefits to current employees, retirees, and their beneficiaries.

The Statement calls for immediate recognition of more pension expense than is currently required. This includes immediate recognition of annual service cost and interest on the pension liability and immediate recognition of the effect on the net pension liability of changes in benefit terms. Other components of pension expense will be recognized over a closed period that is determined by the average remaining service period of the plan members (both current and former employees, including retirees). These other components include the effects on the net pension liability of (a) changes in economic and demographic assumptions used to project benefits and (b) differences between those assumptions and actual experience. Lastly, the effects on the net pension liability of differences between expected and actual investment returns will be recognized in pension expense over a closed five-year period.

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Report to the City Council General Information Regarding New Accounting Standard (Continued) For the Fiscal Year Ended June 30, 2012

Statement No. 68 also requires employers to present more extensive note disclosures and RSI, including disclosing descriptive information about the types of benefits provided, how contributions to the pension plan are determined, and assumptions and methods used to calculate the pension liability.

These changes, however, relate only to accounting and financial reporting, not to how governments approach the funding of their pension plans. Pension funding is a policy decision made by government officials.

MANAGEMENT RESPONSE

Management is aware of GASB Statement No. 68 and is starting to evaluate the effects on City accounting and financial reporting.

**CITY OF SACRAMENTO
SCHEDULE OF UNCORRECTED MISSTATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

Government Wide Statements - Business-type Activities

| Description (Nature) of Audit Difference | Impact of Adjustments on Government-Wide Financial Statement - Increase (Decrease) | | | | | | | | |
|--|--|-------------|--------------|-------------------------|------------|-------------|------------------------|---------------------|--|
| | Statement of Net Assets | | | Changes in Net Position | | | | | |
| | Assets | Liabilities | Net Position | Revenues | Expenses | Transfers | Beginning Net Position | Ending Net Position | |
| I To record the interest expense and the interest payable on the Wastewater fund related to the Refuse Trucks (Vac-Con) Capital lease agreement as of June 30, 2012. | \$ - | \$ 59 | \$ (59) | \$ - | \$ 59 | \$ - | \$ - | \$ (59) | |
| Total | \$ - | \$ 59 | \$ (59) | \$ - | \$ 59 | \$ - | \$ - | \$ (59) | |
| Financial statement amounts | \$ 1,285,657 | \$ 423,126 | \$ 862,531 | \$ 260,581 | \$ 220,473 | \$ (22,722) | \$ 845,145 | \$ 862,531 | |
| Impact as a percentage of financial statement amounts | 0.00% | 0.01% | -0.01% | 0.00% | 0.03% | 0.00% | 0.00% | -0.01% | |

Proprietary Funds - Wastewater Major Enterprise Fund

| Description (Nature) of Audit Difference | Impact of Adjustments on Fund Financial Statement - Increase (Decrease) | | | | | | | | |
|--|---|-------------|--------------|-------------------------|-----------|-----------------------------|------------------------|---------------------|--|
| | Balance Sheet | | | Changes in Net Position | | | | | |
| | Assets | Liabilities | Net Position | Revenues | Expenses | Contributions and Transfers | Beginning Net Position | Ending Net Position | |
| I To record the interest expense and the interest payable on the Wastewater fund related to the Refuse Trucks (Vac-Con) Capital lease agreement as of June 30, 2012. | \$ - | \$ 59 | \$ (59) | \$ - | \$ 59 | \$ - | \$ - | \$ (59) | |
| Total | \$ - | \$ 59 | \$ (59) | \$ - | \$ 59 | \$ - | \$ - | \$ (59) | |
| Financial statement amounts | \$ 142,203 | \$ 17,759 | \$ 124,444 | \$ 21,853 | \$ 20,491 | \$ (718) | \$ 123,800 | \$ 124,444 | |
| Impact as a percentage of financial statement amounts | 0.00% | 0.33% | -0.05% | 0.00% | 0.29% | 0.00% | 0.00% | -0.05% | |