COUNTY OF MILWAUKEE, WISCONSIN

REPORT ON INTERNAL CONTROL

As of and for the Year Ended December 31, 2011

COUNTY OF MILWAUKEE, WISCONSIN

TABLE OF CONTENTS
As of and for the Year Ended December 31, 2011

BAKER TILLY

Baker Tilly Virchow Krause, LLP
115 S 84th St, Ste 400
Milwaukee, WI 53214-1475
tel 414 777 5500
fax 414 777 5555
bakertilly.com

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

In planning and performing our audit of the financial statements of the County of Milwaukee, Wisconsin as of and for the year ended December 31, 2011, in accordance with auditing standards generally accepted in the United State of America, we considered its internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of its internal control. Accordingly, we do not express an opinion on the effectiveness of its internal control.

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 significant deficiencies or material weaknesses and, therefore, there can be no assurance that all such deficiencies have been 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 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, as defined above.

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 the following deficiencies in the County's internal control to be significant deficiencies:

- Financial reporting
- Time card approval

In addition, during our audit we became aware of additional 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 31, 2012, 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.

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

The status of these comments will be reviewed during the 2012 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.

The County of Milwaukee's written responses to the significant deficiencies and other matters identified in our audit have not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

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 these specified parties.

Baker Tilly Virchow Krause, LLP

Milwaukee, Wisconsin
July 31, 2012

SIGNIFICANT DEFICIENCIES

Financial Reporting

In theory, a properly designed system of internal control staffed with enough people with sufficient training would provide your organization with the ability to not only process and record monthly transactions, but also to accurately prepare the annual financial statements in a timely manner.

With the departure of the Deputy Comptroller and the restructuring of the Comptroller's position, there was a lack of resources in the Department and available time by the Comptroller to prepare and review a complete and accurate financial statement in a timely manner.

Certain portions of the County's financial statements, specifically the portion of the financial statements applicable to the government-wide financial statements and related reconciliations and the general fund budgetary statement required significant changes to bring them into conformance with generally accepted accounting principles. The remaining sections of the report were materially correct based upon our audit.

The County should evaluate the need to provide additional, competent staff resources to provide timely and accurate yearend financial reporting.

Office of the Comptroller Response

The Comptroller's office realizes the need to meet internal control standards and to provide a timely financial report for the use of the County and other users of the financial report. The addition of the Comptroller's office, under State Statute, will provide additional review for County financial issues, and greater internal control compliance, by providing a segregation of duties between offices. However, this cannot be achieved without adequate staffing, and as you have noted above, additional staff is needed to meet the restructuring. The Office of the Comptroller will be requesting additional positions, and will work hard to fill the vacant positions in the department. We take the recommendation seriously, and will address the issue.

Time Card Approval

Our testing of time card approvals noted that time cards do not always have the required approval of the department supervisor. This situation was not isolated to any one department but appears to occur within almost every department. We have estimated that the frequency of occurrence is approximately 2.2%. Unapproved time cards increases the risk that employees are not properly compensated for the correct number of hours worked. In addition, the documentation of time card approval by authorized personnel which is required by County policy is lacking in these instances. The County should review and strengthen its time card approval process to ensure that all time cards are approved in accordance with established policies. As part of any change in procedures, a system of monitoring should be implemented to identify and follow up on time cards not approved.

Office of the Comptroller Response

While a high percentage of time cards are being approved by responsible managers, it has been noted that we still have less than 100% compliance with the approval process. The County may consider a change in its requirement of 100% approval, but only if it can identify an alternative control that can be implemented to ensure that payroll payments are proper. The County will work with Human Resource coordinators, department managers and payroll clerks to find a solution to this issue.

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.

Office of the Comptroller Response

The Office of the Comptroller and the Treasurer's Office have been working on the reconciling of major accounts for the past several years in order to clear outstanding items. These two offices will work together to develop a policy and procedure for the timely clearing of reconciling items. This process could take up to a year to complete, and will focus initially on accounts with larger balances and greater levels of activity. From 2009 – 2011, the Treasurer's office has cleared reconciling items for the major accounts of the County including payroll and accounts payable.

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.

Office of the Comptroller Response

As of December 31, 2011, Milwaukee County had five cash and investment accounts recorded in the Advantage Financial System which had outstanding reconciling items. Many of these were trust accounts, which will require further investigation and entries to be made. We may find that these accounts are no longer needed and the account closed.

COUNTY-WIDE MATTERS

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.

Office of the Comptroller Response

The County will review the accounts during the year and make a determination for write-off of the accounts or the establishment of a reserve for doubtful accounts.

Internal Service Fund Deficit
(Repeated comment since 2010 report)

At December 31, 2011, the Information Management Services internal service fund had a deficit net asset balance of $4.0 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 changes.

Office of the Comptroller Response

The deficit in the Internal Service Fund is in invested 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. The Office of the Comptroller will evaluate the timing of the amortization of bonds and the depreciation of assets and provide a status update to the external audit firm within the next six months regarding a potential solution.

COUNTY-WIDE MATTERS

Wire Transfer Approval

During our testing of internal control procedures related to wire transfers it was noted that the procedures followed for wire transfers are inconsistent. In some instances, it was noted that transfers are being initiated before they have proper approval. We also noted that department heads are able to approve EFT forms as well as prepare them, which does not provide for a proper segregation of duties. We recommend that all wire transfers be reviewed and approved by appropriate supervisory personnel not involved with the wire transfer and that such approval be documented.

Office of the Comptroller Response

The Office of the Comptroller will review procedures related to wire transfers and modify them as necessary to strengthen internal controls and achieve desired processing consistency. The Office of the Comptroller is looking to institute an automated EFT process within the Advantage Financial System, which would simply allow for an EFT payment process. As a result of this change, the EFT payments will flow through all of the controls placed into Advantage before payment can be made. Approvals will then follow protocol and payment will not be made until all steps have been successfully completed.

Evaluation of Investment Values

The County uses a variety of investment vehicles with values that fluctuate throughout the year due to interest rates and market conditions. The County utilizes investment managers for these investments and places reliance on the monthly investment statements for adjusting the carrying value of the County's investment to the appropriate value. It was noted during the audit process, that a few of the investment vehicles included on the statements did not use current market values to determine the investment values. We recommend that County implement a procedure to confirm that current market values are used in the investment statements which the County relies upon to adjust investments to market value at year end.

Office of the Comptroller Response

The Office of the Comptroller will develop a procedure that will ensure current market values are used to adjust investments to market value at year end. At year end, the County will take a sample of the investments and verify their listed fair market value. Any issues with the sample will require an increase in the sample size, and a discussion with the investment firms that prepared the report.

COUNTY-WIDE MATTERS

Encumbrances

The County utilizes a process of encumbering funds upon the issuance of contracts or purchase orders. Through this process, fund balance is segregated to provide funding for the ultimate payment of the obligation once the work or service has been performed and the County is invoiced. As part of the yearend closing process, the County reviews open encumbrances, identifying those encumbrances which have been invoiced and applicable to the previous year. Those amounts are reclassified and recorded as an expenditure/expense and accounts payable. It was noted that the County only performs this process through the month of February. We recommend that the County extend this process through the end of period 14-3 to ensure that all material expenditures/expenses of the prior year are identified and properly reported.

Office of the Comptroller Response

The Office of the Comptroller will modify closing procedures to extend its review of open encumbrances through the end of the close so that all expenditures/expenses of the prior year are identified and properly reported. This review will include an evaluation of capital projects for hold backs on contracts.

OFFICE OF THE COMPTROLLER

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

We noted that approximately 46 adjusting journal entries were made subsequent to April 16, 2012 relating to the 2011 financial statements, which is an increase in the number of entries that were made during the 2010 audit. 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 2012 budget surplus calculation. The enforcement of individual department's compliance with the year-end closing calendar may help to improve this process.

Office of the Comptroller Response

The Office of the Comptroller realizes that it has taken longer with the closing process than 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 more timely and therefore, reducing the number of closing entries. These issues include the addition of accounting help for positions that are currently vacant, adding additional accounting positions, 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 Office of the Comptroller will work towards eliminating post-close entries in order to expedite the external audit process and financial statement preparation.

Construction in Progress
(Repeated comment since 2010 report)

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 timelier basis.

Office of the Comptroller Response

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

Trust and Agency Funds

Trust and agency funds are to be reviewed once every two years in accordance with County policy. The most recent review completed was for the year 2007. Based on our inquiries during the audit, it was noted that a review as of December 31, 2009 has been started but the review has not been finalized. We recommend that the 2009 review be finalized and that the County has a process in place to ensure that these trust and agency accounts are reviewed every other year, as required by County policy.

Office of the Comptroller Response

The Office of the Comptroller will finalize its review of trust and agency funds as of December 31, 2009. A process will be developed to ensure that trust and agency funds are reviewed every other year to comply with County policy.

DEPARTMENT OF ADMINISTRATIVE SERVICES – PROCUREMENT DIVISION

Purchase Card Policy

During our testing of internal control procedures related to purchase cards, we noted that the County has established and implemented a standard purchase card policy county-wide; however, it was noted that several departmental policies / procedures have deviated from the County's standard policy. We reviewed and tested compliance with the general policies for multiple departments and found that there are inconsistencies in the applications of the policies. Exceptions to the policies noted during our testing included the following:

- No physical documentation of supervisory personnel review.
- No pre-authorization documented for required pre-authorization purchases.
- No separate review of Purchase Card Manager's activity.

We recommend that the County communicate the importance of compliance with the County's standard purchase card policy, particularly the process and procedures related to appropriate documentation, approval and monitoring.

DAS – Procurement Division's Response

The Procurement Division will inform the departments of the importance of compliance with purchasing card policy and procedures with emphasis on the Approving Supervisor and/or Department Card Coordinator reviewing, signing and/or initialing log sheets and other related documents as evidence that a review was performed.

COUNTY BOARD

Budget Publication

The budget is required to be published following Wis. State. 59.60(7). In 2011, the County was unable to comply and publish the budget within the required guidelines. We recommend that the County has a process is in place to ensure that the budget is published following state guidelines.

County Board Response

The County Board will comply with Wisconsin Statutes by publishing the budget summary at least 14 days prior to the public hearing scheduled on October 29, 2012. In future years, the Board will follow a process that ensures that these state guidelines are followed.

Benefit Payments

During the audit of benefit payments, it was discovered that the V-3 system was not using the correct COLA amount for one beneficiary and was not using the proper factor rate for another beneficiary. In both cases, it appears as though the ERS staff caught these problems and was able to accurately calculate each participant's benefit payment. The V-3 system was overridden so that the participants received the appropriate amounts. Furthermore, it was also noted that several beneficiaries eligible for backDROP payments received incorrect benefit payments as the V-3 system was incorrectly calculating the backDROP amounts. It is our understanding that management previously became aware of this situation while performing an internal audit of the V-3 system, and that the issues stem from the way V-3 was programmed rather than V-3 not functioning as programmed.

Through communications with various ERS staff members, it has been expressed to us that the ERS staff conduct a multi-layer review of each and every new benefit calculation. Although the COLA and factor rates as well as backDROP errors did not materially impact the financial statements, we continue to recommend that ERS monitor every facet of the benefit calculations, including but not limited to, factor rates, service credits, final average salaries, and the accuracy of both monthly and backDROP calculations.

Employees' Retirement System Response

The V-3 system is being reprogrammed to calculate backDROP payments correctly. All payment calculations to beneficiaries will continue to be reviewed at three levels.

Actuarial File

As part of our audit procedures over the actuarial valuation, we are required to test the underlying data used in the valuation. We use the actuarial file that is derived from the V-3 system to perform our audit procedures over the participant data information. After receiving the initial actuarial file, it was noticed that the pension earnings field and the service credits field were incomplete. ERS management had to provide the actuary with a separate file containing complete pension earnings data. Based on communications with the third party actuary, it appears that the actuary completes a multi step process each year in order to obtain a reasonable level of comfort regarding the accuracy and completeness of the underlying demographic data. The actuary confirmed that information has to be sent in multiple files and a comparably significant amount of data reconciliation takes place between the actuary and ERS staff. While this comprehensive process appears to result in the accumulation of necessary data sufficient to meet the needs of the third party actuary, the process includes several manual steps which can increase the chance of human error.

To further satisfy our audit procedures, we selected a sample of participants, including active, newly participating, newly terminated, and newly retired. The demographic data of these people per the actuarial file was traced to supporting documentation included in the V-3 system. We also sent confirmation to the actuary to verify the final results of the participant data testing. Ultimately, we did not find any major discrepancies or multitude of discrepancies that would materially impact the valuation.

We strongly encourage ERS to improve the process of downloading and transferring the actuarial file from the V-3 system to the actuary. Further, the actuarial file(s) should be reviewed for accuracy and completeness by a person or persons on the ERS staff with a comprehensive understanding of both County benefits/operations, as well as the ultimate actuarial calculations, prior to remitting the information to the actuary. As this data is essential to the valuation performed by the actuary, complete and accurate data is vital. Improving the process will mitigate the risk of a misstated actuarial valuation.

Employees' Retirement System Response

ERS is working with the actuary and system consultants to review the process for creating the actuarial file. ERS staff will review all information and the completeness of the file prior to release to the actuary.

Risk Assessment

A vital part of internal control includes the means to effectively analyze potential risks within the organization. While certain functional areas, such as expense disbursements and the multi-layered review over benefit calculations, do have controls in place over them, it is our understanding that ERS does not have a formal process in place to analyze all potential risks over the ERS operations and financial statements. Such a process may allow those charged with governance to identify risks up front and establish the necessary controls to prevent a misstatement.

We recommend that ERS consider establishing a formal risk assessment policy at both the operating and financial reporting level. The formal policy should include not only continuous discussions and brainstorming of potential risks to the pension plan, but also should include the documentation of steps taken to identify those risks over the pension plan as well as the actions taken to mitigate such risks.

Employees' Retirement System Response

ERS appreciates this recommendation and will undertake a risk assessment at levels suggested. At completion of the assessment, a formal policy will be developed to assist in the identification, avoidance or mitigation of potential risk factors.

Housing Loan Allowance
(Repeated comment since 2010 report)

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

In our response to this recommendation in the previous year, we commented that the allowance for uncollectible housing loans receivables would be recalculated each year for fiscal reporting. The steps listed below describe how HOME wanted to 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:

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

However, it was discovered that our software could not support the data needed to calculate the above formula. We have installed the necessary system upgrade and are waiting for data conversion. The HOME program manager and Deputy Director are attempting to hold the conversion contractor to the agreed upon conversion timeframe. Recognizing that data conversion is not yet complete, we will continue to work with the contractor to get the data conversion ready so that we can implement the new calculations within this program year.

INFORMATIONAL COMMENTS

TWO WAY COMMUNICATION REGARDING YOUR AUDIT

As part of our planning for the 2012 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) Supplementary Information – "In relation to" audit coverage
    2) Required Supplementary Information – Limited procedures
    3) Additional Information – No audit coverage

With regard to the audit of your December 31, 2012 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.

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.

TWO WAY COMMUNICATION REGARDING YOUR AUDIT (continued)

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.

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
- 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 and Office of the Comptroller Response

Milwaukee County management is aware of the importance of segregating duties within the departments. An annual communication will be sent to department heads, including elected administrators, reminding them of their responsibility for designing and implementing controls and procedures to detect and prevent fraud. In addition, the Office of the Comptroller will work with the Department of Administrative Services to periodically evaluate the procedures and controls within the departments to ensure adequate controls are in place. The Department of Administrative Services and the Office of the Comptroller will continue to monitor and evaluate departmental operations to minimize our risk of potential fraud.

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.

Office of the Comptroller Response

The Office of the Comptroller will examine the requirements of this Statement to ensure the new reporting standards are implemented properly.

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 met 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.

Office of the Comptroller Response

The Office of the Comptroller will examine the requirements of this Statement to ensure the new reporting standards are implemented properly. The County will do a survey in 2012 of possible component units and have them answer a set of question in response to the changes created by GASB 61 as it relates to GASB 14 on Component Units.

GASB No. 62: Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements

The Governmental Accounting Standards Board (GASB) has issued Statement No.62, which brings FASB guidance into GASB literature. This document is effective for your financial statements for the year ended December 31, 2012, and is not expected to significantly change current practice.

The objective of this Statement is to incorporate into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the following pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements:

1. Financial Accounting Standards Board (FASB) Statements and Interpretations
2. Accounting Principles Board Opinions
3. Accounting Research Bulletins of the American Institute of Certified Public Accountants' (AICPA) Committee on Accounting Procedure

The requirements in this Statement will improve financial reporting by contributing to the GASB's efforts to codify all sources of generally accepted accounting principles for state and local governments to that they derive from a single source. This effort brings the authoritative accounting and financial reporting literature together in one place, with that guidance modified as necessary to appropriately recognize the governmental environment and the needs of governmental financial statement users. It will eliminate the need for financial statement preparers and auditors to determine which FASB and AICPA pronouncement provisions apply to state and local governments, thereby resulting in a more consistent application of applicable guidance in financial statements of state and local governments.

For the future, all post-1989 FASB guidance will be considered "other accounting literature", meaning that if there is no other guidance on a topic, you "may consider" post-1989 FASB guidance, including future FASBs.

Office of the Comptroller Response

The Office of the Comptroller will examine the requirements of this Statement to ensure the new reporting standards are implemented properly.

GASB No. 63: Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position

The Governmental Accounting Standards Board (GASB) has issued Statement No. 63, which changes governmental financial reporting for certain assets and liabilities. These changes will affect your financial statements for the year ended December 31, 2012, primarily the government-wide financial statements, and possibly the fund financial statements.

This Statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. Concepts Statement No. 4, *Elements of Financial Statements*, introduced and defined those elements as a consumption of net assets by the government that is applicable to a future reporting period, and an acquisition of net assets by the government that is applicable to a future reporting period, respectively. Previous financial reporting standards do not include guidance for reporting those financial statement elements, which are distinct from assets and liabilities.

Examples of deferred outflows may include:

- Loss on refunding of debt
- Certain advances to grantees
- Purchase of future revenues

Examples of deferred inflows may include:

- Advances received for certain grants
- Gain on refunding of debt
- Sales of future revenues
- Certain revenues received under FASB 71

The result of these changes means that your balance sheet may need to have 2 additional categories, one below assets and another below liabilities. In addition, some titles as "statement of net assets" will change to "statement of net position". There are also increased footnote disclosure requirements.

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

Office of the Comptroller Response

The Office of the Comptroller will examine the requirements of this Statement to ensure the new reporting standards are implemented properly.

NEW AUDITING STANDARDS REVISIONS

United States Auditing Standards Revisions

For the past several years, the Auditing Standards Board (ASB) has been involved with a complete rewrite of U.S. auditing standards. This has been known as the Clarity Project. The goal was to make the standards easier to read, understand, and apply. Generally speaking, this rewrite was not intended to change what auditors actually do. However, one area that did result in a significant change is called "Group Audits".

A Group Audit will typically be a situation where one audit firm does the audit for a part of an entity and a different audit firm does the audit for another part of the entity. For many governments, this occurs when one audit firm audits the general or primary government, and another audit firm audits a component unit such as a housing authority or pension plan.

The new standards will require increased communication and cooperation between the units of government and the audit firms. The auditor of the primary government will have more responsibility over the work done by the component auditor, including the planning process and review procedures. Depending on the circumstances and relationships between the government and the component units, there could be problems agreeing on these responsibilities and how to handle additional time and costs relating to the extra work.

The new standards will go into effect for audits of years ending December 31, 2012. We will be contacting you with more details on how these changes will impact you.

Office of the Comptroller Response

The Office of the Comptroller will examine the requirements of the new standards to ensure it is implemented properly.

Yellow Book (Government Auditing Standards) Revisions

In December 2011, the Government Accountability Office (GAO) released a revision to the Yellow Book auditing standards. This is a major revision and the first revision since July 2007. The changes are effective for years ending December 31, 2012.

The major change in the new standards relates to how much assistance the auditor can provide to you during the audit process. The changes cover the area of "nonaudit services". Nonaudit services include such topics as bookkeeping assistance, consulting services, and preparation of the year-end financial statements. The goal of the new standards is to make it more clear to auditors that we cannot provide services to audit clients that would impair our independence. In other words, we cannot be part of your internal control system, and we cannot perform management functions.

We are in the process of developing tools to implement the revised standards. These tools will require us to discuss with you our role and your role regarding audit services and nonaudit services. For any nonaudit services we provide, we will need to document those discussions in our audit files and you will need to confirm that you understand and agree with such documentation. It is likely that there may be other changes to the way we wrap up the financial statement process as well.

We will contact you when we have the new documentation ready for the next year's audit.

Office of the Comptroller Response

The Office of the Comptroller will confer with Baker Tilly to coordinate implementation of changes brought about as the result of the December 2011 Yellow Book revisions.

Proposed Circular A-133 Single Audit Revisions

On February 28th, 2012, the Office of Management and Budget ("OMB") issued a proposal to revise requirements of specific Circulars, including A-133. The OMB is considering an integrated set of guidelines for one consolidated Circular. The proposed changes include:

Concentrating audit resources on higher dollar and higher risk awards: The first proposed reform would not require entities that expend less than $1 million dollars in federal awards to conduct a Single Audit. Additionally, entities that expend more than $1 million but less than $3 million in federal awards will undergo an audit that only concentrates on two compliance requirements. Allowable and unallowable costs will always be a compliance requirement, but the responsible federal agency would be permitted to select the second requirement that it feels best targets risk of waste, abuse, fraud, or improper payment. Any entity expending more than $3 million in federal awards would undergo a full Single Audit.

Consolidating Circulars and cost principles: The second proposed revision includes reforms to the current cost principles (Circulars A-21, A-87, and A-122, and the Cost Principle for Hospitals). These reforms include consolidating the various cost principles into a single document. The goal is to streamline the universal compliance requirements in Circular A-133 Compliance Supplement. The compliance requirements would also be consolidated to include only those elements focused on the stewardship of federal awards.

The OMB is in the process of considering comments from the public.

We recommend that management determine the potential implications these pronouncements may have on the Corporation upon implementation. We would be happy to discuss any of these items with you.

Office of the Comptroller Response

The Office of the Comptroller will review the final pronouncements and assess the potential implications on County government operations.

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.