COUNTY OF MILWAUKEE, WISCONSIN

REPORT ON INTERNAL CONTROL

December 31, 2009

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, 2009, 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 controls 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 6, 2010, 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 2010 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 and management 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 6, 2010

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, the Department of Administrative Services (DAS), the Department of Audit, and the Treasurer's Office continued to work to ensure reconciling items are recorded in a more timely manner. Specifically, the Treasurer's Office eliminated reconciling items for over $485,000 of outstanding checks related to closed bank accounts. In addition, DAS cleared all reconciling items related to the County's payroll account through October 2009. DAS, the Department of Audit, and the Treasurer's Office will continue to work together to ensure that the accounting records are properly adjusted for reconciling items that are identified in the Department of Audit's bank reconciliations.

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, 2009, Milwaukee County had three cash accounts recorded in the Advantage System for which regular cash reconciliations are not performed. Each of these three accounts is used by a different department for petty cash purposes and the total balance of all three accounts as of December 31, 2009 was $17,174. DAS will work with each of these departments to establish procedures to reconcile the petty cash funds on a regular basis.

The remaining miscellaneous cash balances in the Advantage system were the result of coding errors for various cash receipts and journal entries. DAS will investigate each of these balances and work with the appropriate department to ensure the amounts are reclassified to the proper accounts in 2010.

Miscellaneous Receivable Accounts

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 and allowance for uncollectible amounts if necessary to ensure accurate financial reporting.

County's Response

DAS agrees with the auditor's recommendation and will investigate the miscellaneous accounts receivable balances to determine their collectability and adjust any balances as needed.

DEPARTMENT OF ADMINISTRATIVE SERVICES

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

We noted that approximately 37 adjusting journal entries were made subsequent to April 1, 2010 relating to the 2009 financial statements, which is a comparable number of entries that were made during the 2008 audit. We understand that several of the 2009 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 2009 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

Of the 37 adjusting journal entries made subsequent to April 1, 2010 ("post-close entries"), 11 entries were made solely for the purpose of financial statement presentation. These entries were necessary to properly eliminate interdepartmental charges, eliminate the debt service expense for pension obligation bonds from the General Fund, and transfer the Fleet Services and Facility Management funds to the General Fund. The entries related to interdepartmental charges and debt service expense for pension obligation bonds will need to be made each year subsequent to the close of the Advantage accounting system.

In addition, five of the post-close entries were necessary to adjust for operating and capital carryovers after the carryovers were approved by the County Board and County Executive in May 2010. One entry was needed to reflect the County Board and County Executive's approval to place surplus funds from 2009 into the Debt Service Reserve. This action was not finalized until June 2010.

Of the remaining 20 post-close entries, three of the entries impacted the County's overall 2009 surplus. One entry adjusted the Reserve for Investments, resulting in a decrease to the overall surplus of $606,000. The other two entries were posted to accrue an additional $100,000 of expenditures for 2009 services, also resulting in a decrease to the overall surplus. The remaining entries were primarily reclassification entries that were necessary for the financial statements but did not impact the County's 2009 budget surplus. 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 preparation.

EMPLOYEES’ RETIREMENT SYSTEM (“ERS”)

Internal Control Over Plan Investments
(Repeated comment since 2008 report)

During the documentation of internal controls, it was noted that there may not be enough controls in place over the Plan investments. All investments are held with Mellon, and Plan management has relied upon this trustee to handle certain investment transactions and responsibilities. Furthermore, Marquette Advisors are used as the Plan’s investment advisors, and during the audit, it was discovered that the allocation of investments were not in accordance with the stated investment policy. As part of our comments letter for prior audits we recommended that Plan management put into place controls over investments so that a comprehensive review and monitoring of investment performance and transactions takes place. It was also noted at that time that the 2010 ERS budget contained funding to enhance controls over the investments of the Plan, targeted for completion in September 2010. It appears that this control enhancement remains open.

We recommend that the valuation and accuracy of investments should be reviewed to ensure investments are stated at fair value. Additionally, valuation methods over investments should be documented in the trust agreement or in the minutes. Furthermore, even though the trustees have authority to move investments, Plan management should review changes in the portfolio mix for reasonableness and to ensure that purchases and sales of funds are made as authorized by management. Unauthorized or improper valuation methods used by the trustee could cause a material misstatement of investments.

Employees’ Retirement System Response

The current County structure for providing investment oversight is multi-layered. The Pension Board is the fiduciary body that provides governance. The Board approves the Investment Policy, reviews fund rebalancing, oversees the shifting of assets, authorizes all RFP’s, contracts, and payments. The Board delegates research, education and fiscal recommendations to the Investment Committee and Audit Committee. All preliminary work of both committees are directed back to the Pension Board as recommendations for final approval.

In addition, the ERS Manager and Fiscal Officer serve as representatives of the Board for purposes of coordinating invoices, payments, banking authorizations, custodian contacts and investment consultant coordination. Other County departments that provide some level of indirect oversight and support, are the Department of Administrative Services and the County Department of Audit.

The 2010 ERS Budget included two initiatives as an enhanced approach to our existing investment portfolio controls. The first quality assurance enhancement was the creation (in 2009) of a Fiscal Officer Assistant to serve as a second level of review on invoices, payments and the Annual Report. Due to County Budget constraints and recruitment difficulties, a two-person Fiscal operation is in the process of being fully implemented. ERS has posted the Fiscal Officer position to replace the previously retired accountant, and expects to interview and hire someone by the third quarter.

The second and new County initiative funded in the 2010 Budget was an Investment Portfolio Assessment, as recommended by the previous Baker Tilly Management Report. That project was funded for 2010 and is currently underway. Design and process meetings have been held, with specifications enumerated. It is a 90-day project that will review current processes, procedures and controls. Focus will be on calculations, rates of return and fees, including a comparison of gross fees will be made to net fees. The target for completion is September 1, 2010, with a final report provided to the Pension Board's Audit Committee in October 2010.

It was noted in the Baker Tilly Management Letter that our investment advisors were responsible for allocation of investments not being in compliance with the Pension Board's Investment Policy. It should be noted that the Pension Board is comprised of County employees, County retirees and County Executive / County Supervisor appointments. The Investment Policy is written in conjunction with the Board and maintained through close scrutiny of the Board. During the end of 2009 and beginning part of 2010, the Board took on the project of revising the current policy, in light of the desire to do the portfolio rebalancing. In an effort to transition to the new revised policy, the Board approved using a percentage range to shift funds and alter the composition of our investments. Eventually, that process worked, funds were moved, rebalancing occurred, the percentage range and integrity of the portfolio was maintained.

EMPLOYEES’ RETIREMENT SYSTEM (“ERS”)

Participant Files
(Repeated comment from 2007 report)

We selected a sample of participants that were employed during the year to test the accuracy of the calculations, as well as supporting documentation included in the file. It was found that several of the files selected for testing had missing enrollment forms or the files contained incomplete information. Furthermore, there were two retirees for which a retirement application could not be located.

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. 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

ERS Pension system maintained paper records from 1938 to 1991. The Genesys computer system provided a partially automated system from 1992 through 2008. On September 1, 2009, our new V-3 Pension System was implemented. For the first time, the V-3 system determined eligibility, calculated benefits and issued pension payments on a completely automated basis. Prior to going-live, all pension data was reviewed and cleansed, with all major documents being scanned. This system has reduced errors and provided uniformity of ordinance-driven rules.

In conjunction with a new V-3 pension system, ERS has overhauled the record maintenance system. We have gone from two record rooms to one secured facility. Under V-3, all relevant documents are electronically scanned and filed. All pension paper files have been culled, organized and filed by appropriate category: Active, Normal, Beneficiary, Disability, Deferred, and Death. The 18 major documents for retirement files have been scanned on all files going back to 1938. A fire-suppression (sprinkler) system has been installed in the Records Room, to protect the member files. The Records Room is locked and secured with limited access, to maintain member information integrity. Finally, a County employee manages the Records Room, to ensure files are kept confidential and secured.

In 2010, Baker Tilly reviewed approximately 120 ERS record files and 50 fiscal pensionable compensation files. The ERS files revealed four missing enrollment forms and two missing retirement applications. It should be noted that enrollment forms are Human Resource (HR) documents. When new employees are hired, the enrollment forms are completed, with a copy going to ERS files. Copies not found in the record should also be maintained in the HR file and imaged in the V-3 system as an electronic document. All new retirees being processed into V-3, have all relevant documents scanned.

ERS will attempt to recover the identified missing forms and update the files. It should also be noted that ERS budgeted (2010) for a quality assurance project that will do a random sampling of paper and V-3 files. That review will assess the practices followed, forms imaged, and payments rendered. For 2011, ERS will authorize Baker Tilly staff access to V-3 and provide training for system navigation. This will allow for greater transparency in finding and viewing electronic documents.

EMPLOYEES' RETIREMENT SYSTEM ("ERS")

Review of Financial Statements
(Repeated comment from 2007 report)

Management prepares the financial statements and footnotes for the Annual Report. It has been noted that a secondary review may not be performed by someone other than the individual who prepares the Annual Report, which indicates that there may be a lack of segregation of duties in the area of the preparation of the financial statement. Although it is our understanding that the recruitment of a new Fiscal Officer is underway, to date, the Pension System has relied on its external auditors to perform a secondary review of the Annual Report; this includes all applicable footnote disclosures that are required in order for the financial statements to be fairly stated in accordance with accounting principles generally accepted in the United States of America.

If you are comfortable with the current structure – namely the reliance you place on us to ensure you have all necessary required disclosures - no action is required. For instance, if you feel that the cost of developing the expertise internally to perform a secondary review outweighs the benefit, you may choose to accept the risk that information in the report or a required disclosure may be missed, including the potential elevation of this comment to a significant deficiency or material weakness should a future error so require.

If, on the other hand, you prefer to develop a control over the preparation of the annual financial statements, you could do so by appointing a separate member of the accounting department to perform a review of the Annual Report, as well as, review of the interim internally generated financial statements. If an additional member would not already have the expertise necessary to perform an adequate review, we recommend that they attend Continuing Professional Education (CPE) that addresses financial statement preparation, including required footnote disclosures. In addition, that appointee would need to attend CPE on an annual basis to stay current on new pronouncements issued during the most recent fiscal year. The benefit of taking this course of action is that the appointee might identify potential disclosures that we do not, due to their more intimate knowledge of the Pension System.

Employees' Retirement System Response

The Annual Report was prepared by the ERS Fiscal Officer Assistant. In our established practice, the Fiscal Officer would have prepared the report and the Fiscal Officer Assistant would have been the secondary review person. Due to County recruitment practices, this primary position was not filled. This situation should be corrected by the third quarter of 2010, with the hiring of a new Fiscal Officer. In the absence of a two-person fiscal unit, ERS authorized and funded an independent review of the Annual Report, by the former Fiscal Officer.

It should be noted that the Annual Report "review process" includes additional assessment steps. The draft report is first sent to the Benefits Director and ERS Manager for analysis. The Pension Board is provided a copy for comment and review. Corporation Counsel also is provided a copy for review. In the future, as recommended by Baker Tilly, ERS will provide the County Finance Department with an early draft of the prepared Annual Report. This will provide another layer of review. Continuing Professional Education (CPE) will be a high priority for our Fiscal Officer and other appropriate reviewers.

EMPLOYEES' RETIREMENT SYSTEM ("ERS")

Pensionable Compensation

While performing the participant data testing, it was discovered that the actuary had record of pensionable compensation different from that of the ERS for numerous participants in our sample. After further investigation by management, it appears that there is not one constant origin for the differences, but rather varying reasons, including situations such as the exclusion of overtime pay or a complete pay period. Furthermore, in a couple of cases, the cause of the variance in earnings is still unknown at this point. Although there were several instances of discrepancies uncovered, the overall quantitative nature of these discrepancies does not rise to a material magnitude.

Because pensionable compensation is a key component of the actuarially determined obligation of the Plan, it is vital that complete and precise data be provided to the actuary on an annual basis. Inaccurate data could potentially cause a materially erroneous disclosure in the financial statements. We recommend that a review surrounding the pensionable compensation codes set in the system be completed on an internal level. The proper payroll codes should be determined so that on a forward basis, the correct data is provided to the actuary.

Employees' Retirement System Response

The Baker Tilly audit revealed discrepancies between the actuary's participant data and the pensionable compensation of ERS. It appears that the discrepancies related to missing checks, overtime pay and Vitech software. The issue does not seem to have a major impact on the overall actuarial conclusions.

Currently, the V-3 data has been corrected. The excluded pay periods were corrected, with the overtime cases updated. ERS intends to do a monthly random sampling of generated payments, in order to monitor future variances. Vitech software will be an upcoming discussion for review. A Fiscal Procedure will be written in order to clarify pensionable compensation codes, for training purposes.

DEPARTMENT ON AGING

Care Management Organization

Effective January 1, 2010, the State of Wisconsin shifted the oversight for the care management organizations from the Department of Health Services to the Office of the Commissioner of Insurance. As such, there are new sections being added to the Wisconsin Administrative Code to address organizational matters, financial reserve requirement and annual financial reporting requirements. We understand that County management is aware of these new requirements and is currently in the process of determining how the County will comply with these new requirements. We recommend and encourage County management to continue to review these new requirements and develop a plan and procedures to ensure compliance.

Department on Aging Response

The Care Management Organization's senior fiscal and operations staff will continue to review the new requirements of OCI and will formulate a comprehensive plan to insure compliance as well as continue to improve our internal control processes.

HOUSE OF CORRECTION

Trust and Agency Account Reconciliations
(Repeated comment since 2007 report)

The House of Correction (HOC) has responsibility for a number of trust and agency accounts. These accounts are used to account for cash held by the County for use by a third party. Based on our review of the cash account reconciliations provided to us from the Department of Audit, it was noted that the activity for these accounts was not posted to the Advantage System for the entire 2009 fiscal year. We recommend that these accounts are reconciled and the appropriate adjustments posted to the Advantage System on a monthly or quarterly basis during the year.

> ***House of Correction Response***
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> The general inmate trust account activity has been posted as part of the year end closing for 2009. Our work release "Huber" accounts, which are the focus of these comments, are no longer administered at the HOC but are now the responsibility of the Accountant IV position in the fiscal office.

SHERIFF'S DEPARTMENT

Trust and Agency Account Reconciliations
(Repeated comment since 2007 report)

The Sheriff's Department has responsibility for a number of trust and agency accounts. These accounts are used to account for cash held by the Sheriff's Department for use by a third party. As required by County resolution those Departments that have trust and agency accounts are required to demonstrate that the account is properly reconciled throughout the year, and that all activity is proper. This documentation was not completed and submitted to the Department of Administrative Services. We recommend that the Sheriff's Department review their processes relating to these accounts and identify personnel to assume responsibility for the appropriateness of the account and the related account reconciliation.

Sheriff's Department Response

The general inmate trust account activity has been posted as part of the year end closing for 2009. The work release "Huber" accounts, which are the focus of these comments, will be assigned the Accountant IV position to record future account activity on a quarterly basis.

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 new County financial systems including the Ceridian payroll system and the Vitech pension system through the training and post implementation phases. In addition, an internal audit review of applications supporting the County's financial functions has recently begun. Completion is expected by the end of 2010.

DEPARTMENT OF HOUSING

Retention of Housing Loan Agreements

The Department of Housing is responsible for maintaining loan agreements for all housing loans. During our testing of the Housing loans, we noted that there were a number of agreements that were not on file. We recommend that the department review these loan files and determine if the agreements for outstanding loans are on file.

> ***Department of Housing's Response***
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> The Division will undertake to review all outstanding loan files to ensure that all required documents, including completed loan agreements are in the file. This will be completed as quickly as practicable, but in no case later than December 31, 2010.

INFORMATIONAL COMMENTS

GASB No. 51: Accounting and Financial Reporting for Intangible Assets

Governmental Accounting Standards Board (GASB) has issued Statement 51 which will require the recording and amortization of intangible assets. Governments possess many different types of assets that may be considered intangible: easements, water and timber rights, patents, trademarks, and computer software to name a few.

This new standard will require that all applicable intangible assets be recorded as capital assets. This means that intangible assets will be treated the same as other capital assets, such as a truck or building, including being written off over their useful life.

This Statement is effective for periods beginning after June 15, 2009. We recommend that management review the new disclosure requirements and make plans to obtain the required information for proper inclusion in the December 31, 2010 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, if applicable.

GASB No. 53: Accounting and Financial Reporting for Derivative Instruments

Governmental Accounting Standards Board (GASB) has issued Statement 53 which will modify the recognition, measurement and disclosure of information regarding derivative instruments entered into by state and local governments.

This Statement is effective for periods beginning after June 15, 2009. We recommend that management review the new disclosure requirements and make plans to obtain the required information for proper inclusion in the December 31, 2010 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, if applicable.

NEW ACCOUNTING AND REPORTING REQUIREMENTS (continued)

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 in the future, primarily the governmental fund balance sheet presentation. The major change is to the terminology used for fund balance reporting. Reserved, unreserved, and designated terms are all being replaced with nonspendable, restricted, committed, assigned, and unassigned terms and definitions.

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. The final standard for these changes was issued in February 2009. The changes are effective for years ending June 30, 2011 and beyond.

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.

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.