

COUNTY OF MILWAUKEE, WISCONSIN

REPORT ON INTERNAL CONTROL

December 31, 2010

COUNTY OF MILWAUKEE, WISCONSIN

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To the Board of Supervisors
of the County of Milwaukee, Wisconsin

In planning and performing our audit of the basic financial statements of the County of Milwaukee, Wisconsin as of and for the year ended December 31, 2010, we considered the County's internal control over financial reporting (internal control) to determine our auditing procedures for the purpose of expressing our opinions on the basic 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 control and improving operating efficiency. The following comments are related to procedural matters which can be implemented by County staff. As always, you should consider the costs of making improvements to the expected benefits. This report does not affect our report, dated July 28, 2011, on the basic financial statements of the County of Milwaukee. We have also included some comments related to policy matters for your consideration and other comments for informational purposes.

The status of these comments will be reviewed during the 2011 audit. We have already discussed these comments and suggestions with various County personnel, and we will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist the County in implementing the recommendations.

This report is intended solely for the information and use of the Board of Supervisors, management and others within the organization and is not intended to be, and should not be, used by anyone other than the specified parties.

Baker Tilly Virchow Krause, LLP

Milwaukee, Wisconsin
July 28, 2011

PROCEDURAL COMMENTS

COUNTY-WIDE MATTERS

Cash Reconciliations (Repeated comment since 2003 report)

During our audit of various cash account reconciliations, we noted numerous reconciling items affecting a number of County departments that were not recorded in a timely manner into the Advantage System. During its year end closing process, the County has three closing periods and the Department of Audit completes cash reconciliations at each closing period, if necessary. The unrecorded reconciling items are given to the various County departments after each reconciliation is complete. Specifically, our review of these items in the current year noted adjustments for activity covering the entire fiscal year that were not recorded by the responsible department. We recommend that procedures be implemented to ensure that all reconciling items be recorded timely to provide the accurate financial reporting of cash on hand. In addition, we recommend that follow up discussions take place between the various departments and the Department of Audit concerning open reconciliation items to explain the reconciliation items and ensure that these items can be addressed in a timely fashion. Lastly, we also recommend that a review be made of any material reconciling items during the year end closing process to confirm the source and accuracy of these reconciling items.

County's Response

In 2009 and 2010 the Department of Administrative Services (DAS), the Department of Audit, and the Treasurer's Office worked together to ensure reconciling items are recorded in a timelier manner. In 2009, the Treasurer's Office eliminated reconciling items for outstanding checks related to closed bank accounts, and in 2010 began a process to clear outstanding checks for active accounts. In addition DAS has cleared all reconciling items in payroll accounts. DAS, the Department of Audit and the Treasurer's Office will continue to work together to ensure the accounting records are properly adjusted for reconciling items.

Miscellaneous Cash Accounts (Repeated comment since 2007 report)

Our review of the cash and investment accounts noted a number of Advantage System cash accounts which did not have reconciliations prepared during the year. The reasons for the lack of reconciliations vary between accounts; however reconciliations should be maintained for all cash and investment accounts held by the County. We recommend that account reconciliations be prepared for all cash and investment accounts in a timely manner to ensure accurate financial reporting.

County's Response

As of December 31, 2010, Milwaukee County had six cash and investment accounts recorded in the Advantage System which had outstanding reconciling items. Two of the accounts have since been reconciled and cleared. Three accounts have reconciling items that are minor in nature and will be written off. The final cash account has had an outstanding balance since the inception of the current financial system which will also be written off.

COUNTY-WIDE MATTERS (continued)

**Miscellaneous Receivable Accounts
(Repeated comment since 2009 report)**

During our review of the miscellaneous receivable accounts, we noted a number of these accounts which had no activity recorded within them during the past year. We recommend that the County review the collectability of the amounts included in these accounts and establish an allowance for uncollectible amounts if necessary to ensure accurate financial reporting.

County's Response

Three accounts had minor balances which have been outstanding for several years. The County will review the accounts and either make necessary entries or will write off the balances of the accounts.

Approval of Timecards

During our testing of internal control procedures related to payroll, it was noted that five on-line timecards, out of a sample of 184 timecards, did not contain documentation of proper approval. We recommend that all timecards be reviewed and approved by appropriate supervisory personnel and that such approval be documented.

County's Response

While a high percentage of time cards are being approved by managers, we agree with the results of the review that not all time-cards are being approved by management. Departments are responsible for the notification of managers who have not approved time cards. The Department of Administrative Services will prepare a listing of timecards that have not been approved by managers. These lists will be sent to department heads or financial managers to notify them of the importance of timecard approval by managers.

Internal Service Fund Deficit

At December 31, 2010, the Information Management Services internal service fund had a deficit net asset balance of \$5.9 million. A deficit net asset balance in internal service funds is not consistent with generally accepted accounting principles. We recommend that County management evaluate this fund on its appropriate classification as an internal service fund. Items to consider in this evaluation include the recent history of fund expenses exceeding fund revenues and whether it is the County's intention to recover all costs, including depreciation, through user charges.

County's Response

The deficit in the Internal Service Fund is invested in capital Assets, net of related debt. The account consists of capital assets of the fund, net of general obligation bond debt used to build those assets. DAS is evaluating the timing of the amortization of bonds and the depreciation of assets and will provide a status update to the outside auditor within the next six months regarding a potential solution.

DEPARTMENT OF ADMINISTRATIVE SERVICES

Expedite Closing and Financial Reporting Process (Repeated comment since 1999 report)

We noted that approximately 42 adjusting journal entries were made subsequent to April 2, 2011 relating to the 2010 financial statements, which is an increase in the number of entries that were made during the 2009 audit. We understand that several of the 2010 adjustments related to the conversion entries needed to meet the requirements of GASB Statements 34 and 45. However, we recommend the County continue to investigate ways to reduce the number of adjusting entries made long after the end of the fiscal year as a few of these entries significantly impacted the amount of the County's 2010 budget surplus calculation. The enforcement of individual department's compliance with the year-end closing calendar may help to improve this process.

Department of Administrative Services Response

The Department of Administrative Services realizes that it has taken longer with the closing process than what was originally expected. The closing process should be timely in order to issue the financial statements earlier, thus making them more useful for management in dealing with current year financial issues, and budgeting for subsequent years. The County will have to address several issues to make the closing timelier and therefore reducing the number of closing entries. These issues include the addition of accounting help for positions that are currently vacant, the processing of entries that could be made prior to year-end, and the timing of capital carryover reports that cannot be completed until the final reporting period in the financial system.

The Department of Administrative Services will continue to work towards eliminating post-close entries in order to expedite the external audit process and financial statement presentation.

Construction in Progress

During our review of capital assets, we noted that the County does not maintain a current and complete listing of open projects and the corresponding costs to support the construction in progress balance. As part of the year end closing process, the balance reported as construction in progress is calculated based on the expenditures incurred and the funding source of the project. We recommend that the County initiate a process to track and monitor open projects and the related costs on a more timely basis.

Department of Administrative Services Response

The Department of Administrative Services will work with the Department of Transportation and Public Works to develop an automated process that will indicate which projects are substantially complete and generate a report for the outside auditors.

EMPLOYEES' RETIREMENT SYSTEM ("ERS")

Participant Files and Vitech System (Repeated comment from 2007 report)

We selected a sample of participants that were employed during the year to test the accuracy of the actuarial data. We trace the information provided to the actuary on the actuarial file to supporting documentation included in the V-3 system or personnel file. It was found that several of the files selected for testing had missing enrollment forms or the files contained incomplete information. Two instances were found where employees had terminated but this change in employment was not processed in the V-3 system timely. This resulted in the employees being considered active in the actuarial file when in fact they should have been considered terminated. Furthermore, there were four retirees for whom a retirement application could not be located, and an additional five retirees for which work history could not be located in the V-3 system or personnel file.

We recommend that close attention be paid to the existence of participant and retiree files. Furthermore, we recommend that you ensure the information included within the files is complete and accurate and that the V-3 system is updated accordingly and in a timely manner. It is extremely important that participant and retiree files be kept either hard copy or electronically as information included in these files is vital to support the recalculation of the benefit being received as well as documentation of beneficiaries.

Employees' Retirement System Response

Prior to 1994, ERS had a pure paper record system. We then automated with our Genesys system for the next sixteen years. This system was not maintained well by the County, resulting in questionable data, manual work-arounds and inconsistent processing. ERS went live with a new V-3 retirement system in 2009. In the last two years we compounded this complexity by scanning all major documents for our entire record system back to 1938, and transitioning to a new record format system. Although missing documents may have occurred in previous times, it should not be a problem today. In order to retrieve documents, one must search in several locations: 1) V-3 scanned documents file; 2) paper record; 3) HR file; or off-site storage.

Currently, ERS is operating in an emergency mode, with triple-level retirement processing and three simultaneous audits being conducted. However, ERS has made some structural changes in the records room that will expedite the scanning of documents process. ERS does maintain a secured and locked records room, with County staff controlling files retrieval and signing out of records.

EMPLOYEES' RETIREMENT SYSTEM ("ERS") (continued)

Benefit Payments

During the audit of benefit payments, it was discovered that one beneficiary was not receiving the correct monthly payment based on the fact that the COLA increase did not commence during the year. Upon investigation by ERS, it was noted that the beneficiary was not properly "linked" to the former Milwaukee County retiree in the V-3 system. The improper linkage resulted in the COLA increase not taking effect during the year. In holding conversations with ERS staff, it is our understanding that management previously became aware of this situation while performing their monthly inspection over COLA adjustments. We also noted one retiree whose final average salary per the V-3 system did not appear to be calculated properly based on the person's employment status, which resulted in an inaccurate monthly benefit amount. It has been expressed to us that ERS has a multi-layered process in place to review new benefits calculations.

Although the linkage concerning final average salary did not have a material impact on the financial statements as a whole, we recommend that ERS continues performing internal audits on the COLA adjustments each month in order to fulfill its fiduciary responsibilities to the Plan members and beneficiaries. Management should specifically review and make sure that all beneficiaries are properly linked to the respective retirees that were formerly employed by Milwaukee County, and that all COLAs are being adjusted for accordingly. We also recommend that ERS includes the accuracy of the final average salary automatically calculated by V-3 when reviewing benefit calculations as this does factor into a pensioner's benefit amount.

Employees' Retirement System Response

ERS has proactively instituted a system of checks and balances in 2010. These systems remain in place in 2011. Specifically, all COLA's for retirees and beneficiary members are reviewed for accuracy on a monthly basis. In essence, 100% of the COLA's are checked on an annual basis. ERS staff are also being retrained on retiree and beneficiary COLA's. Our quality control efforts are being conducted in an effort to validate V-3 calculations and ensure accurate payments.

It should be noted that ERS has a three-tier process for reviewing all check/payments that are generated on a monthly basis. This includes reviewing eligibility for benefits, service credits and final average salary. These three levels include worker-to-worker review, V-3 Core Team and management random samplings. It is the goal of ERS to implement a fourth review-level by the Fiscal Officer in 2011.

The V-3 system was designed to perform eligibility determination, calculate benefits and generate payments. However, it is the responsibility of ERS to perform quality assurance checks and balances, in order to validate proper system functions and identify malfunctions.

DEPARTMENT OF AUDIT

**Review of Financial Functions
(Repeated comment since 2007 report)**

An internal audit review of IMSD applications supporting the financial functions of the County should be completed. This internal audit should include periodic application audits for material applications.

Department of Audit's Response

Department of Audit staff has been actively involved with oversight of implementation of County financial systems including the Ceridian payroll system and the Vitech pension system through the training and post implementation phases.

In addition, a review of applications supporting the County's financial functions is underway. After first identifying financial systems that interface with the County's Advantage accounting system, a review of the Department of Parks' Fairway Point of Service system was undertaken. Issuance of the audit report associated with this review is anticipated in September 2011.

There are plans to conduct similar reviews of other IMSD applications supporting financial systems on an ongoing basis.

DEPARTMENT ON HEALTH AND HUMAN SERVICES – HOUSING DIVISION

Housing Loan Allowance

During our review of housing loan receivables, it was noted that the allowance for uncollectible housing loans receivable was being calculated based on percentages that were determined several years ago. We recommend that a process be put in place to evaluate the allowance percentages used and adjust those percentages as necessary based on current facts and circumstances.

Housing Division Response

Allowance for Uncollectible Housing Loans Receivables will be recalculated each year for fiscal reporting. The steps listed below describe how HOME will calculate the percentage using a rolling 3 year average:

1. Determine the actual total of loans written off over the prior three year period.
2. Determine the total loans receivable for the same three year time period.
3. Calculate the percentage of total loans receivable that have resulted in bad debt write offs by dividing:

$$\frac{\text{Total actual loans written off (Step 1)}}{\text{Total loans receivable (Step 2)}}$$

INFORMATIONAL COMMENTS

TWO WAY COMMUNICATION REGARDING YOUR AUDIT

As part of our planning for the 2011 audit, the following informational point is intended to provide enhanced communication to you as the individuals charged with governance.

Specifically, we are required to communicate certain things during the planning phase of the audit. The following items are presented to you for your consideration as part of our planning.

- a. We are responsible for forming and expressing an opinion about whether the financial statements that have been prepared by management (or by us) with the oversight of those charged with governance are presented fairly, in all material respects, in conformity with generally accepted accounting principles.
- b. The audit does not relieve management or those charged with governance of their responsibilities.
- c. An audit performed in accordance with generally accepted auditing standards is designed to obtain reasonable but not absolute assurance that the statements are free of material misstatement.
- d. Our consideration of internal control is to determine a basis for designing audit procedures and not for the purpose of expressing an opinion on internal control.
- e. We are responsible for communicating significant financial statement related matters to those charged with governance; however, we are not required to design procedures to find such matters.
- f. The financial statement document may also contain other information for which we have the following responsibility:
 - 1) Supplemental Information – “In relation to” audit coverage
 - 2) Required Supplemental Information – Limited procedures
 - 3) Additional Information – No audit coverage

With regard to the audit of your December 31, 2011 financial statements, the following points are an overview of our scope and timing:

- a. We address the significant risks of material misstatement, whether due to fraud or error, through our detailed audit procedures.
- b. We will obtain an understanding of the five components of internal control sufficient to assess the risk of material misstatement of the financial statements whether due to error or fraud, and to design the nature, timing, and extent of further audit procedures. We will obtain a sufficient understanding by performing risk assessment procedures to evaluate the design of controls relevant to an audit of financial statements and to determine whether they have been implemented. We will use such knowledge to:
 - > Identify types of potential misstatements.
 - > Consider factors that affect the risks of material misstatement.
 - > Design tests of controls, when applicable, and substantive procedures.

TWO WAY COMMUNICATION REGARDING YOUR AUDIT (continued)

We will not express an opinion on the effectiveness of internal control over financial reporting or compliance with laws, regulations, and provisions of contracts or grant programs. For audits done in accordance with *Government Auditing Standards*, our report will contain the following restriction: "This report is intended solely for the information and use of the Board of Supervisors, management, others within the County, federal and state awarding agencies and pass-through entities and is not intended to be, and should not be, used by anyone other than these specified parties."

- c. The concept of materiality recognizes that some matters, either individually or in the aggregate, are important for fair presentation of financial statements in conformity with generally accepted accounting principles while other matters are not important. In performing the audit, we are concerned with matters that, either individually or in the aggregate, could be material to the financial statements. Our responsibility is to plan and perform the audit to obtain reasonable assurance that material misstatements, whether caused by errors or fraud, are detected.
- d. We and other auditors address the significant risks or material noncompliance, whether due to fraud or error, through our detailed audit procedures.
- e. Other auditors will obtain an understanding of the five components of internal control sufficient to assess the risk of material noncompliance related to the federal and state awards whether due to error or fraud, and to design the nature, timing, and extent of further audit procedures. They will obtain a sufficient understanding by performing risk assessment procedures to evaluate the design of controls relevant to an audit of the federal and state awards and to determine whether they have been implemented. They will use such knowledge to:
 - > Identify types of potential noncompliance.
 - > Consider factors that affect the risks of material noncompliance.
 - > Design tests of controls, when applicable, and other audit procedures.

Our audit and the work performed by other auditors will be performed in accordance with U.S. generally accepted auditing standards, *Government Auditing Standards*, OMB Circular A-133 and the *State Single Audit Guidelines*.

The other auditors will not express an opinion on the effectiveness of internal control over financial reporting or compliance with laws, regulations, and provisions of contracts or grant programs. For audits done in accordance with OMB Circular A-133 and the *State Single Audit Guidelines*, the report of other auditors will contain the following restriction: "This report is intended solely for the information and use of the Board of Supervisors, management, others within the County, federal and state awarding agencies and pass-through entities and it not intended to be, and should not be, used by anyone other than these specified parties."

- f. The concept of materiality recognizes that some matters, either individually or in the aggregate, are important for reporting material noncompliance while other matters are not important. In performing the audit, other auditors are concerned with matters that, either individually or in the aggregate, could be material to the County's federal and state awards. The responsibility of the other auditors is to plan and perform the audit to obtain reasonable assurance that material noncompliance, whether caused by error or fraud, is detected.

We are very interested in your views regarding certain matters. Those matters are listed here:

- a. We typically will communicate with your top level of management unless you tell us otherwise.

TWO WAY COMMUNICATION REGARDING YOUR AUDIT (continued)

- b. We understand that the Board of Supervisors has the responsibility to oversee the strategic direction of your organization, as well as the overall accountability of the entity. Management has the responsibility for achieving the objectives of the entity.
- c. We need to know your views about your organization's objectives and strategies, and the related business risks that may result in material misstatements.
- d. Which matters do you consider warrant particular attention during the audit, and are there any areas where you request additional procedures to be undertaken?
- e. Have you had any significant communications with regulators or grantor agencies?
- f. Are there other matters that you believe are relevant to the audit of the financial statements or federal and state awards?

Also, is there anything that we need to know about the attitudes, awareness, and actions of the Board of Supervisors and management concerning:

- a. The County's internal control and its importance in the entity, including how those charged with governance oversee the effectiveness of internal control?
- b. The detection or the possibility of fraud?

We also need to know if you have taken actions in response to developments in financial reporting, laws, accounting standards, governance practices, or other related matters, or in response to previous communications with us.

With regard to the timing of our audit, here is some general information. All work is coordinated and scheduled with the concurrence of management and staff. If necessary, we may do preliminary audit work during the months of October - December and sometimes early January. Our final fieldwork is scheduled during the months of April – July to best coincide with your readiness and report deadlines. After fieldwork, we wrap up our audit procedures at our office and may issue drafts of our report for your review. Final copies of our report and other communications are issued after approval by your management. This is typically 4-8 weeks after final fieldwork, but may vary depending on a number of factors. The other auditors typically perform the single audit fieldwork concurrent with the timing noted above for the financial audit. After the single audit fieldwork, the other auditors wrap up the single audit procedures at their office and then issue drafts of their report for management's review and approval.

Keep in mind that while this communication may assist us with planning the scope and timing of the audit, it does not change the auditor's sole responsibility to determine the overall audit strategy and the audit plan, including the nature, timing, and extent of procedures necessary to obtain sufficient appropriate audit evidence.

At the conclusion of the audit, we are also required to communicate a number of items. One such communication is our identification of significant deficiencies or material weaknesses in internal control. Auditing standards now require us to perform a more in-depth review of the documentation of your internal controls. As a result, our procedures and inquiries may identify situations that are reportable to you as a significant deficiency or material weakness. Examples of such reportable situations are as follows:

- > Lack of segregation of duties (incompatible duties)
- > Lack of review of journal entries by someone other than the preparer or documentation of such review

TWO WAY COMMUNICATION REGARDING YOUR AUDIT (continued)

- > Lack of review of reconciliations of significant account balances by someone other than the preparer or documentation of such review
- > Inability to prepare a complete set of financial statements, including footnotes, in accordance with generally accepted accounting principles
- > Lack of review of the financial statements, if prepared by your staff, by someone other than the preparer or documentation of such review
- > Material adjustments to the financial statements not identified by your internal controls
- > Restatement to previously issued financial statements

This list is not all-inclusive, but does identify common examples of significant deficiencies or material weaknesses. Because your specific circumstances may change from year to year, it is possible that we will be required to report a significant deficiency or material weakness due to the change in circumstances.

While we work with management and staff in reviewing the financial data and the financial statements, our contract is with the Board of Supervisors and our responsibility is to report to the Board of Supervisors. If you have any questions or comments concerning our audit, please contact your engagement partner, John A. Knepel, at 414.777.5359 or email at John.Knepel@bakertilly.com, the engagement senior manager, Steven J. Henke, at 414.777.5342 or email at Steven.Henke@bakertilly.com or the engagement manager, Paul Frantz at 414.777.5506 or email at Paul.Frantz@bakertilly.com. We welcome the opportunity to hear from you.

DEPARTMENTAL CONTROLS

As part of our annual audit process, we focus our efforts on the primary accounting systems, internal controls, and procedures used by the County. This is in keeping with our goal to provide an audit opinion which states that the financial statements of the County are correct in all material respects.

In some cases, the primary system of accounting procedures and controls of the County are supported by smaller systems which are decentralized, and reside within a department or location. In many cases, those systems are as simple as handling cash collections and remitting those collections to the county treasurer. In other cases, the department may send invoices or statements of amounts due, and track collections of those amounts in a standalone accounts receivable system.

Generally, the more centralized a function is, the easier it is to design and implement accounting controls that provide some level of checks and balances. That is because you are able to divide certain tasks over the people available to achieve some segregation of duties. For those tasks that are decentralized, it may be more difficult to provide for proper segregation of duties. Therefore, fewer people involved in most or all aspects of a transaction, you lose the ability to rely on the controls to achieve the safeguarding of assets and reliability of financial records.

As auditors, we are required to communicate with you on a variety of topics. Since there is now more emphasis on internal controls and management's responsibilities, we believe it is appropriate to make sure that you are informed about the possibility that a lack of segregation of duties that may occur at departments or locations that handle cash or do miscellaneous billing. The County has a number of decentralized departments and / or locations that may fit this situation.

As auditors, we are required to focus on the financial statements at a highly summarized level and our audit procedures support our opinion on those financial statements. While we do evaluate internal controls at some decentralized departments each year, departments or locations that handle relatively smaller amounts of money are not the primary focus of our audit. It is not unusual to have a lack of segregation of duties within some of these decentralized departments and, therefore, the opportunity for loss is higher there than in centralized functions that have more controls.

Because management is responsible for designing and implementing controls and procedures to detect and prevent fraud, we believe that is important for us to communicate this information to you. We have no knowledge of any fraud that has occurred or is suspected to have occurred within the County departments. However, your role as the governing body is to assess your risk areas and determine that the appropriate level of controls and procedures are in place. As always, the costs of controls and staffing must be weighed against the perceived benefits of safeguarding your assets.

Without adding staff or splitting up the duties, your own day-to-day contact and knowledge of the operation are also important mitigating factors.

Department of Administrative Services Response

Milwaukee County management is aware of the importance of segregating duties within the departments. The Department of Administrative Services and the Department of Audit periodically evaluate the procedures and controls within the departments to ensure adequate controls are in place. The Department of Administrative Services and the Department of Audit will continue to monitor and evaluate departmental operations to minimize our risk of potential fraud.

NEW ACCOUNTING AND REPORTING REQUIREMENTS

GASB No. 54: Fund Balance Reporting

The Governmental Accounting Standards Board (GASB) has issued Statement No. 54, which changes governmental financial reporting. These changes will affect your financial statements for the year ended December 31, 2011, primarily the governmental fund balance sheet presentation. No changes are necessary for proprietary fund types or government-wide statements. The major change is to the terminology used for fund balance reporting. The terms reserved, unreserved, designated and undesignated are being replaced with the following categories: nonspendable, restricted, committed, assigned, and unassigned. The new categories are designed to promote more consistent financial reporting throughout the nation.

The GASB made these changes to fund balance reporting to make it easier for the reader of financial statements to determine the various levels of restrictions that may exist for the future use of fund balance. In addition to the new method for displaying fund balances, the Statement also clarifies the definitions of the various governmental fund types. You will want to understand the new rules in time for you to make necessary changes by December 31, 2011. You will also need to consider adopting fund balance policies so that options available in GASB No. 54 can be used by your government.

Department of Administrative Services Response

The Department of Administrative Services and the Department of Audit will examine the requirements of this Statement to ensure the new reporting standards are implemented properly.

GASB No. 60: Accounting and Financial Reporting for Service Concession Arrangements

The Governmental Accounting Standards Board (GASB) has issued Statement No.60, which establishes reporting guidance for service concession arrangements (SCAs). These agreements between governments and private entities (sometimes called public-private partnerships) or other governments (public-public partnerships) have become more prevalent. As used in this Statement, an SCA is an arrangement between a transferor (a government) and an operator (governmental or nongovernmental entity) in which (1) the transferor conveys to an operator the right and related obligation to provide services through the use of infrastructure or another public asset (a facility) in exchange for significant consideration and (2) the operator collects and is compensated by fees from third parties.

This Statement is designed to improve consistency in reporting these types of arrangements and consequently enhance the comparability of the accounting and financial reporting of SCAs among state and local governments. This Statement applies specific criteria to determine whether a government transferor has control over the facility and therefore, should report the facility as its capital asset. The Statement also provides guidance related to revenue recognition and other matters that are typically associated with these arrangements. This statement also provides guidance for governments that are operators in an SCA. Lastly, the Statement provides guidance related to financial statement disclosures related to these arrangements. The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2011.

Department of Administrative Services Response

The Department of Administrative Services and the Department of Audit will examine the requirements of this Statement to ensure the new reporting standards are implemented properly.

NEW ACCOUNTING AND REPORTING REQUIREMENTS (continued)

GASB No. 61: The Financial Reporting Entity: Omnibus

The Governmental Accounting Standards Board (GASB) has issued Statement No.61, which changes governmental financial reporting for component units. These changes will affect your financial statements for the year ended December 31, 2013, primarily the government-wide financial statements, and possibly the fund financial statements.

This Statement modifies certain requirements for inclusion of component units in the financial reporting entity. For organizations that previously were required to be included as component units by meeting the fiscal dependency criterion, a financial benefit or burden relationship also would need to be present between the primary government and that organization for it to be included in the reporting entity as a component unit. Further, for organizations that do not meet the financial accountability criteria for inclusion as component units but that, nevertheless, should be included because the primary government's management determines that it would be misleading to exclude them, this Statement clarifies the manner in which that determination should be made and the types of relationships that generally should be considered in making the determination.

This Statement also amends the criteria for reporting component units as if they were part of the primary government (that is, blending) in certain circumstances. For component units that currently are blended based on the "substantively the same governing body" criterion, it additionally requires that (1) the primary government and the component unit have a financial benefit or burden relationship or (2) management (below the level of the elected officials) of the primary government have operational responsibility (as defined) for the activities of the component unit. New criteria also are added to require blending of component units whose total debt outstanding is expected to be repaid entirely or almost entirely with resources of the primary government. The blending provisions are amended to clarify that funds of a blended component unit have the same financial reporting requirements as a fund of the primary government. Lastly, additional reporting guidance is provided for blending a component unit if the primary government is a business-type activity that uses a single column presentation for financial reporting.

This Statement also clarifies the reporting of equity interests in legally separate organizations. It requires a primary government to report its equity interest in a component unit as an asset.

You will need to determine how these new requirements will affect your financial statements.

Department of Administrative Services Response

The Department of Administrative Services and the Department of Audit will examine the requirements of this Statement to ensure the new reporting standards are implemented properly.

CUSTODIAL CREDIT

Governmental Accounting Standards Board (GASB) Statement No. 40 requires disclosures about deposits and investments. One of the main purposes of GASB Statement No. 40 is to indicate to users of financial statements the custodial risks involved with an entity's deposits and investments. These disclosures are included in the notes to your financial statements.

With regard to deposits at banks, the FDIC coverage under the Transaction Guarantee Program (TAG) was greatly expanded for those banks choosing to participate. The FDIC coverage normally was \$250,000 for noninterest bearing accounts. Under the TAG program, the coverage was unlimited for noninterest bearing accounts, which included low interest NOW accounts. This coverage was in effect through December 31, 2010.

As of January 1, 2011, the FDIC will still provide unlimited coverage for noninterest bearing accounts, but the coverage for low interest bearing accounts reverts back to the old limit of \$250,000 for all interest bearing accounts combined. All banks are covered under the new rules.

Department of Administrative Services Response

The Department of Administrative Services is aware of the changes noted above and will ensure that the appropriate disclosures are included in the 2011 comprehensive annual financial report.

BAKER TILLY VIRCHOW KRAUSE'S COMMENTS ON MANAGEMENT RESPONSES

We have reviewed the management responses included herein. We believe management generally has been responsive to the recommendations. For a majority of the recommendations, management has agreed with our comments and has initiated actions to address the comments.