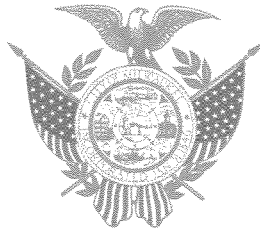


Martin Matson
Comptroller

John M. Egan, CPA
Deputy Comptroller



Glenn Steinbrecher, CPA
Special Deputy Comptroller

Toni Biscobing
Special Deputy Comptroller

Office of the Comptroller

May 21, 2013

To the Honorable
The Common Council
City Hall, Room 205
City of Milwaukee

Dear Council Members,

The following report to this letter is a review that the Comptroller's Office voluntarily requested. The review that was asked for entails a detailed and objective review by an external accounting firm, Baker Tilly. They assessed the City's current Public Debt processes and controls and then made recommendations to further improve our controls. We are committed to continually improving our processes for all of our divisions to ensure that we have properly designed effective internal controls.

As it is proper procedure to always request other departments' responses to the recommendations we provide in our audits and reviews, we will provide an outline of our plans with implementation dates to address the recommendations from this review as well.

With each recommendation listed below, a plan of action is outlined as follows.

1. In order to reduce key-man risk, we recommend cross-training or adding a new position, an assistant to the Public Debt Specialist.

Comptroller Response: With some recent staffing changes in the Financial Advisory Division, a staff member from the Financial Advisory Division will be cross-trained with the Public Debt Specialist in order to reduce the key-man risk of Public Debt. We anticipate this training to be substantially implemented by the first quarter of 2015.

2. Additional individuals (departments) should be involved in the issuance process to ensure accuracy of important steps.

Comptroller Response: The Comptroller's office will actively engage the departments responsible for the capital expenditures before the debt is issued. This will be effective by summer 2013.

3. Critical information utilized in the process of issuing debt is entered manually into spreadsheets. Certain measures should be taken to address this issue as well as having someone else review and verify accuracy of the information.

Comptroller Response: The processes around the spreadsheet data entry and using queries in



FMIS will be investigated and corrected to ease the efficiency and effectiveness of the process. Also, a staff member from the Financial Advisory section will review the spreadsheet for accuracy. Internal reviews will begin in 2013 and substantial improvements completed by December 2014.

4. Spreadsheets are maintained on the file server and could be subject to modification. A review of security and proper backups should be maintained to ensure integrity of the data.

Comptroller's Response: We will conduct our review of security and backups by September 2013.

5. A procedure should be developed to notify the Public Debt Specialist of modifications to capital budgets. The Accounting Manager also enters transactions into FMIS without review – someone else should review data entered into FMIS.

Comptroller's Response: Communications with departments have begun on this matter and a procedure will be developed to ensure proper notification to the Public Debt Specialist. We hope to have this implemented by November 2013. Estimated completion of June 2014.

6. Policies and procedures should be updated with a policy for routine reviews to occur.

Comptroller's Response: Policies and procedures will be redrafted and updated to reflect the changes in procedures as noted in this report and changes that have occurred since the last revision of the policies and procedures. Estimated completion of June 2014.

7. A policy should be developed for the investment of debt proceeds that includes a description of the allowable investments, process of acquisition and disposition of investments, and arbitrage requirements.

Comptroller's Response: We are already in full compliance with IRS debt proceeds investment and arbitrage requirements. A policy is already drafted and will be formalized by December 2013.

8. A policy on the SWAP Standard Practices should include language to utilize an advisor who is an expert on interest rate swap and related agreements.

Comptroller's Response: Policy will be updated to reflect the use of an expert. The draft of the policy will be submitted to the Public Debt Commission for review. Full implementation by December 2013.

9. The City should issue a post-issuance compliance policy that identifies parties responsible for the various requirements of post issuance compliance.

Comptroller's Response: A post issuance compliance policy will be developed reflecting all aspects of the recommendation and identify parties who are responsible for certain tasks. This policy will be drafted and submitted to the Public Debt Commission. Full implementation by December 2013.

10. City officials and department management should be trained around the regulations regarding tax-exempt financing. Also, City-wide procedures should be developed and implemented to notify the Public Debt Specialist when assets financed by tax-exempt debt are sold or used by non-City entities.

Comptroller's Response: The Comptroller will initiate this training and policy for management City-wide. We hope to execute the training and develop the policy through inter-departmental meetings in 2013 and 2014.

11. Contact the Municipal Securities Rulemaking Board (MSRB) to discuss possible solutions to attach the required filings to all of the City's outstanding debt.

Comptroller's Response: We will review our postings on EMMA (Electronic Municipal Market Access) and follow up to ensure required continuing disclosures are attached to all the City's CUSIP numbers. Completed by December 2013.

We would be happy to discuss this report and any questions you may have at the appropriate committee hearing.

Sincerely,



Martin Matson
Comptroller



Aycha Sirvanci, CPA
Audit Manager

MM:as

City of Milwaukee, Wisconsin
Contract B11786-2 Audit Consulting:
Review of Public Debt Process



Candor. Insight. Results.

Final Report

May 13, 2013

Vicki Hellenbrand, Partner

Baker Tilly
Ten Terrace Court
Madison, WI 53718



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May 13, 2013

Mr. Martin Matson, Comptroller
City of Milwaukee City Hall, Room 404
200 East Wells Street
Milwaukee, WI 53202

Dear Mr. Matson:

The City of Milwaukee (the "City") retained the services of Baker Tilly Virchow Krause, LLP (Baker Tilly) "we" or "our") to conduct a review of the process the City uses in the issuance of public debt. The scope of services is outlined below.

Project Objectives and Scope

The project's purpose is to conduct a Review of Public Debt. The results of the review will be to provide an understanding of the process that the City utilizes to issue public debt and how the City monitors compliance with various federal and state regulations.

Project Approach, Work Plan & Deliverables

The Proposed project plan as agreed upon is adaptable to ensure it meets the objectives and overall expectations of the City. To accomplish the goals of this project, we will perform the following activities:

- > We will meet with representatives of The Office of the Comptroller and develop an understanding of the current procedures that are followed in the issuance of public debt.
- > Based on those interviews, we will identify controls in place within the Comptroller's Office regarding the issuance of public debt.
- > Perform a review of the policies provided by the City that have been implemented in the management of public debt, and make recommendations to enhance the current policies.
- > We will randomly select certain debt issuances and perform a review for compliance with certain regulations of the Internal Revenue Service and the State of Wisconsin.
- > Determine applicable debt covenants were properly calculated and the City met or exceeded the covenants.

Mr. Martin Matson, Comptroller
City of Milwaukee

May 13, 2013

We will document the activities noted above in a report containing necessary background information on the process, our findings and recommendations regarding the issuance, compliance and monitoring of public debt. We would like to thank everyone for their involvement and assistance with this project.

Sincerely,

Baker Tilly Virchow Krause, LLP

A handwritten signature in black ink that reads "Vicki Hellenbrand". The signature is written in a cursive, flowing style.

Vicki Hellenbrand, CPA, Partner

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EXECUTIVE SUMMARY

The City of Milwaukee (the "City") retained the services of Baker Tilly Virchow Krause, LLP ("Baker Tilly", "we", or "our") to conduct a Public Debt Process Review. The scope of this project included:

- Meet with representatives of the Office of the Comptroller and document current procedures that are followed in the issuance of public debt
- Identify controls in place related to this function
- Perform a review of public debt issuance policies provided by the City and make recommendations for enhancements
- Randomly select certain debt issuances and perform a review for compliance with certain regulations of the IRS and State of Wisconsin
- Determine applicable debt covenants are properly calculated and the City currently meets the requirements

The following debt policies were included in our review:

- Debt Management Standard Practices
- Public Debt Commission
- Statement of Policy for the Use of Fund Balance of the Public Debt Amortization Fund
- Investment Policies of the Public Debt Amortization Fund
- Policy on Liquidity Needs of the Public Debt Amortization Fund
- Debt Remarketing Practices
- SWAP Standard Practices (Draft)

We documented the process that is currently utilized by the City in summary form on page 3. We provide an overview of the current written debt policy controls that are present and a list of recommended controls on Attachment G.

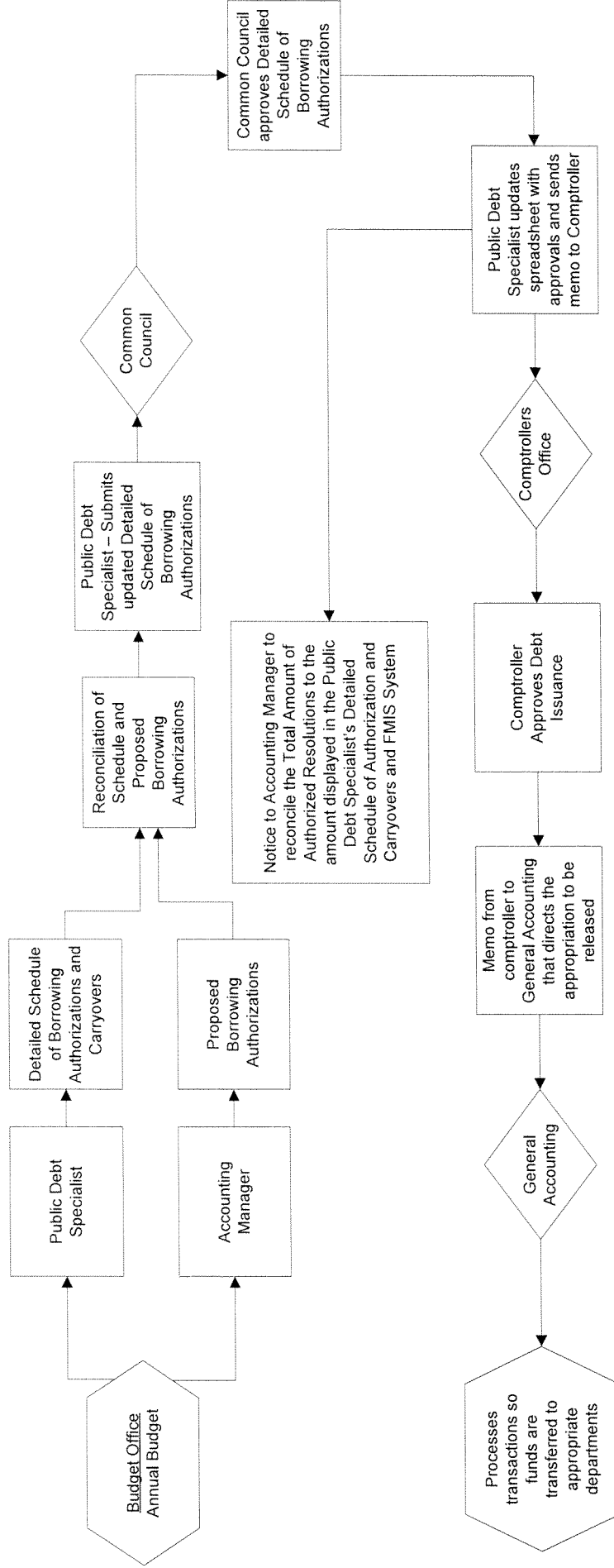
Overall the debt process is very centralized with the Public Debt Specialist. City management is aware of this issue and we believe this was a significant driver for the request for this review. Based upon our review, we have listed several recommendations beginning on page 13; below are the high priority recommendations.

- The Public Debt Specialist performs many functions within the current debt issuance process without oversight or assistance. We recommend additional individuals be involved in the issuance process to ensure accuracy of the important steps, either through cross training of existing staff or a new hire.
- Critical information utilized in the process of issuing debt is compiled manually in spreadsheets. Manual data entry can lead to input errors. Consideration should be given to the development of queries within city systems to create automatic downloads of information. In addition, critical information/formulas should be reviewed by another person to verify accuracy and completeness.

- Spreadsheets are maintained on the Comptroller's Office file server and could be subject to modification by another party. We recommend a review of security to ensure the integrity of the data and that proper backup be maintained in case the files were to be compromised.
- The Public Debt Specialist relies on information from other departments to ensure accuracy of records and completeness of continuing disclosure requirements. We recommend procedures be developed and adopted by the various departments to ensure proper information sharing. In addition, education should be provided to City officials and department heads to familiarize them with the IRS restrictions on the use of tax-exempt debt.
- Several policies were written and approved many years ago. We recommend the debt policies be reviewed, including review by bond counsel and updated
- We recommend the City develop a post-issuance compliance policy. The City should identify the parties responsible for the various requirements of post-issuance compliance. The policy should also discuss areas such as use of proceeds, record retention, filing of arbitrage rebate calculations, annual and material disclosure requirements, and compliance with financial covenants.

We would like to thank the staff of the Comptroller's office for their involvement and assistance with this project. We found the individuals we worked with to be very accommodating and receptive to our suggestions.

CURRENT STATE PROCESS FLOWCHART



CURRENT DEBT PROCESS

The City of Milwaukee issues several types of debt for the City and Milwaukee Public Schools ("School"). These borrowings can be characterized as short-term cash flow borrowings; short-term commercial paper draws for cash flow and capital projects, and long-term bonds and notes issued for capital projects. The long-term bonds can be issued to refinance, on a long-term basis, commercial paper or for new money projects.

APPROVAL TO ISSUE DEBT

The budget process is the first step in the debt issuance process. The budget identifies capital project expenditures and funding sources for projects. Funding sources include: new bond issuance, carry forward authorized debt, or other funding sources, including current cash revenues or grants. For example, the 2013 budget pages 156 to 181 includes the detailed capital expenditures of the Capital Improvement Funds, and pages 182 to 183 provide a summary of the funding sources for the Capital Improvements Funds. These pages include the fund, organization, and account of the capital expenditures, as well as the description of the project and amount budgeted. The capital improvements are subtotaled by department. For 2013, the budget for capital expenditures funded by new borrowing authorizations was \$74,964,900.

The funding sources that relate to debt are summarized by the Budget Office in section II "Summary of Borrowing Authorizations" providing complete information for both current and carry forward borrowing for the City and school purposes. The amount of new borrowing for City purposes in Section II was \$75,855,000 which included \$891,000 of borrowing for capital improvements for parking lot operations which was not included in the capital improvement funds section. Also included in Section II are cash flow and enterprise fund borrowings, thus identifying the total borrowings for the City for the year at \$774,124,000. The budget is usually adopted in November of each year for the subsequent calendar year.

Based on the information provided in the Capital Improvements Fund budget and the information maintained on the activity of previous authorizations, the Public Debt Specialist prepares an excel spreadsheet identified as the "Detailed Schedule of Borrowing Authorization Carryovers." This schedule tracks the prior years' unused authorized borrowings so the City knows the remaining outstanding authority it has to issue debt by capital project category. Pertinent information includes the budget authorization, resolution number, adoption date, resolution amount, amount of debt sold, amount of authorization dropped/repealed (this relates to authorized amounts not used after four years), and the resulting amount to carry over to the next year. This schedule is updated several times a year by the Public Debt Specialist, usually at the beginning of the year and after each issuance of debt. The Accounting Manager maintains similar information separately from the Public Debt Specialist, based on the information in the annual budget and the City's ERP (Enterprise Resource Planning System) FMIS (Financial Management Information System). The Accounting Manager enters into her spreadsheet of Proposed Borrowing Authorization – Bonds and Notes Authorized and Sold; the year, resolution number, and department for each resolution. Each year, the Accounting Manager takes all the active borrowing resolutions from the past four years (the City has a four year period to spend authorized borrowings), and compares the calculated total resolutions of the prior years to the carryover amount calculated in the schedule provided by the Public Debt Specialist. The Public Debt Specialist and Accounting Manager compare the data in each of their spreadsheets and reconcile any differences. This provides an important control to ensure the carryover schedule is accurate and complete.

CURRENT DEBT PROCESS (cont.)

APPROVAL TO ISSUE DEBT (cont.)

With respect to authorized borrowings that are about to expire, the Public Debt Specialist contacts departments, in mid-year before any authorized debt expires, informing them of the pending expiration. This allows the departments to attempt to procure the capital items, or plan to request for reauthorization of the project. The requirement to spend borrowing authorizations within a required time frame is a control as this requires the monies to be spent or the funds will lapse. Hence the City will not have excessive borrowing authorizations outstanding.

The Detailed Schedule of Borrowing Authorization Carryovers is approved by the Common Council. See **Attachment A** for a copy of the Detailed Schedule of Borrowing Authorization Carryovers and related Resolution for new borrowings. We believe this is an important control, since the Common Council is made aware of the amount of authorized debt issuance that is available from previous years as well as the amount authorized for the current year. See **Attachment B** for a copy of the Authorized Borrowing schedules developed by the Accounting Manager.

OFFICIAL INTENT AND OTHER RESOLUTIONS

The City primarily issues debt after the capital expenditures have been paid by the City. The IRS and State of Wisconsin allow for reimbursement of capital expenditures as long as an "Official Notice of Intent" has been approved by the government.

Pursuant to Common Council File number 921116, the Common Council has delegated the responsibility for complying with the IRS Official Intent rules to the Public Debt Commission (PDC). In December or January of each year, the PDC adopts an Official Intent resolution for the new borrowing authorized in the budget. Pursuant to 67.10(6), Wisconsin Statutes, expenditures may be made in advance of receiving funds of borrowing. The Official Intent resolution satisfies the IRS and Wisconsin Statutes requirements. See **Attachment C** for a copy of an Official Intent resolution.

Under Section 65.07(p), Wisconsin Statutes, the City has one year to spend budgeted capital dollars, but the Common Council has the authority to extend (carryover) the period for an additional three years. Pursuant to Section 67.10(4), the City has up to five years to borrow the funds and reimburse the City for these expenditures. The period to borrow is one year more than the period to incur the capital expenditures as this allows the City additional time to reimburse itself for the capital expenditures. Typically, the City reimburses itself within one year of the capital expenditures being incurred. The IRS allows for reimbursement of capital expenditures from three years after the expenditure is paid, or 18 months after the project is complete, as long as there is an Official Intent resolution.

Based on the information in the budget as well as the information used for the current year authorized borrowing, the Public Debt Specialist prepares resolutions for the approval of the Common Council which authorize: 1) new borrowings approved in the budget by each category as identified in Section 67.05(5), Wisconsin Statutes; 2) Bond Resolutions for the Revenue Anticipation Notes, and Notes and Bonds for capital purposes; 3) approval of the Preliminary Official Statement. We noted, the Public Debt Specialist prepares and introduces numerous resolutions to the Common Council without prior legal review or review by other members of the Comptroller's Office. We believe a review of the resolutions should be performed before introduction to the Common Council.

CURRENT DEBT PROCESS (cont.)

OFFICIAL INTENT AND OTHER RESOLUTIONS (cont.)

Upon approval of the resolutions by the Common Council, the Detailed Schedule of Borrowing Authorization Carryovers spreadsheet is updated by the Public Debt Specialist to remove fully used and expired authorizations and to add the new borrowing authorizations. Therefore, all authorized borrowings are included in one document.

After all the resolutions have been approved, the Accounting Manager prepares transactions to record the capital budgets and related new borrowing authorizations for the current year in the FMIS system. The resolutions pertaining to each project or program is the confirmation of the City's intent to sell bonds in order to fund the project or program. Usually in January, the Accounting Manager reconciles the total amount of authorized resolutions to the amount displayed in the Public Debt Specialist's Detailed Schedule of Borrowing Authorization Carryovers, as well as the FMIS system, to ensure completeness and accuracy of the listing.

CAPITAL EXPENDITURES INCURRED

The budgeted capital expenditures are appropriated for programs or specific projects. All budget authority funded by borrowed funds for approved programs and projects is set up in the system under a suspense organization "9990." Funds are released to the proper departmental organization code through a specific process, discussed below, once a determination is made by the Public Debt Specialist whether the program or project meets the requirements of tax-exempt or taxable borrowing based on the public or private use criteria of the capital expenditure as outlined in Section 141 of the Internal Revenue Code, and capital vs. non-capital purposes. The process to release the funds begins early in the year and is initiated by the department with a request to the Public Debt Specialist that includes a description of the project and other relevant facts. This initial step is bypassed for programs/projects already known by the Public Debt Specialist to be tax exempt, such as regular borrowings for the street resurfacing program, library improvements, water main replacements, and treatment facilities, sewer main replacements or lining, etc. Typically, the Public Debt Specialist requests a general release for a large portion of the budgeted projects where there is no question regarding the purpose of the projects or programs meeting the public use criteria. See **Attachment D** for a copy of a general release for these types of programs/projects.

Certain programs, such as with Business Improvement Districts or Tax Increment Districts, may need further information before a decision of taxable or tax-exempt borrowings is made. The department completes a questionnaire to help answer the question about the use, ownership, and revenues of the type of debt needed for issue. For programs or projects in which a question arises regarding the use, the Public Debt Specialist, in consultation with Bond Counsel and the City Attorney's Office, makes a determination whether the release qualifies for tax-exempt borrowing, or not (taxable borrowing). This process provides an internal control to mitigate the risk that tax-exempt bond proceeds are incorrectly used for a private purpose. See **Attachment D** for a copy of a specific release.

CURRENT DEBT PROCESS (cont.)

CAPITAL EXPENDITURES INCURRED (cont.)

The Public Debt Specialist prepares a memo for the Comptroller that directs the appropriation be released to the specific departmental organization, thus transferring the appropriation from the "9990" organization to the actual department organization. Once approved by the Comptroller's representative, General Accounting then processes the transactions so funds are transferred to the department's organization. At this time, the departments have the ability to incur expenditures for the budgeted capital programs/projects. The Accounting Manager must maintain the balance between the four different areas in the accounting system relating to each relative project: the parent, segment, appropriation, and funding source. The parent is the high level program or project; for example, library improvements. The segments are individual projects that comprise the program; for example, the improvements planned for three different libraries would be three segments. The appropriation is the amount of spending authority approved for the program or projects. Lastly, the funding source must equal the amount of the appropriation and is initially recorded based on the information within the annual budget, such as new borrowing or carryover borrowing. When a new authorized borrowing or new bonds are issued, the Accounting Manager must ensure that these items are up to date and correct.

ISSUANCE OF DEBT

In preparation for a debt issuance (approximately 2-3 times per year), the Public Debt Specialist updates a listing (maintained on the Capital Projection Spreadsheet) of the capital projects with unspent borrowing authority. This schedule identifies the budgeted appropriations of the capital project, amount expended to date based on expenditures recorded in FMIS, and unissued debt for the project (**Note:** borrowings are applied using the FIFO method for similar programs/projects). A reimbursement amount [Unissued debt – (Budget-Spent)] is calculated for each project, and expenditures for the next year are conservatively estimated by the Public Debt Specialist for certain projects. In many instances, the Public Debt Specialist is estimating future expenditures without consulting the department's management. We recommend estimates of future expenditures be done in consultation with the department responsible for the capital improvement. See **Attachment E** – Capital Projection Sheet. The schedule is prepared in Excel and FMIS is the source for the budget/expenditure data, and the Detailed Schedule of Borrowing Authorization Carryovers spreadsheet is the source of unissued debt.

For some programs, such as Tax Incremental Districts, General Accounting is the source of budget/expenditure data. The Accounting Manager is able to run nVision Reports on specific TID projects in order to meet the informational needs of the City. The Accounting Manager uses an nVision report on Tax Incremental Districts (TID) in order to create a summary report for the Public Debt Specialist. The Public Debt Specialist utilizes this report created by the Accounting Manager in order to calculate the amount of borrowings that will be needed to be allocated to the TID districts for the current year based on specific projects within each TID. In this TID report, the Accounting Manager records the amount of financing each TID is authorized, and how much the TID has actually received. In addition, the report tracks life-to-date expenditures of the TID as well as any encumbrances and total appropriations. All this information is in an easy to read format which assists the Public Debt Specialist in determining the amount of borrowing to be allocated to the specific projects within the TIDs. See **Attachment F** for a copy of the Analysis of Tax Increment District Borrowing/Appropriations.

CURRENT DEBT PROCESS (cont.)

ISSUANCE OF DEBT (cont.)

With each borrowing, the Detailed Schedule of Borrowing Authorization Carryovers spreadsheet is updated with the purposes and amounts of the borrowing. The purposes and amounts are provided to General Accounting to book the borrowing in FMIS. Within FMIS, each appropriation must have a funding source identified with the appropriation. As debt is issued, the funding source is changed within FMIS to identify the specific debt issue as the source of funds. General Accounting and the Public Debt Specialist work out any final adjustments to the purposes for the borrowing. With each borrowing, the Accounting Manager receives the listing of the purposes and amounts to which the bond issuance proceeds will be allocated. When this happens, the Accounting Manager updates her authorized borrowing on the Analysis of Tax Increment District Borrowing/Appropriations spreadsheet, reducing the amount of authorized borrowing left to be used. The Accounting Manager makes the change in the FMIS system as well, reducing the authorized funding source and replacing that amount with the actual bond issuance funding source. The Accounting Manager does not make a journal entry to make this change; rather the change is noted in a table created in the system. Another accountant in the General Accounting unit records the actual cash receipt and proceeds of debt at the fund level. This process records the use of the proceeds within FMIS and is later used in the reconciliation process between the Public Debt Specialist and the Accounting Manager.

The Public Debt Specialist sizes debt issues with the intention that proceeds of a tax-exempt issue are used for capital expenditures already incurred and for estimated future expenditures to be incurred within 24 months of the debt issue date. This allows the issue to qualify for the 24 month expenditure exemption from arbitrage rebate requirements. The Capital Projection sheets are used to monitor unspent proceeds and, after one year, any unspent proceeds are reallocated to projects that have monies spent. When the Public Debt Specialist draws down tax-exempt commercial paper to finance capital expenditures, the draws are sized so proceeds are used for reimbursement of past and future expenditures within six months of the debt issue date. That allows the entire draw to qualify for an exemption from the IRS Change of Use rules. Commercial paper is used by the Public Debt Specialist to reimburse the City when needed in the interim periods before the long term bonds are issued.

The City utilizes short-term borrowing for cash flow purposes and delinquent taxes not yet collected for the City and other overlapping taxing jurisdictions. These cash flow borrowings are included within the annual budget. Cash flow schedules prepared by the Comptroller's Office are included in the Official Statement for the issuance of revenue anticipation notes, and provide justification for the need to issue short-term borrowing. A resolution prepared by the Public Debt Specialist is approved by the Common Council at the beginning of the year for cash flow borrowings. The resolution is developed from information contained within the annual budget under section II "Summary of Borrowing Authorizations." The majority of the debt issued related to cash flow typically matures within one to two years.

CURRENT DEBT PROCESS (cont.)

ISSUANCE OF DEBT (cont.)

Per discussion with the Public Debt Specialist, long-term borrowing for capital is done in conjunction with the cash flow borrowing. The long-term borrowing reimburses the City for capital expenditures already incurred, and/or the repayment of commercial paper that was issued in the interim to pay for capital expenditures, plus some amount for future expenditures. The longest maturity for long-term borrowing can be up to 20 years, per State of Wisconsin Statute Chapter 67.07 and the City's Debt Management Standards Practice policy. Typically maturities occur throughout the life of the issuance. The IRS requires the weighted average maturity of the bonds to be equal to or less than 120% of the average estimated useful life of the capital assets financed by the bonds. If, as a result of the issuance, a premium is received on the bonds; pursuant to 67.1(d), Wisconsin Statutes, those monies are deposited in the Debt Service Fund for payment of principal and interest. The City issues commercial paper to fund additional projects, and immediately pays off the commercial paper with the excess bond premium.

The City's policies require; a financial advisor be retained for all debt sales to advise the City in decision making during the debt issuance process, and bonds be sold using a competitive method rather than negotiated unless special circumstances exist. By using the competitive method, the City expects to get the lowest cost and selection of the underwriter is through a fair and transparent process. In addition, the City utilizes bond counsel to assist in preparing the official statement and related filings. These policies provide controls as how the debt will be sold and the use of experts during the issuance.

The PDC is required to approve the sale of the bonds and, therefore, the Commission meets on the date of sale and approves the bond issuance. The Public Debt Specialist and a Financial Advisor provide market, bidding, and other information to the Commission at the meeting.

PORTFOLIO MANAGEMENT

The Public Debt Specialist reviews the City's and Schools' debt portfolios for refunding opportunities. Previously, a policy for advance refunding was in place where the present value savings must equal 3%. Currently, as a result of historically low interest rates, savings significantly in excess of 3% is desired for an advanced refunding. DBC Finance and Debt Manager Software programs are used by the Public Debt Specialist to identify potential bonds for refunding. In addition, the Financial Advisor and various underwriters monitor the City's portfolio and provide possible structures. If a refunding is advantageous, the bond issue is sized to include the bonds to be refunded as part of the normal debt issuance process.

PAYMENT OF DEBT SERVICE

Payment of the City's debt service is provided for in the annual budget in the debt service funds. The Comptroller's Office develops the budget for the next year based on known debt service requirements plus the estimated interest payment on the current expected borrowings for that year. This information is provided to the Budget Department for inclusion in the budget. Since 65.06(18), Wisconsin Statutes, gives the Comptroller authority to add to the levy any amount required for the payment of principal and interest on General Obligation Debt, the Budget Department does not alter the debt service budget without the Comptroller's approval.

General Accounting is provided the information needed for the payment of debt and processes the payments at the required times.

COMPLIANCE WITH CERTAIN IRS AND STATE OF WISCONSIN REGULATIONS

We performed certain limited procedures regarding compliance with IRS and State of Wisconsin Regulations as we developed our understanding of the City's processes regarding the issuance of debt and managing its debt portfolio. IRS regulations regarding the issuance and post issuance compliance of tax exempt debt are numerous and complex. The main purpose of this engagement was not to determine that the City was in compliance with all aspects of the IRS and State of Wisconsin Regulations but rather develop an understanding of the debt process and provide recommendations related to that process.

As part of developing an understanding of the debt process, we did make inquiries of the Public Debt Specialist how the City maintains compliance with regulations regarding the post issuance compliance. Post issuance compliance centers on the use of the proceeds and related private activity bond tests and arbitrage yield restriction and rebate requirements. Previously in the report, we discussed the processes performed by the Public Debt Specialist in identifying capital expenditures that would involve private activity use. Therefore, as part of our understanding of the debt process, we inquired into processes regarding arbitrage yield restriction and rebate requirements as well as certain reporting requirements.

We randomly selected five bond issues and requested evidence of the City filing arbitrage rebate reports in a timely fashion. Another procedure performed was to determine if the City was filing timely annual disclosures and material events as required under SEC Rule 15c212. We also reviewed evidence of the City meeting the requirements of the State of Wisconsin Statute 67.03 regarding limitations of indebtedness. Lastly, we looked at certain debt covenants regarding revenue coverage requirements for the City's water and sewer operations.

Of the five bond issuances we selected to review compliance with filing arbitrage rebate reports, only one, the Sewerage Revenue Bonds Series 2003, had arbitrage reports filed for the years 2006 and 2011. We noted the reports were filed within the required periods and did not result in a liability to the City. The remaining bonds selected were various general obligation bonds and notes. Per discussion with the Public Debt Specialist, the remaining issuances selected did not have any reports filed because the proceeds were spent down within the 24 month period as allowed for under Section 1.148-7(e) of the Code; therefore, reports were not required to be filed. Per review of the related official statements, the majority of proceeds received from those issues were used to reimburse the City for capital expenditures that were already paid which validates the statement of the Public Debt Specialist.

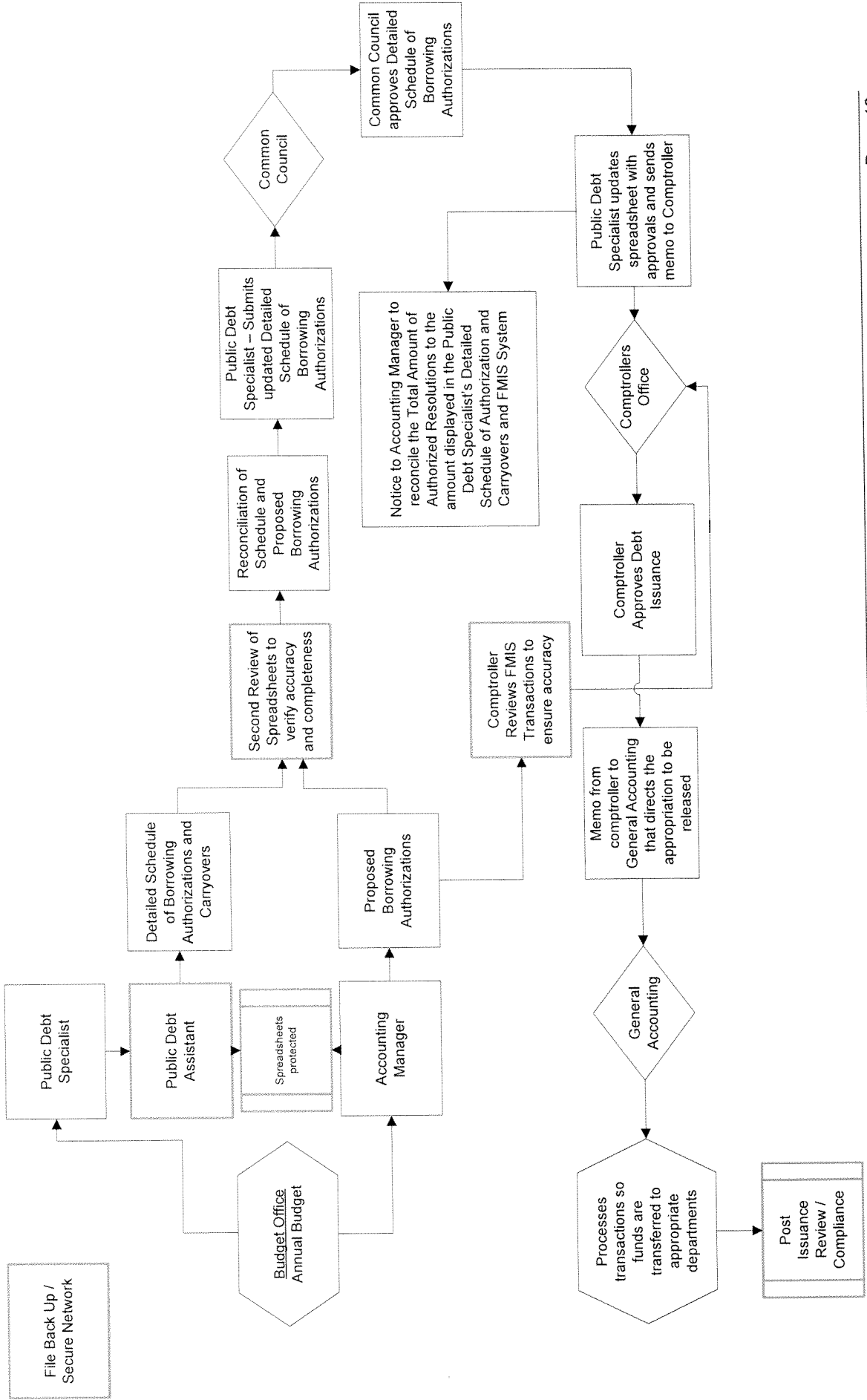
The City is required under SEC Rule 15c212 to provide certain City-related financial information and operating data to the Municipal Securities Rulemaking Board (MSRB) and to provide annual notices of the occurrence of certain events enumerated in the Securities Exchange Act of 1934 either electronically or as prescribed by the MSRB. The MSRB uses its Electronic Municipal Market Access (EMMA) system as the system to be used for continuing disclosures to investors. We viewed the continuing disclosures on MSRB's EMMA electronic database for the Series 2010 S1 Sewerage Bonds, noting the 2010 audited financial statements posted in August of 2011 within the nine month required time frame, and a material event notice of a Moody's Rating Change posted timely in April 2012. As noted below, the 2011 audited financial statements were not attached to the Series 2010 S1 Sewerage Bonds. We noted for several maturities of general obligation bonds and notes, the 2011 financial statements were properly posted to EMMA. In other instances, certain CUSIP numbers were selected from various debt issues, and not all current filings were displayed. Per discussion with the Public Debt Specialist, the required filing was timely made, but may not have been attached to all of the City's outstanding bonds' CUSIP numbers. We recommend contacting the MSRB to discuss possible solutions to attach the filing to all of the City's outstanding debt.

COMPLIANCE WITH CERTAIN IRS AND STATE OF WISCONSIN REGULATIONS (cont.)

The water and sewerage systems have debt covenants to ensure that the debt coverage for both senior bonds and second lien debt exceed the minimum requirement for debt coverage of 1.20 of revenues available for debt service as compared to debt service requirements. We reviewed information from the City of Milwaukee's 2011 and 2010 Comprehensive Annual Financial Report noting that the debt coverage for both the water and sewerage systems far exceeded the requirement.

In addition, we noted the City provides within its official statements, a calculation demonstrating compliance with the requirements of the State of Wisconsin Statute Chapter 67.03. The statute requires "the aggregate amount of indebtedness, including existing indebtedness, of any municipality shall not exceed 5% of the value of the taxable property located in the municipality as equalized for state purposes except that the aggregate amount of indebtedness of any school district that offers no less than grades 1 to 12 and that at the time of incurring the debt is eligible to receive state aid under 121.08 shall not exceed 10% of the equalized value of the taxable property located in the school district." For the issuances selected, we noted a schedule was provided within the Official Statement demonstrating that the requirements were met. In addition, a similar schedule was included in the City's CAFR, and we noted that compliance was also met at year end.

FUTURE STATE PROCESS FLOWCHART



RECOMMENDATIONS

- 1) The Public Debt Specialist performs many functions within the current debt issuance process that are highly specialized and known only to the individual in that position.
 - a) In order to reduce the key-man risk, we recommend either through cross training of existing staff or by adding a new position, an assistant for the Public Debt Specialist. This position would provide some duplication of knowledge and would allow the Public Debt Specialist to delegate routine tasks allowing the Specialist to spend more time on higher level tasks.
- 2) The Public Debt Specialist performs many functions within the current debt issuance process without oversight or assistance. For example, the Public Debt Specialist prepares and introduces numerous resolutions to the Common Council without prior legal review or review by other members of the Comptroller's Office. In addition, no other members of the Comptroller's Office assist with developing or reviewing the spreadsheets used to identify the amount of the current borrowing. Other departments are not consulted on the amount of future expenditures to be included in the determination of the amount borrowed.
 - a) We recommend additional individuals be involved in the issuance process to ensure accuracy of these important steps, including consultation with departments responsible for capital expenditures.
- 3) Critical information utilized in the process of issuing debt is developed from information in the annual budget and FMIS and manually entered into spreadsheets. Manual data entry can lead to input errors and formulas may be compromised.
 - a) Consideration should be given to the development of queries within FMIS to create the Detailed Schedule of Borrowing Authorization Carryovers and the Capital Projections Spreadsheet.
 - b) We recommend the City identify cells that should be protected to prevent formulas from being overwritten.
 - c) Critical information and formulas should be reviewed by another person to verify the accuracy and completeness of the information.
- 4) Spreadsheets are maintained on the Comptroller's Office file server and could be subject to modification by another party.
 - a) We recommend a review of security to ensure the integrity of the data.
 - b) Proper backups should be maintained in case the files become compromised.
- 5) The budget, expenditure, and unissued debt information in the Capital Projection sheet is typically updated a few times a year by the Public Debt Specialist. Changes in the allocation of borrowing authority need to be properly reflected within the document. Allocation changes are not always communicated to the Public Debt Specialist when departments request and receive approval from the Budget Department to modify the capital project fund budgets.
 - a) We recommend a procedure to notify the Public Debt Specialist of modifications to capital budgets.
 - b) Similarly, the Accounting Manager prepares information on spreadsheets and enters transactions into FMIS without review. We recommend another person in the Comptroller's Office perform a review of the information to ensure its completeness and accuracy.

RECOMMENDATIONS (cont.)

- 6) Several policies were written and approved many years ago.
 - a) We recommend the debt policies be reviewed and updated.
 - b) A policy for routine reviews should be put in place.
- 7) At this time, the majority of the proceeds of debt issued are used to reimburse the City for capital expenditures that have already taken place. Conversely, a small portion of the proceeds are deposited with the City Treasurer in an aggregate investment pool, or held by the trustee for a specific purpose required under the bond ordinance, such as a debt service reserve. If the City were to issue a larger portion of the debt on a prospective basis, a policy does not exist regarding the investment of debt proceeds.
 - a) We recommend a policy be developed for the investment of debt proceeds that includes a description of the allowable investments (including those for defeasance escrows), process of acquisition and disposition of investments, and arbitrage requirements.
- 8) The policy on SWAP Standard Practices provides guidance with respect to the use of interest rate swap agreements to manage exposure to interest rate risk. These transactions can be complex, and contract provisions can vary between different swap counterparties.
 - a) The City should include language similar to the Debt Management Standard Practices policy regarding the use of an advisor who is an expert on interest rate swap and related agreements.
 - b) We recommend the City approve this policy, as it is currently in draft form.
- 9) Tax-exempt bonds have many requirements that must be met, not only at the time the bonds are issued, but throughout the term of the bonds as well. Ongoing compliance with the IRS regulations is critical in order to maintain their tax exempt status. Actions must be taken throughout the term of the bonds to identify matters that need to be analyzed by the City that could have an effect on the tax-exempt status of the bonds. Key areas of post-issuance compliance include: recordkeeping and retention (life of the issue plus 3 years), timing of the spending of proceeds, investment of proceeds, arbitrage rebate calculations, monitoring and measuring private business use and private loans, and changes in the use of debt financed assets.
 - a) We recommend the City develop a post-issuance compliance policy incorporating the post-issuance tax compliance checklist developed by the National Association of Bond Lawyers and the Government Finance Officers Association.
 - b) The City should identify the parties responsible for the various requirements of post-issuance compliance.
 - c) The policy should discuss areas such as; use of proceeds, record retention, filing of arbitrage rebate calculations, annual and material disclosure requirements, and compliance with financial covenants.

RECOMMENDATIONS (cont.)

- 10) Like many governments, the City utilizes tax-exempt borrowing to finance capital assets for public use such as roads, bridges, fire, libraries, etc. Tax-exempt borrowings reduce the interest expense the City pays, as those rates are lower than taxable rates. The IRS has issued many complex regulations associated with tax-exempt financing.
- a) We recommend that City officials and management be provided a basic overview of the regulations regarding tax-exempt financing in order to familiarize them with the IRS restrictions on the use of tax-exempt debt and restrictions on the facilities financed with tax-exempt debt.
 - b) City wide procedures should be implemented to notify the Public Debt Specialist or the City Comptroller when assets financed with tax-exempt debt are sold or used by non-city (including 501(c)(3) and private) entities. Communication of these events is essential in maintaining the tax-exempt status of the City's debt.
- 11) We noted for several maturities of general obligation bonds and notes, the 2011 financial statements were properly posted to EMMA. In other instances, certain CUSIP numbers were selected from various debt issues, and not all current filings were displayed. Per discussion with the Public Debt Specialist, the required filing was timely made, but may not have been attached to all of the City's outstanding bonds' CUSIP numbers.
- a) We recommend contacting the MSRB to discuss possible solutions to attach the filing to all of the City's outstanding debt.