

CITY OF SACRAMENTO, CALIFORNIA

MANAGEMENT LETTER

JUNE 30, 2014



December 19, 2014

To the Honorable Mayor
and Members of City Council
City of Sacramento
Sacramento, California

We have audited the basic financial statements of the City of Sacramento, California (the City) for the year ended June 30, 2014, and have issued our report thereon dated December 19, 2014. In planning and performing our audit of the basic financial statements of the City, we considered internal control in order to determine our auditing procedures for the purpose of expressing our opinions on the basic financial statements. An audit does not include examining the effectiveness of internal control and does not provide assurance on internal control. We have not considered internal control since the date of our report.

During our audit we noted certain matters involving internal control and other operational matters that are presented for your consideration. These observations and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies and are summarized as follows:

DEVELOPER DEDICATIONS

OBSERVATION:

As a result of our audit procedures over capital and infrastructure additions, it was noted that the City is adding the developer infrastructure dedications from the fiscal year ended June 30, 2013 in the June 30, 2014 fiscal year. As a result, the City has routinely had a one-year lag to incorporate developer dedications into the accounting records.

RECOMMENDATION:

We recommend that the City consider whether there are alternative methods for which to gather information from departments in a more timely manner in order to match up the acceptance of infrastructure dedications with the appropriate accounting period. This may include utilizing an estimate of the infrastructure dedications accepted during the period based on initial documentation provided by developers until final verification can be performed by the City departments.

MANAGEMENT'S RESPONSE:

The City agrees with the recommendation and will formalize its processes and procedures to determine a yearly estimated amounts of developer dedications for financial reporting.

RETIREE HEALTH BILLING RECONCILIATION

OBSERVATION:

During our inquiries with the City's Human Resources department regarding Other Post Employment Benefits, we noted that the City is not performing a monthly reconciliation of healthcare bills received from insurance providers to the City's records of participating retirees at the Sacramento City Employees' Retirement System (SCERS) and the City retirees of the California Public Employees' Retirement System (CalPERS).

As a result, the City's Human Resources department is aware that they have had duplicate or erroneous billings, have been charged for deceased individuals, and these errors had not been identified in a timely manner. This was due to a not having routine healthcare billing reconciliation process not being in place for retirees that participate in the City's healthcare programs.

RECOMMENDATION:

We recommend the City work with their healthcare providers to develop a process and procedure to reconcile the City's records of enrolled retirees participating in the healthcare program to the invoices of the insurance providers. As part of this monthly process, the City should ensure that they have received an appropriate cost sharing portion of the premium from those participating retirees. We further recommend that the City develop procedures to ensure deceased retirees are identified timely and proper action is taken to remove them from the healthcare billing.

MANAGEMENT'S RESPONSE:

The City agrees with the recommendation and will develop policies and procedures to reconcile healthcare bills to City records to ensure that proper costs are being charged and paid.

LANDFILL REGULATORY REPORTS

OBSERVATION:

During our review of the City Landfill Closure and Postclosure Liability, we noted that the City Department of Solid Waste was not submitting the Financial Assurances report to the California Department of Resources Recycling and Recovery (CalRecycle), a division of California Environmental Protection Agency. The report is required for all owners of solid waste landfills by Title 27 of the California Code of Regulations and requires the calculation of the inflationary increases in the City's closure, postclosure maintenance, and corrective action cost estimates from previous technical closure and postclosure plans.

RECOMMENDATION:

We recommend the City work with the CalRecycle to ensure that all necessary submissions of regulatory reports are being made in relation to the City's closed landfills.

MANAGEMENT'S RESPONSE:

The City agrees with the recommendation and will develop policies and procedures to ensure that all necessary submissions of regulatory reports are made in relation to the City's closed landfills.

INTERFUND LOAN POLICY

OBSERVATION:

As a result of our audit procedures over the interfund advances of the City, it was noted that the city does not have an Interfund Loan Policy. While the practice of interfund loans is a recognized and necessary aspect of municipal finance, they are typically short term in nature, and constitute the allocation of resources between individual funds for working capital purposes. The City has an interfund loans from the Risk Management Fund to the Golf Fund (a subfund of the Culture & Leisure Fund), that is long term in nature and does not have a set repayment schedule.

RECOMMENDATION:

We recommend that the City adopt policies and procedures regarding the terms and conditions by which interfund loans are initiated and subsequently managed. Common characteristics of an interfund loan policy adopted by municipalities might include:

- Purpose of Interfund Loan
- Identification of the Source Fund
 - Availability of unrestricted funds in the source fund
 - Review of multi-year plans for use of source fund monies
 - Analyze and legal or contractual restrictions
 - Ensure loan will not hinder functions or projects of source fund
- Term/Repayment of Interfund Loan
 - Repayment should have a payment source and funding stream
 - Specific repayment schedule
 - Interest imposed at a rate equality to at least investment earning if loan did not occur
 - Loan must be due and payable if funds needed by source fund
- Other Considerations
 - Feasibility of repayment
 - Internal controls of monitoring repayment

MANAGEMENT'S RESPONSE:

The City agrees with the recommendation and will develop policies and procedures to ensure interfund loans made by the City are initiated and managed in accordance with City guidelines.

NEW FINANCIAL REPORTING STANDARDS

INFORMATIONAL ONLY

GOVERNMENTAL ACCOUNTING STANDARD No. 68

In June 2012, GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27*. The objective of this Statement is to improve accounting and financial reporting by State and local governments for pensions. This Statement replaces the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, as well as the requirements of Statement No. 50, *Pension Disclosures*, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria. The requirements of Statements No. 27 and No. 50 remain applicable for pensions that are not covered by the scope of this Statement. This Statement is not effective until the fiscal year ending June 30, 2015.

GOVERNMENTAL ACCOUNTING STANDARDS BOARD No. 71

In November 2013, GASB issued Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*. The objective of this Statement is to address an issue regarding application of the transition provisions of Statement No. 68, *Accounting and Financial Reporting for Pensions*. The issue relates to amounts associated with contribution, if any, made by a state or local government employer or nonemployer contributing entity to a defined benefit pension plan after the measurement date of the government's beginning net pension liability. This statement is not effective until June 30, 2015.

Our audit procedures are designed primarily to enable us to form an opinion on the financial statements, and therefore, may not bring to light all weaknesses in policies or procedures that may exist. We aim, however, to use our knowledge of the City gained during our work to make comments and suggestions that we hope will be useful to you.

We would be pleased to discuss these comments and recommendations with you at any time.

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

Varrinck, Trine, Day & Co. LLP

Sacramento, California
December 19, 2014



To the Honorable Mayor and
Members of the City Council
City of Sacramento
Sacramento, California

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 (the City) for the year ended June 30, 2014, and have issued our reports thereon dated as indicated below:

Reporting Entity

Comprehensive Annual Financial Report
Sacramento City Employees' Retirement System (SCERS)
Child Development Program Enterprise Fund
Special Tax Revenue Bonds, Series A and Subordinate Special Tax
Revenue Bonds (Bond Programs) of the Sacramento City Financing
Authority

Audit Report Date

December 19, 2014
December 19, 2014
October 30, 2014

December 19, 2014

We are currently performing the compliance audit of the City's federal award programs and plan to issue our reports prior to January 31, 2015.

Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and *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 June 10, 2014. Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Findings

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. As described in Note 1 to the financial statements, the City adopted new accounting guidance, Governmental Accounting Standards Board (GASB) Statement No. 65, *Items Previously Reported as Assets and Liabilities* and GASB Statement No. 67, *Financial Reporting for Pension Plans – An Amendment of GASB Statement No. 25*, as of July 1, 2013. We noted no transactions entered into by the City 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 City's financial statements were:

Management's estimates were used in establishing allowances for accounts receivable, establishing self insurance reserves, estimating landfill closure and post closure care costs, estimating fair value of investments and derivative instruments, estimating useful lives to calculate depreciation of capital assets, estimation of the other post employment liability, estimation of pension liability amounts and disclosures, and estimation of pollution remediation liabilities. We evaluated the key factors and assumptions used to develop the estimates in determining that they are 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 were:

The disclosure of the Funded Status of the City's Pension Plans in Note 8 of the financial statements where the City has an Unfunded Actuarial Accrued Liability of the City's CalPERS Safety and Miscellaneous Pension Plans of \$379 million and \$237 million, respectively, as of the June 30, 2013 actuarial valuation and an Unfunded Actuarial Accrued Liability of the SCERS Pension Plan of \$60 million as of the June 30, 2014 actuarial valuation.

The disclosure of the Other Post Employment Benefits (OPEB) in Note 9 of the financial statements where the City has an Unfunded Actuarial Accrued Liability of \$433.7 million and actuarial value of assets of \$0 as of the most recent actuarial valuation of June 30, 2013.

The disclosure of the subsequent event in Note 20 where the City entered into a forward bond purchase agreement in connection with the Entertainment and Sport Center (ESC) project in July, 2014.

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 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. The misstatements that we identified as a result of our audit procedures were brought to the attention of, and corrected, by management are attached in the Schedule of Corrected Misstatements.

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 of the City, SCERS, and Bond Programs that are included in the management representation letters dated December 19, 2014. We obtained certain representations from management of the Child Development Program Enterprise fund in the management representation letter dated October 30, 2014.

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 City’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 the management’s discussion and analysis and schedules of funding progress, 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 combining and individual nonmajor fund financial statements, which accompany the financial statements 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. We did not audit or perform other procedures on this other information and we do not express an opinion or provide any assurance on it.

Restriction on Use

This information is intended solely for the use of the Mayor, 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.

Vavrinik, Trine, Day & Co. LLP

Sacramento, California
December 19, 2014

CITY OF SACRAMENTO
Schedule of Corrected Misstatements
For the Year Ended June 30, 2014

Number	Fund	Description	Debit	Credit
1	Solid Waste Enterprise Fund	Liability for Landfill Closure Special Item	\$ 18,527,000	\$ 18,527,000

The adjustment was to adjust the Liability for Landfill Closure costs to bring the estimate in line with the new independent engineering estimate related to the City's annual postclosure monitoring costs and the remaining required monitoring period required by the US Environmental Protection Agency.

2	Capital Grants Governmental Fund	Capital Outlay Accounts Payable	\$ 184,000	\$ 184,000
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The adjustment was to record an accrual for a construction invoice related to services provided by the contractor for the period of June, 2014 that was not previously accrued.

3	Private Purpose Trust Fund	Accreted Interest Net Position - Beginning	\$ 293,000	\$ 293,000
	Private Purpose Trust Fund	Accrued Interest Interest Expense	\$ 677,000	\$ 677,000

The adjustment was to adjust the City's calculation of the accretion of interest related to the 1993 Merged Downtown Tax Allocation Bonds of the Private Purpose Trust Fund (Redevelopment Successor Agency) to match the accretion schedule and to only accrue the incremental accretion between the May 1 accretion date and June 30.

4	Private Purpose Trust Fund	Net Position - Beginning Accreted Interest Accrued Interest	\$ 33,380,000	\$ 32,934,000 446,000
	Private Purpose Trust Fund	Interest Expense Accreted Interest Accrued Interest	\$ 5,442,000	\$ 5,419,000 23,000

The adjustment was to record the accretion of interest related to the 2005 Merged Downtown and Oak Park Tax Allocation Bonds of the Private Purpose Trust Fund (Redevelopment Successor Agency) that was previously unrecorded as of June 30.