



4.1-A

DEPARTMENT OF
ADMINISTRATIVE SERVICES

ACCOUNTING DIVISION

SUSAN G. MAYER
ACCOUNTING MANAGER

CITY OF SACRAMENTO
CALIFORNIA

APPROVED
BY THE CITY COUNCIL

DEC 2 1997
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SACRAMENTO, CA
OFFICE OF THE
CITY CLERK

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October 29, 1997

City Council
Sacramento, California

Honorable Members in Session

SUBJECT: ACCEPTANCE OF THE COMPREHENSIVE ANNUAL FINANCIAL REPORT AND MANAGEMENT LETTER FOR THE FISCAL YEAR ENDING JUNE 30, 1997 AND AMENDMENT OF 1997-98 BUDGET TO REFLECT ACTUAL BEGINNING AVAILABLE FUND BALANCES

LOCATION AND COUNCIL DISTRICT: CITYWIDE

RECOMMENDATION:

It is recommended that the City Council accept the Comprehensive Annual Financial Report and Management Letter for the fiscal year ending June 30, 1997.

It is also recommended that the City Council adopt the attached resolution authorizing amendment of the 1997-98 budget to reflect actual beginning of the year available fund balances.

CONTACT PERSON: Susan Mayer, Accounting Manager, 264-5058
Barbara Joy, Accountant Auditor III, 264-7943

FOR THE COUNCIL MEETING OF: December 2, 1997

BACKGROUND INFORMATION:

ANNUAL AUDIT

Each year the City contracts for an independent audit of its financial records. KPMG Peat Marwick LLP has completed an audit for the 1996-97 year and has rendered its unqualified

opinion that the City's financial statements present the financial position of the City in conformance with generally accepted accounting principles.

COMPREHENSIVE ANNUAL FINANCIAL REPORT

The City's Comprehensive Annual Financial Report (CAFR) is presented as Exhibit A to this report. The report includes the following key information:

- A transmittal letter summarizing economic conditions, major initiatives, and financial results.
- Statements of revenues and expenditures, for all City funds, which show the flow of resources into the City and the programs supported with these resources
- Balance sheets, which show the net City resources available at the end of the year to support future programming

Please note that these financial statements include the operations and financial position of both the City and the Sacramento Housing and Redevelopment Agency.

CITY GENERAL FUND

The 1997-98 budget, adopted by the City Council in June of 1997, included a five-year financial strategy for the General Fund, referred to as the "Five-year Workout." One of the key assumptions in this "Workout" was a projection that the General Fund would end the 1996-97 fiscal year with an undesignated fund balance of \$9.4 million.

This report is one of good news. The City has achieved and exceeded this goal, and is on track with out "Five-year Workout." The following points summarize 1996-97 results:

- **1996-97 General Fund operating revenues** of \$209 million exceeded budget by \$5.7 million. Surplus was generated in utility user taxes submitted by telecommunications providers, real property transfer tax from a high level of commercial property sales, vehicle license fees, and additional department fees and charges. Property taxes were slightly below budget.

These operating revenues represent a 3.5% growth over the prior year. The 1997-98 midyear budget report will provide an updated analysis of all general fund revenues and the impact of this surplus revenue on the City's five year financial plan.

- **1996-97 General Fund expenditures** of \$215 million were \$726,000 favorable to budget. While several departments exceeded their budget these overruns were generally offset with corresponding department revenue surplus. The City Attorney, Administrative Services, Fire, and Public Works departments had combined budget savings of \$2.3 million.

- **Transfers** of \$5 million from capital projects funds, after completion of debt-financed projects, has contributed to a significant growth in General Fund fund balance from the prior year.
- **Total General Fund ending fund balance** grew from \$26 million at June 30, 1996 to \$37 million at June 30, 1997. Of the ending fund balance, \$5 million is reserved for various required purposes, \$9 million is designated for economic uncertainty, \$7 million is designated for subsequent year's expenditures, and \$10 million is undesignated, as further explained below.
- The **Fund Balance Designated for Economic Uncertainty** of \$9 million is presented at the amount approved in the 1996-97 budget. The 1997-98 budget authorizes an increase in this balance to \$20 million to provide contingency for various significant financial issues facing the City in its "Five-Year Workout."
- The **Fund Balance Designated for Subsequent Years' Expenditures** includes \$2.3 million of 1996-97 savings realized by those departments which had financial results favorable to their budget. The City's current budget policy provides a savings incentive by allowing departments to "carry over" budget savings achieved in one fiscal year into the subsequent fiscal year. This report, however, proposes that FY 1996-97 savings instead be held in reserve, by each Department, until the results of the November, 1998 ballot measures are known, or, until appropriated with City Council approval for specific Department needs.
- **Undesignated fund balance** of \$10 million is \$0.8 million higher than assumed in the adopted 1997-98 budget. Separate staff reports propose appropriation of this \$0.8 million surplus for two CIP projects for which expenditures to date have exceeded appropriations.

OTHER GOVERNMENTAL FUNDS

- Certain restricted revenues, such as gas tax, grants, and bond proceeds, are reported in other governmental funds called special revenue, capital projects, and debt service funds.
- Other governmental fund revenues and expenditures are summarized on page 10 of the CAFR. Note that the City and SHRA together have leveraged \$171 million of revenue from federal state, and other outside sources to support local services.

ENTERPRISE FUNDS

Enterprise funds account for operations where user charges are intended to fully support the cost of the program, similar to a commercial entity. Enterprise funds include Utilities, Solid Waste, Parking, Convention Center, Golf, and the Marina.

- Operating results of the enterprise funds are presented on page 108 of the CAFR.
- The Utility and Solid Waste Funds realized profits for the year which will finance scheduled infrastructure improvements and landfill closure project costs. These funds remain in sound financial condition.
- The Community Center Fund operated at a loss during the year due to start-up of the Convention Center.
- The Golf Fund ended the year ahead of plan because of deferred capital/maintenance spending.
- The Marina Fund also realized a loss during the year since flood erosion in the river channel limited Marina access during the winter months.
- Exhibit B proposes adjustments to the 1996-97 budget for actual net assets available for appropriation in these funds. The deficit in the Marina Fund has been addressed in FY 98 through renegotiation of the Marina's state loan.

INTERNAL SERVICE FUNDS

- The Risk Fund rebated \$3 million of surplus equity to the General and enterprise funds during 1996-97.
- The Fleet Fund also ended the year with resources in excess of the 4% designated vehicle replacement reserve. The 1997-98 budget assumes a \$2 million rebate of this surplus to the General and enterprise funds.

MANGEMENT LETTER

The independent auditors evaluated the City's internal control structure as part of their financial audit. Their recommendations to management are summarized in Exhibit C. Recommendations address oversight of investment activities and related policies, and information system disaster planning.

FINANCIAL CONSIDERATIONS:

This resolution adjusts the 1997-98 budget to reflect actual resources carried over from the 1996-97 fiscal year.

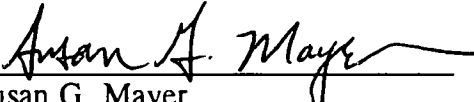
POLICY CONSIDERATIONS:

This action is consistent with the past practice of adjusting the current year budget for beginning of the year actual fund balances.

MBE/WBE

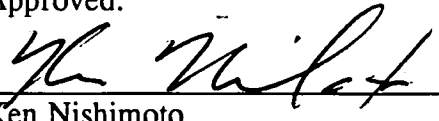
No goods or services are being purchased.

Respectfully submitted:



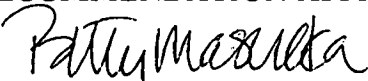
Susan G. Mayer
Accounting Manager

Approved:



Ken Nishimoto
Director of Administrative Services

RECOMMENDATION APPROVED:



for WILLIAM H. EDGAR
City Manager

APPROVED
BY THE CITY COUNCIL

DEC 2 1997

OFFICE OF THE
CITY CLERK

RESOLUTION NO. 97-657

ADOPTED BY THE SACRAMENTO CITY COUNCIL

ON DATE OF _____

**RESOLUTION ACCEPTING THE COMPREHENSIVE ANNUAL AUDITED
FINANCIAL REPORT AND MANAGEMENT LETTER FOR THE FISCAL YEAR
ENDING JUNE 30, 1997 AND AMENDING THE 1997-98 BUDGET TO REFLECT
ACTUAL BEGINNING AVAILABLE FUND BALANCES**

BE IT RESOLVED BY THE CITY COUNCIL OF THE CITY OF SACRAMENT:

The Director of Administrative Services is hereby authorized to amend the 1997-98 fiscal year budget to reflect actual beginning available fund balances.

MAYOR

ATTEST:

CITY CLERK

FOR CITY CLERK USE ONLY

RESOLUTION NO.: _____

DATE ADOPTED: _____ 6

CITY OF SACRAMENTO
Net Assets Available For Appropriation - Proprietary Funds
June 30, 1997
(in thousands)

	Water Fund	Sewer Fund	Solid Waste Fund	Golf Fund	Parking Fund	Community Center Fund	Storm Drainage Fund	Marina Fund	Total Enterprise Funds	Fleet Management Fund	Risk Management Fund	Total Internal Service Funds
Current Assets:												
Unrestricted	\$ 43,089	\$ 18,579	\$ 30,935	\$ 1,744	\$ 2,701	\$ 9,207	\$ 59,483	\$ 505	\$ 166,243	\$ 14,628	\$ 52,409	\$ 67,037
Restricted	6,380	1,070		792	4,041	10,618	765	-	23,666	-	-	-
Subtotal	49,469	19,649	30,935	2,536	6,742	19,825	60,248	505	189,909	14,628	52,409	67,037
Less Current Liabilities	(11,869)	(5,769)	(8,697)	(589)	(2,551)	(6,291)	(15,070)	(640)	(51,476)	(3,638)	(25,574)	(29,212)
Net Working Capital	37,600	13,880	22,238	1,947	4,191	13,534	45,178	(135)	138,433	10,990	26,835	37,825
Less:												
Encumbrances	(3,920)	(2,684)	(2,568)	(56)	(74)	(704)	(12,757)		(22,763)	(2,099)	(59)	(2,158)
Appropriated for Capital Projects	(26,824)	(5,775)	(3,630)	(450)	(568)	(410)	(25,323)	(23)	(63,003)	(1,609)	(162)	(1,771)
Self-insurance Catastrophic Loss Reserve									-		(3,800)	(3,800)
Other Restrictions/Designation	(1,408)	(535)	(7,214)	(792)	(3,059)	(10,618)	(765)		(24,391)	(2,198)	(22,704)	(24,902)
Net Assets Available for Appropriation	\$ 5,448	\$ 4,886	\$ 8,826	\$ 649	\$ 490	\$ 1,802	\$ 6,333	\$ (158)	\$ 28,276	\$ 5,084	\$ 110	\$ 5,194
Beginning fund balance as adopted in 97 - 98 budget	4,470	4,954	5,253	94	21	2,065	5,278	-	22,135	3,086	-	3,086
Increase <decrease> in 97 - 98 budget available resources	\$ 978	\$ (68)	\$ 3,573	\$ 555	\$ 469	\$ (263)	\$ 1,055	\$ (158)	\$ 6,141	\$ 1,998	\$ 110	\$ 2,108

400 Capitol Mall
Sacramento, CA 95814

October 10, 1997

To the Honorable Mayor and
Members of the City Council
City of Sacramento:

We have audited the general purpose financial statements of the City of Sacramento (the City) for the year ended June 30, 1997, and have issued our report thereon dated October 10, 1997. In planning and performing our audit of the financial statements of the City, we considered the internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on financial statements and not to 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 comments 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:

City Investment Policy

The California Legislature enacted SB 564 Chapter 783 and SB 866 Chapter 784 late in 1995 to restrict permissible investments and to provide oversight procedures for the management of public funds. In July of 1996, SB 864 and AB 2845, modified certain provisions of SB 564 and SB 866. There is widespread support for the objectives of these investment laws; however, many local officials have expressed uncertainty over their implementation. To address these concerns, the California Debt Advisory Committee and representatives from seven statewide associations and staff from the California Legislature (the Committee) have prepared interpretative guidelines—*Local Agency Investment Guidelines (the Guidelines)*—to aid local officials in their efforts to implement the new laws. Generally, it is the consensus of the Committee that all local agencies, regardless of their characterization, are subject to these *Guidelines*.

The *Guidelines* state that a good investment policy drives the cash, treasury, and investment management functions of an agency. Further, a strong investment policy serves as a guide for setting and achieving program objectives, defines rules and establishes benchmarks, and reduces the exposure liability of both the investment staff and the governing board. With the exception of county governments, the investment laws do not contain any provisions specifying what must be included in the investment policy of a local agency. However, the *Local Agency Investment Guidelines* do suggest that any agency would benefit from inclusion of these elements in its investment policy:

- A list of allowable securities and instruments, according to the law, and the maximum percentage and term of each type;
- The manner of calculating and apportioning the costs of the overall investing, handling, and managing of funds;
- Limits on the receipt of honoraria, gifts, and gratuities to the Treasurer or oversight committee members;
- Criteria for selecting security brokers and dealers.

In reviewing the City's adopted investment policy and Council's annual resolution delegating investment authority to the City Treasurer and approving the City's investment policy, KPMG noted that the policy does not list allowable investments nor the maximum percentage and term of each type of instrument.

KPMG recommends that the City's investment policy be amended to include a listing of permissible investments, the maximum percentage, and term of each type of instrument.

City Response - City Treasurer

In 1979, the City Treasurer presented and the Mayor and City Council approved a formal investment policy for the investment of City monies. The investment policy established the prudent person standard for persons involved in City investments, specified investment techniques and practices and established limits on individual investment authority. The investment policy was developed to address the investment authority and responsibilities of the City Treasurer as Investment Officer of the City and the various investment instruments that are managed by the Sacramento City Treasurer. That investment policy, technically modified from time to time, has served the City well through several significant market cycles and numerous staff changes in the Office of the City Treasurer.

Following the Orange County investment fiasco in December 1994 (which resulted in legislation cited by the auditors and the resulting California Debt & Investment Advisory Commission's Local Agency Investment Guidelines), the City Treasurer determined that it was in the City's best interest to not amend a time- and market-tested investment policy. It is the City Treasurer's opinion that the City should retain flexibility to respond to changing financial markets in instruments. Although it has not been litigated, the City Treasurer believes that Sacramento's authority over revenue matters precludes the California State Legislature from regulating City investments. Further, the City Treasurer believes that the City's investment policy goes beyond the limits and bounds of CDIAC guidelines since the City of Sacramento's authority goes beyond that of the State Treasurer and other municipal investment programs which do not have responsibility for common stocks, corporate bonds and other such investment vehicles.

Oversight of Investment Decisions

The *Local Agency Investment Guidelines* outline requirements for County treasury oversight committees and recommend that agencies other than counties consider whether oversight committees are appropriate for their organization. This determination should be based upon the agency's current oversight procedures, the complexity of the investment portfolio, the frequency with which securities are purchased, and the agency staff skill level. County requirements for membership on the oversight committee include representatives from the county, the board of supervisors, investing agencies as well as members from the public with appropriate expertise.

The Sacramento Treasurer's Office has established an investment committee (the Committee) consisting of the City Treasurer, Assistant City Treasurer, both Deputy City Treasurers, and the two investment officers. This committee meets once a month to review the investment portfolio, discuss market trends, and to develop investment portfolio strategies. The Committee prepares minutes of these meetings in addition to various monthly and quarterly reports which are submitted to Council for approval.

We recommend the City consider expanding the membership on the investment committee, or creating a subcommittee, that encourages representation from outside City management. While reports are submitted to the Council for approval, that process does not encourage as broad a dialog over investment decisions than would be provided by an oversight committee.

City Response - City Treasurer

The foremost responsibility for and oversight of the City's investments rests with the Mayor and City Council members. There are reporting and internal controls currently in place which have provided adequate safekeeping and oversight of the City's investments.

However, due to the City Council's workload, time is not always available for an in-depth discussion of the reports. The auditor's recommendation that the City Council appoint a City Council oversight sub-committee to review these reports would provide additional access and discussion.

Finally, the City Treasurer believes the public presentation of the investment reports would be a better oversight mechanism.

Determination of Independent Contractor Status

The Internal Revenue Service (IRS) requires the withholding of income taxes by employers on employees' wages. In general, the IRS classifies individuals providing services to an entity as "employees" if the following provisions are met:

- Services are provided to an entity at the entity's place of business
- Services provided are under the direct supervision and control of the entity
- The individual utilizes the tools and equipment of the entity while providing the service

Accordingly, an independent contractor who meets the above criteria, should have income taxes withheld by the entity for which the independent contractor performed the services. It is, therefore, important for entities who hire independent contractors, such as the City, to properly assess the independent contractor "employee" status under IRS regulations and withhold income taxes accordingly.

It is our understanding that a uniform monitoring procedure or checklist is not provided to those individuals at the City responsible for making the independent contractor "employee" determination.

We recommend that the City reinforce procedures for monitoring independent contractor vs. "employee" status and develop written guidance to assist those responsible for making this determination so that income taxes are properly withheld.

City Response - Labor Relations

The City believes it has appropriately classified all independent contractors. The City Attorney's Office reviews all contracts before they are executed. However, to reinforce IRS requirements, guidelines will be distributed to program managers for use as a tool as contracts are developed.

Information Technology Security Administration

Written guidelines are available for security usage procedures in the Network Users Guide that primarily center around how users interface with the mainframe's various applications. We recommend additional formal written information security policies be developed for the following:

- Security administration and reporting
- Information access controls
- Network security

- Security policy for each type of processing platform
- Governmental records retention policy

In addition, we believe the security environment would be strengthened by:

- Supporting a reporting framework and consistent review of security violations by information asset owners
- Increasing minimum password length from four to six and decreasing password reset attempts before suspension from six to three
- Strengthening authentication requirements of the help desk before a telephone request to reset a password is fulfilled

City Response - Computer Services

Security administration policies will be discussed as time and resources are available.

Information Technology Business Continuity Plan

The City of Sacramento has a written Disaster Recovery (Business Continuity) Plan that has not been recently updated and tested to guide the City effectively in responding to a disruption in business operations. Where individual departmental recovery plans are available, they are currently not directly coordinated with the Information Communication Services (ICS) Business Continuity Plan (BCP). We recommend the City's ICS BCP be updated with specific consideration of the following aspects:

Business Continuity Planning

- Segment the plan into four to seven phases along a seven-day recovery time line, each phase with its own milestones and deliverables for ICS, City management and the user base/departments. (This would include, for example, how and when network connectivity should be expected for those recovering various distributed environments.)
- Include procedures for what to do during non-business hours when ICS/all other City staff are not present.

ICS Recovery

- Develop a high level recovery plan that outlines all of the different recovery procedures that make up the ICS recovery plan (database, operations, applications, security, online support, network connectivity, etc.).
- Develop a coordinated approach so that DASD, database, CICS, batch and applications recovery schedules occur when they are supposed to and related tasks do not interfere with one another, or slow down the recovery of critical business applications

- Formalize service contracts with PacBell to provide a full transfer of all critical telephone numbers at the data center en masse to the recovery site
- Bring all hardware/software inventory lists up to date and develop a plan to maintain them
- Include updates to the BCP in systems development and change management procedures. Upgrade capacity for short and long term recovery as systems and software requirements are upgraded for the OS/390

Coordination of Recovery Plans with Distributed Environments

- Time and coordinate with other city-wide recovery plans
- Create service level agreements with all supported departments for both availability and recoverability to ensure the BCP's proposed timeline is sufficient to support expectations of the departments
- Plan for at least two recovery tests per year where all user departments participate at least once per year

Enhancing the City's Business Continuity Plans and ICS Recovery Procedures, as well as integrating these plans with other departmental plans (such as Public Works Advanced Solutions Group (ASG) distributed network environments) will significantly improve the viability of City wide operations in the event of a disruption in operations due to disaster or other unforeseen emergency.

City Response - Computer Services

Business Continuity Plans are being updated.

Public Works Department Information Technology Distributed Network Environment

The distributed/desktop/applications environment requires resources to ensure a well-controlled distributed network environment.

Procedures for tape backups of all the production servers are currently under development. Nightly incremental as well as weekly/monthly full backups reside only on backup servers. Should a city-wide or area-wide disaster hit the downtown Sacramento area, access to both the primary and backup servers for the distributed networks would be completely cut off. To strengthen the viability of the distributed ASG environment in the event of a city-wide disaster, we recommend:

- Identify an offsite location to store backups outside of Sacramento
- Develop a business continuity plan for the environments ASG maintains

- Develop service level agreements with the ASG customer base for availability, recoverability and security

Although ASG is not responsible for any of the core financial systems of the City, several City departments depend on the financial management reporting provided by the download of mainframe financial information onto these distributed environments. Therefore, coordinating recovery efforts with Computer Services would be more effective through the implementation of the above recommendations.

City Response - Public Works

We agree that the development and implementation of business continuity plans in concert with the Computer Services team will enhance the usefulness of and confidence in our distributed network environment. We will continue to coordinate security protocols with Computer Services and will implement network level access controls deemed necessary within our distributed network environment.

* * * * *

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's organization 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, and management of the City and should not be used for any other purpose. This restriction is not intended to limit distribution of this letter, which is a matter of public record.

Very truly yours,

KRMS Peat Marwick LLP