

**CITY OF NEVADA CITY,
CALIFORNIA**



**REQUIRED COMMUNICATION AND MANAGEMENT REPORT
FOR THE YEAR ENDED
JUNE 30, 2012**

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CITY OF NEVADA CITY
Required Communication and Management Report
For the Year Ended June 30, 2012

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The Honorable Mayor and Members of the City Council
City of Nevada City
Nevada City, California

In planning and performing our audit of the financial statements of City of Nevada City as of and for the year ended June 30, 2012, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing our audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control. We have issued a separate report on Internal Control Over Financial Reporting and on Compliance and Other Matters Required by Government Auditing Standards dated November 30, 2012.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies.

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. We did not identify any deficiencies in internal control that we consider to be material weaknesses.

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. We consider deficiency 12-FS-01 in the City's internal control over financial reporting to be a significant deficiency. This finding is presented in the separate report referred to above and also in the Schedule of Findings and Recommendations that accompanies this letter.

Following this letter, we have included a report on communications as required by auditing standards generally accepted in the United States of America.

The Honorable Mayor and Members of the City Council
City of Nevada City
Nevada City, California

This communication is intended solely for the information and use of management, the City Council, others within the entity, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in cursive script, appearing to read "Smith & Newell".

Smith & Newell, CPAs
Yuba City, California
November 30, 2012

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We have audited the financial statements of the governmental activities, business-type activities, each major fund, and the aggregate remaining fund information of the City of Nevada City for the year ended June 30, 2012. 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 during the planning of our audit. 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 City are described in the notes 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, 2012. We noted no transactions entered into by the government unit 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 estimate affecting the City's financial statements is depreciation of capital assets.

We evaluated the key factors and assumptions used to develop the City's estimate in determining that they are reasonable in relation to the financial statements taken as a whole.

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 agreed to correct 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 each opinion unit's financial statements taken as a whole.

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Disagreements with Management

For purposes of this letter, a disagreement with management is 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.

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 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.

OTHER MATTERS

With respect to the supplementary information accompanying the financial statements, 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.

CITY OF NEVADA CITY
Schedule of Findings and Recommendations
For the Year Ended June 30, 2012

12-FS-01 Deficit Unassigned Fund Balance (Significant Deficiency)

Condition

During our audit we noted that the General fund and seven nonmajor special revenue funds had deficit unassigned fund balances. The balance in unassigned fund balance is the amount of current net assets available to finance future operations. In particular, an adequate level of unassigned fund balance in the General fund is essential to mitigate current and future risks and to ensure stable service levels. This is a repeat of a prior year finding.

Cause

The City has not been able to maintain adequate levels of unassigned fund balance in the General fund and seven nonmajor special revenue funds.

Criteria

The Governmental Accounting, Auditing and Financial Reporting (Blue Book) recommends that local governments regardless of size, maintain unrestricted fund balance in their General fund of no less than two months of regular general fund operating revenues or regular general fund operating expenditures.

Effect of Condition

The City may not be in a position to adequately fund required future operations.

Recommendation

We recommend that the City establish a formal policy on the level of unassigned fund balance to be maintained in the General fund. This policy should provide both a temporal framework and specific plans for increasing the level of unassigned fund balance to bring it in compliance with that policy. In addition the City should review all special revenue funds with negative unassigned fund balance and determine what action is appropriate.

Corrective Action Plan

The Finance Director will establish a formal policy on the level of unassigned fund balance to be maintained in the General Fund. The policy will address and outline a specific plan for increasing the level of unassigned fund balance to bring the City into compliance with the policy. The Finance Director and Accounting Clerk will review all special revenue funds for negative unassigned fund balances on a quarterly basis and determine the corrective action to be taken.

CITY OF NEVADA CITY
Schedule of Prior Year Recommendations
For the Year Ended June 30, 2012

Audit Reference

Status of Prior Year Recommendations

11-FS-01

Deficit Unassigned Fund Balance

Recommendation

We recommend that the City establish a formal policy on the level of unassigned fund balance to be maintained in the General fund. This policy should provide both a temporal framework and specific plans for increasing the level of unassigned fund balance to bring it in compliance with that policy. In addition the City should review all special revenue funds with negative unassigned fund balance and determine what action is appropriate.

Status

In Progress

11-FS-02

Budget

Recommendation

We recommend that the City control and monitor expenditures so that they do not exceed the approved budget. If a budget revision is required, we recommend that the City take appropriate action to amend the original budget.

Status

Implemented