

CITY OF SACRAMENTO

Report to Management

For the Fiscal Year Ended June 30, 2007

**CITY OF SACRAMENTO
REPORT TO MANAGEMENT
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

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

We have audited the financial statements of the City of Sacramento, California (City) for the year ended June 30, 2007, and have issued our report thereon dated December 20, 2007. Professional standards require that we provide you with information related to our audit. That information is included in the Required Communications section of this report.

In planning and performing our audit of the financial statements of the City, we considered the City's internal controls in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the internal control. However, during our audit, we became aware of several matters that are opportunities for strengthening internal controls and operating efficiency. The memorandum that accompanies this letter summarizes our current year comments and recommendations.

This letter does not affect our report dated December 20, 2007, on the financial statements of the City.

The accompanying 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.

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. We have discussed our comments and suggestions with management and would be pleased to discuss them further.

Macias Gini & O'Connell LLP

Certified Public Accountants

Sacramento, California
December 20, 2007

**CITY OF SACRAMENTO
REPORT TO MANAGEMENT
REQUIRED COMMUNICATIONS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

Professional auditing standards require auditors to communicate with the audit committee (or in the absence, the governing body) on a number of subjects.

I. The Auditor's Responsibility Under Generally Accepted Auditing Standards and *OMB Circular A-133*

As stated in our engagement letter dated May 31, 2007, our responsibility as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute assurance about whether the financial statements are free of material misstatement and are fairly presented in accordance with U.S. generally accepted accounting standards. Because an audit is designed to provide reasonable, but not absolute assurance, and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

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 2005 audited financial statements in the Official Statements for the following:

\$28,825,000 Sacramento City Financing Authority 2006 Capital Improvement Revenue Bonds, Series C

\$2,430,000 Sacramento City Financing Authority 2006 Taxable Capital Improvement Revenue Bonds, Series D

\$186,950,000 Sacramento City Financing Authority 2006 Refunding Revenue Bonds, Series E

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REPORT TO MANAGEMENT
REQUIRED COMMUNICATIONS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

II. Other Information in Documents Containing Audited Financial Statements (continued)

We do not have an obligation to perform any procedures to corroborate other information contained in the Official Statements. We were not associated with and did not have any involvement in the Official Statements. Accordingly, we did not perform any procedures on these documents and provide no assurance as to the other information contained in the Official Statements.

III. Significant Accounting Policies

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. 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 the year ended June 30, 2007. We noted no transactions entered into by the City during the fiscal year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

IV. Accounting Estimates

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 are as follows:

- Accrual and disclosure of self insured claims liabilities
- Accrual and disclosure of compensated absences
- Depreciation of capital assets

Self insured claims liabilities are actuarially determined based on the City's loss history. The accrual for compensated absences is based on earned vacation and sick leave. Depreciation is estimated based on the estimated useful lives of the related capital assets. We evaluated the key factors and assumptions used to develop these estimates in determining that they are reasonable in relation to the financial statements taken as a whole.

V. Audit Adjustments

For the purposes of this report, professional standards define an audit adjustment as a proposed correction of the basic financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the City's financial reporting process (that is, cause future financial statements to be materially misstated). In our judgment, none of the adjustments we posed, whether recorded or unrecorded by the City, either individually or in aggregate, indicate matters that could have a significant effect on the City's financial reporting process.

**CITY OF SACRAMENTO
REPORT TO MANAGEMENT
REQUIRED COMMUNICATIONS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

VI. Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter 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.

VII. Consultations with Other 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.

VIII. Issues Discussed Prior to Our Retention of Independent Auditors

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.

IX. Difficulties in Performing the Audit

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

This letter is intended solely for the information and use of the Honorable Mayor, City Council, management and others within the organization.

**CITY OF SACRAMENTO
REPORT TO MANAGEMENT
FINDINGS AND RECOMMENDATIONS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

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 indentified will be done on a City risk and priority basis. For example, review and improvement of inventory controls is currently being done.

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.

**CITY OF SACRAMENTO
REPORT TO MANAGEMENT
FINDINGS AND RECOMMENDATIONS (CONTINUED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2007**

I. IDENTIFICATION AND EVALUATION OF INTERNAL CONTROLS (CONTINUED)

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.

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.

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.