

February 23, 2012

To the Audit Committee
of the City of San Diego

This letter is in response to the following questions asked by the City of San Diego's (City's) Audit Committee with respect to the audit of the City's financial statements for the year ended June 30, 2011. Our responses to the questions are specifically related to our audit of the City, as the primary government, and does not extend to the City's discretely presented and blended component units.

- 1. Was any audit work not performed due to any limitations placed on you by management (e.g., any areas scoped out by management, or any restriction on fees that limited the scope of your work)?**

No.

- 2. Explain the process your firm goes through to assure that all of your engagement personnel are independent and objective with respect to our audit. Do any non-audit services performed for the City or its related entities affect the work that you do or the manner in which the engagement team or others are compensated?**

All Macias Gini & O'Connell LLP (MGO) staff sign an annual independence statement effective July 1 of each year, attesting to their independence related to all of our clients. MGO staff are provided with a complete listing of all active clients for review prior to completing the annual independence statement. The annual independence statements are reviewed by our Human Resources department and all instances of potential conflicts of interest are forwarded to the firm's Quality Control Partner for resolution. All prospective work with existing clients is reviewed in advance to determine potential conflicts of interest. MGO does not compensate staff for "selling" additional work. We are not aware of any independence issues related to the services performed for the City.

- 3. Was the audit performed in accordance with generally accepted auditing standards (GAAS standards) or generally accepted government auditing standards (GAGAS standards)? If not, why?**

Yes, the audit was performed in accordance with GAAS and GAGAS.

- 4. Do the financial statements contain deviations from generally accepted accounting principles (GAAP)? If so, why?**

The financial statements do not contain material deviations from GAAP.

5. Were any new accounting principles adopted, were any changes made, or did you recommend any changes, in the accounting policies used or their application?

Yes. As disclosed in Note 1(w) to the financial statements, the City adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 54, "Fund Balance Reporting and Governmental Fund Type Definitions" and GASB Statement No. 59, "Financial Instruments Omnibus".

- *Required disclosures related to GASB Statement No. 54 are included in Note 1(s) and Note 22.*
- *Required disclosures related to GASB Statement No. 59 are included in Note 3.*

We did not recommend any changes in the accounting principles used or their application.

6. Were there any significant accounting adjustments affecting the financial statements (prior year as well as current year)?

All known accounting adjustments (corrected or uncorrected) identified during the audit have been disclosed in the schedules attached to our Statement on Auditing Standards No. 114, "The Auditor's Communication with Those Charged with Governance" (SAS 114) letters to the Audit Committee for the years ended June 30, 2010 and 2011.

7. Are there any areas of the financial statements, including the notes, in which you believe we could be more explicit or transparent, or provide more clarity to help a user better understand our financial statements?

No. We believe that the financial statements and disclosures are appropriate.

8. Have you expressed any concerns or comments to management with respect to how our presentation, including the notes or Management's Discussion & Analysis, could be improved?

Management incorporated our recommendations into the City's FY 2010/11 Comprehensive Annual Financial Report (CAFR).

9. Based on your audit procedures, do you have any concerns as to whether management may be attempting to commit management override? Have you noticed any biases as a result of your audit tests with respect to accounting estimates made by management?

Based on our audit procedures, we did not note any attempts by management to commit management override, nor did we notice any biases with respect to accounting estimates made by management.

- 10. Did you encounter any difficulties in dealing with management in performing the audit, including any disagreements with management regarding any accruals, estimates, reserves or accounting principles? Did you have the full cooperation of management and staff?**

We did not experience any significant difficulties in dealing with management throughout the audit process nor did we have any significant disagreements with management regarding accruals, estimates, reserves or accounting principles. We received full cooperation from management and staff.

- 11. Were there any accounting issues on which you sought the advice of other audit firms or regulatory bodies?**

No. We did not seek the advice of other audit firms, nor did we consult with regulatory bodies concerning accounting issues related to the City's FY 2010/11 CAFR.

- 12. Describe any difficulties you encountered while performing the audit (e.g., delays by management in allowing you to begin the audit, lack of access to information, unreasonable timetables, unavailability of personnel, etc.)**

We did not encounter any significant difficulties in performing the audit.

- 13. Discuss your impressions of the performance of the City's financial management in terms of the completeness, accuracy and faithfulness of the financial reporting process.**

The City continues to make strides towards improving the external financial reporting process. The City has been actively updating and documenting its financial reporting process and internal controls related to significant transaction cycles and/or business processes through the completion of process narratives and process flow diagrams.

In addition, as a testament to the continuous improvements that have been made, the number and size of any corrected and/or uncorrected misstatements has decreased.

- 14. Describe any situation in which you believe management has attempted to circumvent the spirit of GAAP, but has yet complied with GAAP.**

We are not aware of any situation in which management attempted to circumvent generally accepted accounting principles.

- 15. Would you characterize management's application of GAAP as conservative, aggressive or somewhere in between?**

Management's application of GAAP is conservative in nature.

16. Are there any new pronouncements and or areas of potential financial risk affecting future financial statements of which the Audit Committee should be aware?

The following table outlines the new accounting and reporting standards that could have a future impact on the City’s basic financial statements.

<i>New Accounting Standard</i>	<i>Required Implementation Date</i>
<i>GASB Statement No. 60, Accounting and Financial Reporting for Service Concession Arrangements</i>	<i>FY 2012/13</i>
<i>GASB Statement No. 61, The Financial Reporting Entity – Omnibus – An Amendment of GASB Statements No. 14 and No. 34</i>	<i>FY 2012/13</i>
<i>GASB Statement No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements</i>	<i>FY 2012/13</i>
<i>GASB Statement No. 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position</i>	<i>FY 2012/13</i>
<i>GASB Statement No. 64, Derivative Instruments – Application of Hedge Accounting Termination Provisions – An Amendment of GASB Statement No. 53</i>	<i>FY 2011/12</i>

The City will be required to implement GASB Statement No. 64 for FY2011/12. This could impact the City’s disclosures related to Cash and Investments since the San Diego City Employees’ Retirement System (SDCERS) has derivative instruments.

In June 2011, GASB issued two Exposure Drafts (ED), which propose changes to existing accounting and reporting for pension benefits provided to employees by state and local governments. One ED addresses the accounting and reporting for employers and the other ED addresses the accounting and reporting for the pension plan. Our discussion focuses on the impact of the proposed standard on reporting by employers.

The proposed changes relate only to the accounting and reporting, and do not extend to the governmental entities approach toward the funding of pension plans. The exposure draft and proposed updates arise from GASB’s reexamination of its current pensions standards, which

is part of the broader effort of periodically examining the effectiveness of existing accounting and financial reporting standards.

Currently, state and local governments are required to recognize a net pension obligation to the extent that a deficiency exists between the employer's actuarially determined annual required contribution (ARC) and the actual contributions made. This net pension obligation is then adjusted annually for one year's interest on the net pension obligation and an adjustment to the ARC for amortization of past contribution deficiencies. Also, the difference between a government's total pension obligation and plan assets available to fund benefits is referred to as the "unfunded obligation", which is not recorded in the financial statements, but is disclosed in the notes.

If the proposed changes are adopted by GASB, the net pension liability, which governments would report in their financial statements, would be equal to the difference between the total pension liability (as actuarially determined) and the fair value of the assets set aside in a pension plan to pay the benefits to current employees, retirees, and beneficiaries at each fiscal year end. This proposed change is anticipated to have a profound effect on the government's financial statements, and will likely result in large deficit unrestricted net assets.

In October 2011, the GASB held public testimony concerning the proposed changes. GASB's current technical plan anticipates that the final standard will be issued in the second quarter of 2012. Assuming that the standard becomes effective as set forth in the current ED, it is anticipated that the City would be required to implement the provisions of the new standard for the year ended June 30, 2014.

GASB is currently revisiting the accounting and reporting of other postemployment benefits (OPEB) and plans to issue new standards after the final pension standards are issued. GASB's current technical plan anticipates the issuance of an exposure draft in the third quarter of 2013 with a final standard issued in the second quarter of 2014.

17. How would you compare the City's financial reporting with that of comparable government entities with which you are familiar?

The City appears to have a sufficient level of expertise related to financial reporting due in part to the commitment and experience of the City's financial management and reporting team. Additionally the City surpasses most of its peers in the use of its Disclosure Practices Working Group (DPWG) and proactive audit committee.

18. Please explain the significance of any significant deficiencies or material weaknesses referenced in your letter or report dealing with the City's internal controls.

There were no significant deficiencies or material weaknesses identified during the FY 2010/11 audit.

Our response to this question only pertains to the City, as the primary government, and does not relate to other stand alone audits of the City's discretely presented or blended component units that we conducted, as any internal control or compliance findings would be separately reported to those respective entity's governing body.

19. Are there any questions we have *not* asked that should have been asked? If so, what are those questions?

No.

Sincerely,

Macias Fini & O'Connell LLP