

CITY OF SACRAMENTO

Report to the City Council

For the Fiscal Year Ended June 30, 2008

CITY OF SACRAMENTO
Report to the City Council
For the Fiscal Year Ended June 30, 2008

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NEWPORT BEACH

SAN MARCOS

SAN DIEGO

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 aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Sacramento (City) for the fiscal year ended June 30, 2008, and have issued our report thereon dated April 21, 2009. Professional standards require that we provide you with certain information related to our audit, which is included in the Required Communications section of this report.

In planning and performing our audit of the financial statements of the City for the fiscal year ended June 30, 2008, we considered the City's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide an opinion on internal control.

During our audit, we became aware of certain matters that represent an opportunity for strengthening internal controls and operating efficiency, which are included in the Current Year Findings and Recommendations section of this report.

We also followed up on last year's findings and recommendations in the Status of Prior Year Findings and Recommendations section of this report.

This letter does not affect our report dated April 21, 2009, on the financial statements of the City.

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.

Macias Gini & O'Connell LLP

Certified Public Accountants

Sacramento, California
April 21, 2009

CITY OF SACRAMENTO

Report to the City Council
Required Communications
For the Fiscal Year Ended June 30, 2008

I. Our Responsibilities under U.S. Generally Accepted Auditing Standards and OMB Circular A-133

As stated in our engagement letter dated August 14, 2008, our responsibility, as described by professional standards, is to express opinions about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of your responsibilities.

In planning and performing our audit, we considered the City's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide assurance on the internal control over financial reporting. We also considered internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

As part of obtaining reasonable assurance about whether the City's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit. Also in accordance with OMB Circular A-133, we examined, on a test basis, evidence about the City's compliance with the types of compliance requirements described in the "U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement" applicable to each of its major federal programs for the purpose of expressing an opinion on the City's compliance with those requirements. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on the City's compliance with those requirements.

II. Other Information in Documents Containing Audited Financial Statements

During the year, the City included its fiscal year 2006 audited financial statements in the Official Statement for the \$70,930,000 Sacramento City Financing Authority 1997 Lease Revenue Bonds Remarketing. We do not have an obligation to perform any procedures to corroborate other information contained in the Official Statement. We were not associated with and did not have any involvement in the Official Statement. Accordingly, we did not perform any procedures on this document and provide no assurance as to the other information contained in the Official Statement.

CITY OF SACRAMENTO

Report to the City Council
Required Communications (Continued)
For the Fiscal Year Ended June 30, 2008

III. Planned Scope and Timing of the Audit

We performed the audit according to the planned scope previously communicated to you in our meeting about planning matters on August 26, 2008. However, due to the implementation of the City's new financial management and information system (eCAPS) our fieldwork was completed subsequent to the initial timeline communicated to you in our meeting.

IV. 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. Effective July 1, 2007, the City implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions (OPEB)*, and Statement No. 50, *Pension Disclosures, an amendment of GASB Statements No. 25 and No. 27*. We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

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:

- Fair market value of investments
- Depreciation estimates for capital assets
- Self-funded insurance liabilities
- Compensated absences liabilities
- Pension expense
- OPEB expense and unfunded OPEB obligation
- Landfill post-closure costs

CITY OF SACRAMENTO

Report to the City Council
Required Communications (Continued)
For the Fiscal Year Ended June 30, 2008

IV. Significant Audit Findings (Continued)

Management's estimate of the fair value of investments is determined based upon quoted market prices. Management's estimate of depreciation is estimated based on the estimated 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. Management's estimate of the City's compensated absences liabilities is based on earned vacation hours and hourly rate of each employee at year-end. Management's estimate of the City's annual pension expense is based on the estimated costs of providing pension benefits to the City's current and retired employees and spouses using actuarial methods and assumptions prescribed by GASB Statements No. 27 – *Accounting for Pensions by State and Local Governmental Employers*. Management's estimate of the City's annual OPEB expense and unfunded OPEB obligation are based on the estimated costs of providing benefits to the City's current and retired employees and spouses using actuarial methods and assumptions prescribed by GASB Statement No. 45 – *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. Management's estimate of its landfill post-closure 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.

The disclosures in the financial statements are neutral, consistent, and clear. 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 regarding the City's Pension and OPEB plans in Notes 8 and 9, respectively. The content of the Pension disclosure was determined in accordance with the provisions of GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, and GASB Statement No. 50, *Pension Disclosures*. The content of the OPEB disclosure was determined in accordance with the provisions of GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pension*.

Difficulties Encountered in Performing the Audit

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

CITY OF SACRAMENTO

Report to the City Council
Required Communications (Continued)
For the Fiscal Year Ended June 30, 2008

IV. Significant Audit Findings (Continued)

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 uncorrected misstatements of the financial statements. Management has determined that their effect is immaterial, both individually and in the aggregate, to the financial statements taken as a whole. 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 each opinion unit's 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 April 21, 2009.

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.

CITY OF SACRAMENTO

Report to the City Council Current Year Findings and Recommendations For the Year Ended June 30, 2008

I. AUDIT COMMITTEE

In an effort to enhance the quality of the City's financial reporting, we recommend the establishment of an audit committee. An audit committee assists the City Council (Council) in providing independent review and oversight to the City's financial reporting processes, internal controls, and independent auditors. The audit committee would be responsible for engaging the independent auditors, reviewing the overall audit plan, reviewing the audited financial statements and the related management letter, monitoring internal controls over financial reporting and compliance, and initiating, if necessary, investigations for the Council. An audit committee also provides a forum separate from management in which independent auditors and other interested parties may candidly discuss concerns

Management's Response:

The City will consider this recommendation in the context of other evaluations currently in progress involving City governance and other organizational structure matters.

II. CONSTRUCTION IN PROGRESS

During our audit, we noted the City currently does not have a formal review and approval process for the determination of the classification of capital project costs at year-end. As part of the year-end closing process, Finance Department staff collaborates with various project managers to determine the proper classification of capital project costs included in construction-in-progress (CIP). Project costs are evaluated to determine amounts related to completed portions of projects requiring reclassification from CIP to land and land improvements or depreciable capital assets in accordance with generally accepted accounting principles. The process does not provide for documentation of the project manager's approval of the proper asset classification. To improve this process, we recommend the City establish year-end close processes and procedures requiring project managers to evaluate project costs and to complete and approve standardized documentation which details project costs by asset classification.

Management's Response:

The City agrees with the recommendation and will formalize its processes and procedures to determine the proper classification of capital projects costs for financial reporting.

CITY OF SACRAMENTO

Report to the City Council Current Year Findings and Recommendations (Continued) For the Year Ended June 30, 2008

III. PROCUREMENT

During our audit, we noted a purchase on a City provided credit card was split over three different transactions related to an invoice totaling \$6,837.43 effectively circumventing City required procurement procedures. According to the City of Sacramento Policy for Procurement of Supplies and Non-Professional Services, procurement activities necessary to acquire a purchase order must be performed for purchases above \$5,000. The condition resulted from the improper supervision, review and authorization of purchases using the City's credit card program. We recommend the City design and implement procedures to ensure that credit card purchases follow written City procurement policies.

Management's Response:

The City agrees with the recommendation and has implemented procedures to ensure that credit card purchases follow written City procurement policies.

IV. SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (SEFA)

During our review of the City's SEFA, it was noted that the annual expenditures were misstated by an amount of approximately \$134,000 or less than 1% of total Federal Awards. The variance was a result of the City reporting federal program expenditures that were not fully reimbursed by the granting agency in accordance with program guidelines. We recommend that the City develop procedures to ensure that total Federal expenditures for each program are reconciled to the amounts reported to their granting agencies at the program level as part of the year-end SEFA preparation procedures.

Management's Response:

The City agrees with the recommendation and will develop processes and procedures to ensure that federal program expenditures reported on the SEFA are reconciled to amounts reported to granting agencies.

CITY OF SACRAMENTO

Report to the City Council Status of Prior Year Findings and Recommendations For the Year Ended June 30, 2008

I. IDENTIFICATION AND EVALUATION OF INTERNAL CONTROLS

The City has a responsibility for the stewardship and safeguarding of public resources. In order to fulfill this responsibility, the City has implemented internal controls that serve as the first line of defense in safeguarding assets. Additionally, these controls are designed to ensure: (1) effective and efficient operations, (2) reliable financial reporting and (3) compliance with applicable laws and regulations. The Committee on Sponsoring Organizations of the Treadway Commission (COSO) has established a nationally recognized framework for internal control in its *Internal Control – Integrated Framework* and its related *Guidance for Smaller Public Companies: Reporting on Internal Controls over Financial Reporting*. The COSO framework establishes five elements of internal control: (1) Control Environment; (2) Risk Assessment; (3) Control Activities; (4) Information and Communication; and (5) Monitoring. Risk Assessment and Monitoring are integral parts of internal control and management should periodically evaluate the risks and monitor the changes facing the System. This process involves evaluating both previously identified risks and potential new risks and providing assurance that (1) controls are designed properly to address significant risks and (2) controls are operating effectively. The Auditing Standards Board (ASB) of the American Institute of Certified Public Accountant's (AICPA) recently adopted a set of eight Statements of Auditing Standards (SAS No. 104 through 111), which, among other things, require auditors to assess an organization's design of controls and determine whether the controls have been placed in operation for all elements of internal control over financial reporting. If controls do not exist, are poorly designed or not operating effectively, the auditor must evaluate the control deficiency and report the deficiency to management, including whether the control deficiency is a significant deficiency or material weaknesses. These standards are also incorporated in *Government Auditing Standards (July 2007 Revision)* issued by the Comptroller General of the United States. The City should perform a comprehensive risk assessment analysis and document its risk assessment policies and procedures for each fiscal year beginning July 1, 2007. We recommend the City should review the COSO *Internal Control – Integrated Framework* and its related *Guidance for Smaller Public Companies: Reporting on Internal Controls over Financial Reporting* and comply with the best practices outlined therein.

Management Response:

The City accepts these recommendations and understands its responsibility for the stewardship and safeguarding of public resources. The City will work collaboratively with the independent auditors as they adopt new audit standards during the performance of their audit of the City's fiscal year ending June 30, 2008.

Together, the Finance Department and City Internal Auditor plan for gradual improvement of the City's internal controls. However, the process cannot be completed in time for the fiscal year 2008 audit. The examination of internal controls and the correction of any weaknesses which may be identified will be done on a City risk and priority basis. For example, review and improvement of inventory controls is currently being done.

CITY OF SACRAMENTO

Report to the City Council
Status of Prior Year Findings and Recommendations (Continued)
For the Year Ended June 30, 2008

I. IDENTIFICATION AND EVALUATION OF INTERNAL CONTROLS (CONTINUED)

A comprehensive risk assessment analysis would require diversion of staff and resources from core financial support of City operations such as payroll, payments to vendors, and review of financial transactions on a daily basis. It is clear that additional resources will not be available for the next several years.

The City will establish a working group to meet on at least a quarterly basis to:

- Evaluate internal control risks;
- Prioritize work on internal control improvements;
- Evaluate best practices of other governmental agencies;
- Report to City Management when appropriate.

This working group will consist of the Finance Director, Accounting Manager, Internal Auditor, the City Treasurer, and representatives from other departments when appropriate.

Status:

The City has worked with the independent auditors as they adopted their new audit standards during the performance of the audit of the City's fiscal year ending June 30, 2008. During fiscal year 2008, and through fiscal year 2009 to date, the City Finance Department has reviewed and documented key internal control procedures and performed a high-level risk assessment based on the COSO guidance. The internal working group has met quarterly to evaluate internal control risks and discuss priorities for internal control improvements. The City has made satisfactory progress toward the implementation of this recommendation. The status of the continued implementation efforts will be reviewed during the City's audit for the fiscal year ended June 30, 2009.

II. PHYSICAL INVENTORY

During our audit, we noted that the City does not have a consistent system of taking periodic inventory counts. This is a deficiency in the system of controls and has the potential for allowing abuse, including fraud and other defalcation, to exist and not be detected. Physical counts of inventory should be performed at least quarterly. The results should be reviewed and reconciled to the perpetual system by the department manager. The perpetual inventory listing should be reconciled to the general ledger, with any large discrepancies investigated and explained. Any adjustments should be made and a procedure should be implemented to allow for these adjustments to occur on a monthly basis.

CITY OF SACRAMENTO

**Report to the City Council
Status of Prior Year Findings and Recommendations (Continued)
For the Year Ended June 30, 2008**

Management Response:

The City agrees with the recommendation and is taking steps to improve inventory controls. The City has hired an independent consulting firm to evaluate the current inventory systems and provide recommendations to improve inventory policies and procedures. These recommendations will be presented to all City departments responsible for inventory.

Status:

Based on the results of the independent consulting firm evaluation and the City's internal audit, improved inventory controls have been developed, reviewed, and implemented in the Utilities Department. The recommendations were also presented to other City departments responsible for inventory. We consider this matter to be resolved.

CITY OF SACRAMENTO
Schedule of Uncorrected Misstatements
For the Year Ended June 30, 2008

Government Wide Statements - Governmental Activities

Impact of Adjustments on Government-Wide Statement Financial Statement Captions (\$000) - Increase (Decrease)

Description (Nature) of Audit Difference	Statement of Net Assets			Changes of Net Assets		
	Assets	Liabilities	Net Assets	Current Year	Prior Year	Total
GOVERNMENTAL ACTIVITIES						
To correct securities lendig obligation	\$ -	\$ (239)	\$ 239	\$ 239	\$ -	\$ 239
Financial statement amounts	\$ 2,597,902	\$ 897,519	\$ 1,700,383			\$ 62,324
Impact as a percentage of financial statement amounts	0.00%	-0.03%	0.01%			0.38%

Government Wide Statements - Business-Type Activities

Impact of Adjustments on Government-Wide Statement Financial Statement Captions (\$000) - Increase (Decrease)

Description (Nature) of Audit Difference	Statement of Net Assets			Changes of Net Assets		
	Assets	Liabilities	Net Assets	Current Year	Prior Year	Total
BUSINESS-TYPE ACTIVITIES						
To correct securities lendig obligation	\$ -	\$ (49)	\$ 49	\$ 49	\$ -	\$ 49
Financial statement amounts	\$ 1,227,902	\$ 450,976	\$ 776,926			\$ 22,485
Impact as a percentage of financial statement amounts	0.00%	-0.01%	0.01%			0.22%

CITY OF SACRAMENTO
Schedule of Uncorrected Misstatements
For the Year Ended June 30, 2008

Governmental Funds

Impact of Adjustments on Fund Financial Statement Captions (\$000) - Increase (Decrease)

Description (Nature) of Audit Difference	Balance Sheet			Changes in Fund Balance		
	Assets	Liabilities	Net Assets	Current Year	Prior Year	Total
GENERAL FUND						
To correct securities lendig obligation	\$ -	\$ (72)	\$ 72	\$ 72	\$ -	\$ 72
Financial statement amounts	\$ 171,389	\$ 72,427	\$ 98,962			\$ (32,516)
Impact as a percentage of financial statement amounts	0.00%	-0.10%	0.07%			-0.22%
GENERAL FUND PROJECTS FUND						
To correct securities lendig obligation	\$ -	\$ (60)	\$ 60	\$ 60	\$ -	\$ 60
Financial statement amounts	\$ 128,844	\$ 31,169	\$ 97,675			\$ (31,549)
Impact as a percentage of financial statement amounts	0.00%	-0.19%	0.06%			-0.19%
CROCKER ART MUSEUM FUND						
To correct securities lendig obligation	\$ -	\$ (18)	\$ 18	\$ 18	\$ -	\$ 18
Financial statement amounts	\$ 34,767	\$ 7,283	\$ 27,484			\$ 14,954
Impact as a percentage of financial statement amounts	0.00%	-0.25%	0.07%			0.12%
FINANCING PLANS FUND						
To correct securities lendig obligation	\$ -	\$ (74)	\$ 74	\$ 74	\$ -	\$ 74
Financial statement amounts	\$ 164,157	\$ 47,167	\$ 116,990			\$ (941)
Impact as a percentage of financial statement amounts	0.00%	-0.16%	0.06%			-7.86%

Proprietary Funds

Impact of Adjustments on Fund Financial Statement Captions (\$000) - Increase (Decrease)

Description (Nature) of Audit Difference	Statement of Net Assets			Changes of Net Assets		
	Assets	Liabilities	Net Assets	Current Year	Prior Year	Total
WATER FUND						
To correct securities lendig obligation	\$ -	\$ (29)	\$ 29	\$ 29	\$ -	\$ 29
Financial statement amounts	\$ 514,935	\$ 195,187	\$ 319,748			\$ 2,912
Impact as a percentage of financial statement amounts	0.00%	-0.01%	0.01%			1.00%
PARKING FUND						
To correct securities lendig obligation	\$ -	\$ (20)	\$ 20	\$ 20	\$ -	\$ 20
Financial statement amounts	\$ 91,226	\$ 48,561	\$ 42,665			\$ 7,414
Impact as a percentage of financial statement amounts	0.00%	-0.04%	0.05%			0.27%

Aggregate Remaining Funds

Impact of Adjustments on Fund Financial Statement Captions (\$000) - Increase (Decrease)

Description (Nature) of Audit Difference	Statement of Fiduciary Net Assets / Statement of			Changes in Fiduciary Net Assets / Changes in		
	Assets	Liabilities	Net Assets	Current Year	Prior Year	Total
INVESTMENT TRUST FUND						
To correct securities lendig obligation	\$ -	\$ (43)	\$ 43	\$ 43	\$ -	\$ 43
WORKERS' COMPENSATION INTERNAL SERVICE FUND						
To correct securities lendig obligation	\$ -	\$ (15)	\$ 15	\$ 15	\$ -	\$ 15
Total	\$ -	\$ (58)	\$ 58			\$ 58
Financial statement amounts	\$ 1,292,372	\$ 346,492	\$ 945,880			\$ (16,755)
Impact as a percentage of financial statement amounts	0.00%	-0.02%	0.01%			-0.35%