



## ITEM 13

Executive Staff

Richard Stensrud  
Chief Executive Officer

Steve Davis  
Chief Investment Officer

Robert L. Gaumer  
General Counsel

Kathryn T. Regalia  
Chief Operations Officer

John W. Gobel, Sr.  
Chief Benefits Officer

**For Agenda of:**  
December 21, 2016

December 15, 2016

**TO:** President and Members  
Board of Retirement

**FROM:** Kathryn T. Regalia  
Chief Operations Officer

**SUBJECT:** Independent Auditor's Report, Report on Internal Controls and Compliance,  
and Report to Management

As you will recall, each year SCERS undergoes a financial audit by an independent, external auditing firm. At the Board Meeting, Rick Green, Partner, and Leah Jue Cochran, Manager, of Macias Gini & O'Connell, LLP, (Macias Gini) will present the three attached reports to your Board:

- In the Independent Auditor's Report as of and for the fiscal years ended June 30, 2016 and 2015, Macias Gini expresses a 'clean' opinion on SCERS' financial statements based on its audit. The Independent Auditor's Report is also contained in the Financial Section of SCERS' Comprehensive Annual Financial Report on pages 18-20.
- The Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards (Report on Internal Controls and Compliance) noted no matters involving internal controls that Macias Gini considered to be material weaknesses, and their tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.
- The Report to the Board of Retirement contains communications required by auditing standards.

Independent Auditor's Report, Report on Internal Controls and Compliance,  
and Report to Management  
December 15, 2016  
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Mr. Green and Ms. Cochran will be available to answer any questions during the meeting.  
If you have any questions in the interim, please call me at 874-9088.

Respectfully submitted,

Concur:

Kathryn T. Regalia  
Chief Operations Officer

Richard Stensrud  
Chief Executive Officer

Attachments



## INDEPENDENT AUDITOR'S REPORT

To the Board of Retirement of the  
Sacramento County Employees' Retirement System  
Sacramento, California

### Report on the Financial Statements

We have audited the accompanying financial statements of the Sacramento County Employees' Retirement System (the System) as of and for the fiscal years ended June 30, 2016 and 2015, and the related notes to the financial statements, which collectively comprise the System's basic financial statements as listed in the table of contents.

### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditor's Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatements of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## ***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net position of the Sacramento County Employees' Retirement System as of June 30, 2016 and 2015, and the changes in fiduciary net position for the fiscal years then ended in accordance with accounting principles generally accepted in the United States of America.

## ***Emphasis of Matter***

As discussed in Note 2 to the basic financial statements, the System implemented the provisions of Governmental Accounting Standards Board Statement No. 72, *Fair Value Measurement and Application*, effective for the fiscal years ended June 30, 2016 and 2015.

As discussed in Note 4 to the basic financial statements, the total pension liability based on actuarial valuations as of June 30, 2016 and 2015, exceeded the System's fiduciary net position by \$1.8 billion and \$1.1 billion, respectively. Actuarial valuations are very sensitive to the underlying actuarial assumptions, including a discount rate of 7.50 percent, which represents the long-term expected rate of return.

Our opinion is not modified with respect to these matters.

## ***Other Matters***

### ***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that management's discussion and analysis, the Schedule of Changes in Net Pension Liability and Related Ratios, Schedule of Employer Contributions, and Schedule of Annual Money-Weighted Rate of Return, as listed in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about 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 audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

### ***Other Information***

Our audits were conducted for the purpose of forming an opinion on the financial statements that collectively comprise the System's basic financial statements. The other supplemental information, introductory, investment, actuarial and statistical sections are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The other supplemental information in the financial section is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the other supplemental information is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

The introductory, investment, actuarial and statistical sections have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on them.

**Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated December 2, 2016 on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the System's internal control over financial reporting and compliance.

Macias Gini & O'Connell LLP

Sacramento, California  
December 2, 2016



**INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL  
OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER  
MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED  
IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

To the Board of Retirement of the  
Sacramento County Employees' Retirement System  
Sacramento, California

We have audited, in accordance with the auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Sacramento County Employees' Retirement System (the System), as of and for the fiscal years ended June 30, 2016 and 2015, and the related notes to the financial statements, which collectively comprise the System's basic financial statements, and have issued our report thereon dated December 2, 2016. Our report contained emphasis-of-matter paragraphs that describe the implementation of Governmental Accounting Standards Board Statement No. 72, *Fair Value Measurement and Application* and the total pension liability in relation to the fiduciary net position of the pension plan as of June 30, 2016 and 2015.

***Internal Control over Financial Reporting***

In planning and performing our audit of the financial statements, we considered the System's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, we do not express an opinion on the effectiveness of the System's internal control.

A *deficiency in internal control* 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 a 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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

### ***Compliance and Other Matters***

As part of obtaining reasonable assurance about whether the System's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

### **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*Macias Gini & O'Connell LLP*

Sacramento, California  
December 2, 2016

**SACRAMENTO COUNTY EMPLOYEES'  
RETIREMENT SYSTEM**

Report to the Board of Retirement

For the Fiscal Year Ended June 30, 2016



Certified  
Public  
Accountants





December 2, 2016

To the Board of Retirement of the  
Sacramento County Employees' Retirement System  
Sacramento, California

We have audited the financial statements of the Sacramento County Employees' Retirement System (the System) for the fiscal year ended June 30, 2016. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and *Government Auditing Standards*, 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 September 7, 2016. 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 System are described in Note 2 to the financial statements. As discussed in Note 2 to the basic financial statements, the System implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 72, *Fair Value Measurement*, for the fiscal years ended June 30, 2016 and 2015. We noted no transactions entered into by the System 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 financial statements were:

- Fair value of real assets, absolute return, private equity, and opportunities investments and related income
- Actuarial valuation of the total pension liability and actuarially determined contributions for the defined benefit pension plan

As described in Note 3 to the basic financial statements, limited partnership real assets, absolute return, private equity, and opportunities investments are reported at net asset value based on the System's ownership interest in partners' capital to which a proportionate share of net assets is attributed. Investments at net asset value are commonly calculated by subtracting the fair value of liabilities from the fair value of assets. The System reported its net asset values based on the related partnerships' June 30, 2016 financial statements. Real assets also include direct investments in real estate, which are classified as Level 3 in the fair value hierarchy as the fair value of properties owned directly are based on annual independent third-party appraisals.

***Qualitative Aspects of Accounting Practices (Continued)***

The actuarial pension data contained in Note 4 to the basic financial statements and required supplementary information is based on actuarial calculations performed in accordance with the parameters set forth in GASB Statement No. 67, *Financial Reporting for Pension Plans – an amendment of GASB Statement No. 25*. The actuarial valuation is very sensitive to the underlying actuarial assumptions, including the discount rate. As described in Note 4 to the basic financial statements, the actuarial valuation for the defined benefit pension plan involves estimates of the value and assumptions about the probability of events far into the future, and those amounts and assumptions are subject to continual revision as actual results are compared to past expectations.

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.

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosure affecting the financial statements was the employers' net pension liability for the defined benefit pension plan, which is the difference between the total pension liability measured in the most recent actuarial valuation as of June 30, 2016 and the defined benefit pension plan's fiduciary net position as of June 30, 2016.

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 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. Management has corrected all such misstatements. 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 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 2, 2016.

### ***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 System’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 System’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 following required supplementary information (RSI) that supplements the basic financial statements:

1. Management’s Discussion and Analysis
2. Schedule of Changes in Net Pension Liability and Related Ratios
3. Schedule of Employer Contributions
4. Schedule of Annual Money-Weighted Rate of Return

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 nor provide any assurance on the RSI.

We were engaged to report on the following supplementary information, which accompany the financial statements but are not RSI:

1. Schedule of Administrative Expenses
2. Schedule of Investment Fees and Expenses
3. Schedule of Payments to Consultants
4. Statements of Changes in Assets and Liabilities - Agency Fund

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.

**Other Matters (Continued)**

We were not engaged to report on the introductory, investment, actuarial, and statistical sections, which accompany the financial statements in the Comprehensive Annual Financial Report, but are not RSI. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, 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 board of retirement and management of the System and is not intended to be, and should not be, used by anyone other than these specified parties.

Very truly yours,

*Macias Gini & O'Connell LLP*