July 30, 2007

The Honorable Members
of the Common Council
of the City of Milwaukee

Dear Council Members:

We have audited the basic financial statements of the City of Milwaukee (a municipality incorporated under the laws of the State of Wisconsin) (the City) as of and for the year ended December 31, 2006, and have issued our report thereon dated July 30, 2007. In planning and performing our audit of the financial statements of the City, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

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

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies included in Appendix A to be significant deficiencies in internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. We believe the significant deficiencies included in Appendix A are not material weaknesses.

Although not considered to be significant deficiencies or material weaknesses, we also noted other items during our audit which we would like to bring to your attention. These items are included in Appendix B.

This communication is intended solely for the information and use of the Common Council, management, and others within the City, and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

KPMG LLP

Accounting for Capital Assets

The City does not adequately evaluate whether certain capital expenditures are properly recorded as capital assets in both the government-wide and enterprise fund financial statements. As a result, adjustments were required to be recorded in the financial statements. Deficiencies and misstatements identified included the following:

- The Comptroller's office performs a very manual and time intensive process at year-end to evaluate certain capital expenditures, including buildings. This process also relies on user departments to perform their own analysis and provide accurate information to assist the Comptroller's office in evaluating whether the infrastructure expenditures should be capitalized and how they should be classified.

- There was no evaluation initially performed of capital outlay expenditures incurred in the Special Assessments, Sewer and Tax Increment Financing capital project sub funds. Although these funds typically have not incurred significant expenditures for which the City receives beneficial ownership of the assets, there were expenditures identified in our testwork totaling approximately $3.7 million that should have been capitalized and resulted in adjustments to the financial statements.

- There was approximately $2 million in capital assets in the Port Fund for railroad ties that was improperly included as a nondepreciable asset (i.e. land). Upon further analysis, it was determined these assets should be depreciated resulting in a cumulative catch up depreciation of approximately $1.4 million.

We recommend that the City review its policies and procedures and implement changes to ensure that capital outlay expenditures are properly reconciled to capital asset additions in the government-wide financial statements, including consideration of all capital project sub funds.

Management's Response

The City has two basic types of expenditures that can result in a capital fixed asset. Fixed assets can be expended in the annual operating departmental budgets and in the multi-year capital project budgets.

Primarily, the majority of equipment purchases are coded with a specific type of account to denote equipment in the City's financial system. Not all equipment coded purchases are a fixed asset under the City's policy of capitalization.

Most capital projects are used to account for the City's major infrastructure construction projects that can be major repairs or additional infrastructure assets. These project expenditures include City payroll charges as well as vendor contract payments.

At the time of compliance with GASB 34, the assumption was made that certain types of capital projects were basically repairs or economic development expenses and would not be analyzed for capitalization.

The Comptroller's office manually reviews the expenditures over the established threshold to determine if the expenditure should or should not be capitalized in accordance with the fixed asset definition. In order to document and support the accounting entries for fixed asset, our staff must spend considerable time to ensure the accuracy of the transaction.

We rely upon the user departments to provide accurate information to assist the Comptroller's Office in evaluating whether the infrastructure expenditures should be capitalized and how they should be classified.

In response to the specific recommendation, we concur with the auditors that the policies and procedures be reviewed and we will add the special assessments sewer projects, the regular capital sewer project and the tax incremental financing expenditures from the Department of Public Works to the capital asset analysis.

Reconciliation of Customer Deposits

Customer deposits are those amounts paid by contractors to the City for permits. The City returns these deposits upon completion of the contractor's work. Upon collection of the deposit and issuance of the required permit, the permit desk will enter the deposit into the PeopleSoft system. The documentation is then forwarded on to the Department of Public Works (DPW). The DPW enters the deposit amount and detail regarding the contractor into a standalone accounts receivable system.

The DPW does not reconcile the customer deposits recorded in their system to the general ledger. During our audit, we noted differences between the deposits recorded by the DPW and the general ledger system.

We recommend that the City reconcile the customer deposits on a regular basis

Management's Response:

Department of Public Works:

The DPW receives customer deposits primarily in two ways, through the Department of City Development's Development Center as part of the permit process and through DPW's Contract Office as part of larger development projects. The information is entered into the City's Financial Management Information System and into DPW's customer deposit module, which is part of the department's invoice accounts receivable program. DPW has had to develop its own system as there is no citywide customer deposit program. Because information has to be entered multiple times and paperwork has to move between departments, the chance for errors increases.

DPW is working with the Department of City Development to modify the public way permit system so if a customer deposit is required as part of a permit, the information can be transferred to the customer deposit module when staff enters the permit information.

The department's reconciliation process has been hampered by data integrity issues caused by the conversion from a paradox to an oracle-based system. We are currently working with the Comptroller's Office to resolve some of these issues. Nevertheless, the DPW can improve its internal reconciliation procedures. Currently, the majority of the reconciliation is completed at year end. As a result, it is more difficult to find errors that may have occurred several months prior. The department is committed to conducting reconciliation activities on a monthly basis.

Reconciliation of Parking Revenue

During our audit, we noted that there is no reconciliation between the cash collected at the parking structures managed by CPS and the amount of parking revenue recorded for these parking structures.

We recommend that the City reconcile the cash receipts and the parking revenue recorded on a regular basis.

Management's Response:

Department of Public Works:

Revenue collected at the City's parking structures is deposited directly into the City's bank account by Loomis Fargo. The City Treasurer's Office then compares the deposit receipt with the actual amount of cash deposited. The Treasurer's Office then makes the entry into the City's Financial System.

Office of the Comptroller:

The Comptroller will work with the Department of Public Works to develop procedures that will reconcile the cash receipts and the parking revenue recorded on a regular basis.

Reconciliation of Parking Permits

During our audit, we noted that there is no reconciliation of the number of permits distributed to the police stations, number of permits sold, and the number of unsold permits as of year end. The lack of reconciliation exposes the City to the risk of permits being issued without a cash payment.

We recommend that the City reconcile the number of parking permits issued, sold, and unsold at the end of each year.

Management's Response:

Office of the Comptroller:

The Police Department handles the cash receipts from the sale of parking permits by their staff and quarterly sent a permit sales report to the Comptroller's Office. The Police Department believed no additional reconciliation of parking permits sold was needed. To ensure a reconciliation of parking permits is performed by the City, the Comptroller's Office will now be responsible for this reconciliation.

Password Requirements

The PeopleSoft password parameters do not enforce the minimum requirements established in the Information Policies and Standards. Accounts are not locked following 3 unsuccessful logon attempts and users are not prevented from reusing old passwords. The current settings are 10 incorrect logon attempts and users are not prevented from using their prior password.

The Windows password parameters do not enforce the minimum requirements established in the Information Policies and Standards. Accounts are not locked following three unsuccessful logon attempts and passwords are not required to have one non-alphabetic character. The current settings are four incorrect logon attempts and password complexity is not enabled.

We recommend that management take measures to communicate and reinforce the City of Milwaukee Information Security Policies and Standards. Management should further review the password settings in the major systems and applications to help ensure the policies are adhered to.

Management's Response:

Department of Administration-Information and Technology Management Division (ITMD):

a. PeopleSoft Passwords: With recent changes, the PeopleSoft passwords are now in greater compliance, i.e. they are complex, have minimum length, cannot be reused and are locked out after 5 attempts.
b. Windows passwords: ITMD has met with the department level network administrators concerning enabling password complexity. Implementation of complex passwords and aligning the number of incorrect attempts before lockout will be presented at the next CIMC meeting. An implementation schedule would then be set.
c. ITMD does take steps to communicate and reinforce the City of Milwaukee Information Security Policies and Standards by meeting with the department Information Security Coordinators. Due to the decentralized structure of IT at the City, it is the departments' responsibility to review password settings in the major systems and applications that they are responsible for.

Shared Administrator Account

It was noted that one shared user account (ITMD) with administrator access can be used by six members of the Network Administration team. The City of Milwaukee Information Policies and Standards prohibit the use of shared accounts, except for use in emergency functions. In addition, there were no control mechanisms in place to track the use of the account.

We recommend that management prohibit the use of shared user accounts to help ensure that accountability exists within systems and applications for individual employees. If management determines that such an account is required, a control mechanism should be implemented to track the limited use and adopt the practice of periodically changing the passwords and only providing passwords at the time of need.

Management's Response:

Department of Administration-Information and Technology Management Division (ITMD):

ITMD no longer uses the shared user account for the ITMD Active Directory group. Each person in this group will use their own account and have the elevated rights that enable ITMD to manage Active Directory. This will allow for tracking the usage by person and their passwords will be under the rules of passwords for complexity, periodic changing, etc. The one main password will be recorded and secured in our fire protected limited access vault.

Periodic Access Review

A periodic review of active Windows accounts has not been performed.

We recommend that all departments be required to periodically review active network accounts. KPMG recommends that documentation of the reviews, as well as any inappropriate access identified in the review, be retained.

Management's Response:

Department of Administration-Information and Technology Management Division (ITMD):

ITMD (and several departments) have recently migrated from a Novell and Windows mixed environment to an Active Directory environment (Windows). With the completion of this migration, ITMD will now be able to develop a procedure to do a periodic review of Windows accounts. Once this is developed we would recommend this to the department administrators when we meet with them.

Access to Tax and Credit Rates for Generating the Tax Roll

The Treasurer's Department was found to have a shared account that had access to update special charges that are calculated into the Tax Roll. This account did not have access to update the tax rates table.

We recommend that the Treasurer's Department be restricted from having access to change the tax and credit rates when generating the tax roll. Management should prohibit the use of shared user accounts to help ensure that accountability exists within systems and applications for individual employees. If management determines that such an account is required, a control mechanism should be implemented to track the limited use and adopt the practice of periodically changing the passwords and only providing passwords at the time of need.

Management's Response:

Office of the City Treasurer:

Only one member of the City Treasurer staff has read only access to the tax rate table via her unique N275 User ID and Password.

Four members of the City Treasurer staff have access to the N819.490A application that allows them to effectuate corrections to the tax roll / tax receivable file during the current tax period requested through Letters to the Treasurer. These corrections are limited to changes in assessed value and changes to special assessments and charges added to the tax roll.

Each of the staff members has a unique User ID and Password to enter the N275 system. In addition, each user has a unique Password to enter the N819.490A application.

Payroll to General Ledger Interface

Although control totals were used to determine that the Payroll to General Ledger interface processed completely and accurately, the critical manual interface steps were not properly documented.

We recommend that key manual interface processes be documented to help ensure that the interfaces process complete and accurate data. A final review and check-off should be performed by management to validate that the entire process was documented and complete.

Management's Response:

Office of the Comptroller:

We agree with the auditors that the documentation of the manual interface process will help ensure this process continues to be performed accurately. The Comptroller's Office will prepare written documentation of the payroll to general ledger interface process.

Water Works A/R Exception Reports

The Usage on Inactive Account report and the Kick Out report are not being retained as evidence of review performed prior to the final bill generation process. The Bill Summary report, Sales by Rate, and Sales by Meter reports are retained for the prior year, but no sign-off or evidence of a review exists to help ensure it was performed prior to the final bill generation process.

We recommend that exception reports be dated and retained as evidence of the review being performed prior to the final billing process. Check-off sheets could also be used as evidence that the exception reports were run and reviewed by management.

Management's Response:

Department of Public Works-Milwaukee Water Works:

Water Works has instituted the practice of retaining the exception reports generated by the final bill generation process. These are initialed by a manager, dated and retained as evidence of the review being performed prior to the final billing process.

Review of Treasurer Cash Receipting Data

Although access is appropriately restricted to make cash receipt adjustments, and audit reports can be produced to review cash receipt adjustment transactions by user, a control does not exist for management to review all cash receipting data on a regular basis.

We recommend management establish controls to review cash receipting data to identify any inappropriate manual intervention.

Management's Response:

Office of the City Treasurer:

Only the Lead Teller and Revenue Collection Manager have the ability to adjust cash transactions. Tellers balance their work daily. Once each pay-period, each teller is subject to a random cash count to assure the accuracy of her cash on hand. All cashier system uploads are reconciled daily. The City Treasurer's Office believes that the current procedures in place are adequate to assure transactions are being processed properly and manual intervention is limited to error correction.

Systems Innovators, Inc. states that the next version of their iNovah cashiering system, which is used by the City, will provide enhanced transaction reporting. The upgraded version of iNovah should be available and implemented by mid 2008.

Access to Water Works Accounts Receivable Application

Terminated employee notifications and access removal tasks are not formally documented as evidence of timely access removals. Access to the EnQuesta Water Works accounts receivable application is not reviewed on a periodic basis.

We recommend that access notifications and removals be formally documented and retained as evidence of access being removed in a timely manner. Access to the application should be reviewed on a periodic basis and documentation of the reviews, as well as any inappropriate access identified in the reviews, should be retained.

Management's Response:

Department of Public Works-Milwaukee Water Works:

Water Works has put in place a formalized separation checklist. When an employee separates from the Water Works service the form is completed and routed to the areas in question so that the employee's access (physical and electronic) can be severed. Keys and access cards are exchanged on the last working day and the employee is removed from call out lists and phone logs and listings are amended in the quarterly printing.

Water Works has instituted the review of electronic access logs on a periodic basis and will document such review as well as take the appropriate action should any anomalies be found.

Access to Property Tax System

User access requests, authorizations, and terminations are not formally documented. Passwords are set by the system administrator and users do not have the ability to change their passwords periodically. The Property Tax system does not enforce minimum password length, age, or complexity requirements.   Although active accounts are informally reviewed annually, the review is not documented.

We recommend that access requests, authorizations, and access removals be formally documented. Access to the application should be reviewed periodically and documentation of the reviews, as well as any inappropriate access identified in the reviews, should be retained. Password requirements should be enforced by the application and comply with the City of Milwaukee Information Policies and Standards.

Management's Response:

Assessor's Office:

KPMG's comments can be broken down into two categories. The first is that the property tax system does not comply with City of Milwaukee Information Policies and Standards. It should be noted that KPMG is referring to the current information policies and standards. At the time our system was developed it did comply with all information policies and standards. The cost of making changes outweighs the benefit of modifying the system to make it compliant with the current standards. In our opinion, our current password schema is sufficient.

KPMG also recommends that a formal documentation process for access control be created. At this time we believe that any added paperwork is not necessary. There are only 5 non-department individuals that have a partial access to our system; all other users are department employees. The Assessor's comprise a small department located together in one office. This allows us to respond quickly to authorizations and access removals without creating additional bureaucracy. A formal documentation process is not needed and would cause an unneeded delay in the procedure.

Access to CityTime Time Entry System

The CityTime application does not enforce the minimum password requirements established in the Information Policies and Standards document. These requirements include a minimum password length of 6 characters, 1 non-alphabetic character, maximum age of 60 days, and account lockout after three unsuccessful login attempts.

We recommend that password requirements be enforced by the application and comply with the City of Milwaukee Information Policies and Standards.

Management's Response:

Department of Public Works:

As CityTime is likely the most widely used application in City government, the department has concerns about forcing City employees to follow complicated password procedures. This would place an undue burden on those users who only access the system once every two weeks to enter their time as well as system administrators who would respond to requests for password assistance.

When an employee enters their time, it must be approved by two other people, a manager and a payroll clerk. We feel that a reasonable compromise would be to impose the password requirements on managers, payroll clerks and other system administrators. This would protect the integrity of the system where it is most important.

Access to Treasurer Cash Receipt System

The Treasurer Cash Receipt system does not enforce minimum password length, complexity requirements, expiration periods, or account lockouts after unsuccessful login attempts. Documented access requests and authorizations were not retained for a selection of two new users. Terminated employee access removal tasks are not formally documented as evidence of timely access removals. Access is not reviewed on a periodic basis.

We recommend that access requests, authorizations, and access removals be formally documented. Access to the application should be reviewed periodically and documentation of the reviews, as well as any inappropriate access identified in the reviews, should be retained. Password requirements should be enforced by the application and comply with the City of Milwaukee Information Policies and Standards.

Management's Response:

Office of the City Treasurer:

The City Treasurer's Office has a form for supervisors to request, change, or cancel user system access. The form is prepared by the user's respective manager and requires the approval of a member of the executive staff prior to user access being authorized. Only four members of the City Treasurer staff have Administrator rights to manager user access. Prospectively, the request forms will be filed and maintained in the respective users' personnel folders.

The two tellers referenced were not "new" users, but were existing users merely being moved from one teller window to another. No change in user rights was made.

In the sixteen years that Systems Innovators' software has been in use, there has been no unauthorized access to the City Treasurer's cashiering system. System Innovators, Inc. states that the next version of their Web based iNovah cashiering system will provide enhanced password requirements and enforcement. The upgraded version of iNovah should be available and implemented by mid 2008.

IT Policies and Standards

The Information Policies and Standards document has not been updated since 1996, and does not include responsibilities and authorities for the newly appointed Information Security Officer and Information Security Coordinator roles. Although the policy was informally reviewed in 2006 for applicability, evidence of the review was not retained and outdated information was not updated.

The Information Policies and Standards document does not include policies or requirements for periodic vulnerability assessments, intrusion detection, or penetration tests to be performed.

We recommend that the Information Policies and Standards document contain policies regarding all aspects of information security, including detailed requirements for periodic vulnerability assessments, intrusion detection, or penetration. The Information Policies and Standards document should be also formally reviewed on a periodic basis and be updated as appropriate.

Management's Response:

Department of Administration-Information and Technology Management Division (ITMD):

The Information Security Policies and Standards are in the process of being updated. The updated document will continue and strengthen our existing policies of: Defense in depth; Principle of least access; and Departmental security officers reporting to their respective department heads to carry out City policy.

The updated document will also note the Comptroller's office role in carrying out periodic security audits which may contain vulnerability assessments, intrusion detection and/or penetration tests to be performed.

Security Awareness Training

An end-user training or security awareness program does not exist to communicate the information security policies and acceptable use policies to new users or current users on an ongoing basis. The end users might not be aware of the unauthorized use of data or programs and thus proactively prevent or effectively detect such practice.

We recommend that the information security policy be communicated throughout the organization to both full time and temporary personnel who have access to financial reporting applications and data. We recommend that an end-user training or security awareness program be developed and required to be agreed to for new employees and current employees on an ongoing basis.

Management's Response:

Department of Administration-Information and Technology Management Division (ITMD):

The City employs an Intranet site – MINT (Milwaukee Intranet) - to communicate a number of IT documents and guides, among them the Security Policies and Procedures. ITMD will contact the Department of Employee Relations to see if they can highlight security in their new employee orientation. The usage of MINT has been and will continue to be the preferred avenue to disseminate this information, as it has been a cost effective means to communicate with the City workforce.

User Provisioning

A written policy does not exist for the entire organization to specify consistent or minimum requirements for documenting user access requests and authorizations for network (Windows Domain) access. Departments with Network Administrators are able to administer their own access and might not document access requests or approvals within Track-It or with hard copy forms.

We recommend that a cross-department access policy be established and require that new and modified access requests be consistently documented. Minimum documentation requirements should be established, regardless of who requests or completes the access setup.

Management's Response:

Department of Administration-Information and Technology Management Division (ITMD):

ITMD will create a new/modified user access form and include it in the revised Security Policies and Procedures. This will allow departments to adopt or modify this form to satisfy their provisioning requirements. As the City has a decentralized IT structure the provisioning of new users is the responsibility of department level staff.

Terminated Users

A written policy does not exist for the entire organization to specify consistent or minimum requirements for documenting and removing network (Windows Domain) access from terminated employees. Departments with Network Administrators are responsible for removing network (Windows Domain) access from their department's terminated employees, but access removals are not always documented within Track-It or with hard copy forms.

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We recommend that a cross-department access policy be established and require that access removal notifications and the completions of the removals be consistently documented.   Minimum documentation and access removal timeframe requirements should be established and enforced, regardless of who completes the access removal. It is also recommended that management implement terminated employee reporting from the HR system to notify system and application administrators in a timely manner.

Management's Response:

Department of Administration-Information and Technology Management Division (ITMD):

ITMD will analyze the costs to implement terminated reporting from the HR system and propose that this be funded. As part of this project request, the documentation, timeframe requirements and enforcement will be developed.

Changes to the Employee Master File

During our audit, it was noted that certain users were found to have inappropriate access to change employee master file data due to turnover or transfers. Access lists had not been reviewed and approved by the individual department heads to confirm that users in their department have appropriate access.   Employee Master File is one of the key files in PeopleSoft and inappropriate change could cause risks to operations and financial reports.

We recommend that access to modify and view data in the Employee Master File be reviewed by individual department heads and any inappropriate access should be removed on a timely basis.

Management's Response:

Department of Administration-Information and Technology Management Division (ITMD):

Starting in 2006, ITMD began an annual internal audit of departmental users. All department heads are requested to review their department's access to both financials and HRMS and update as needed.

Segregation of Duties

Segregation of duty conflicts have not been formally identified and documented for access within the PeopleSoft application. A risk exists that users with multiple roles could have conflicting access and controls do not exist within the access provisioning process to prevent this from occurring. Segregation of duty conflicts have not been incorporated into periodic access reviews.

We recommend that segregation of duty conflicts be identified and formally documented for access within the PeopleSoft application. Segregation of duty conflicts should be incorporated into the access provisioning and access review processes to help ensure that users do not obtain inappropriate combinations of access within the application.

Management's Response:

Department of Administration-Information and Technology Management Division (ITMD):

Segregation of duties conflicts for PeopleSoft applications have been documented in the ITMD PeopleSoft Security Administration manual.

Program Change and Program Development

The City of Milwaukee Information Policies and Standards require the program change requests to have documented business management approval. During our audit, we noted a selection of PeopleSoft change requests that did not have documented business management approval on file. These approvals are crucial to help ensure the test results are satisfactory and appropriate approvals are given prior to the program's migration to the production environment.

We recommend that IT and business management take measures to reinforce that all IT and business management approvals be obtained, documented, and retained for all change requests.

Management's Response:

Department of Administration-Information and Technology Management Division (ITMD):

Change request procedures have been modified to require end user approval as part of the e-mail to request migration of change to production and to require the e-mail notification of a completed migration (as a reply to the request for a migration) to become part of the permanent change control documentation.

Physical Access to the Network File Server Room

During our audit, it was noted that the lock on the Network File Server Room entrance was broken. As a result, all users with access to the Operators Room have access to the Network File Server Room. The Network File Server Room contains the Windows domain and file servers, networking equipment, firewalls, and onsite (file server) backup media. The Network File Server Room also contains the direct T1 network connection to CedarCrestone, who hosts the PeopleSoft application. Lack of additional security to such critical areas can cause undue risks to the system operations.

We recommend that the Network File Server Room entrance be repaired as soon as possible so that access is appropriately restricted by the electronic card reader to only those employees who need access based on their job function.

Management's Response:

Department of Administration-Information and Technology Management Division (ITMD):

The broken lock condition was reported to DPW maintenance at the time of the physical walk through. The door was secured until the lock was repaired the following day. KPMG did a subsequent walk through and noted that the lock was in working condition, with access restricted to the electronic card reader.

Information Security Function

A dedicated information security function does not exist with responsibilities and authority over the entire City of Milwaukee. The current Chief Information Officer has information security responsibilities and authority over a limited number of departments. Individual departments are not required to have an information security position.

Lack of dedicated information security function can result in risks in enforcing information security practices and leave the City of Milwaukee data and programs susceptible to unauthorized access and use.

We recommend that a dedicated information security function be created to cover the entire City of Milwaukee organization. Such function should be staffed with individuals who have appropriate technical expertise to understand IT security concepts and practice. The function should be appropriately aligned within the IT organization and be independent of IT operations and development.

Management's Response:

Department of Administration-Information and Technology Management Division (ITMD):

Lack of funding makes this recommendation unfeasible at this time. We are working with the City Information Security Coordinator position in ITMD to meet on a periodic basis with the department-level security coordinators to share ideas, policies, and security awareness initiatives. With the decentralized structure of citywide IT, department-level coordinators are the most cost effective approach that the City currently can achieve.

Intergovernmental Agreements

In accordance with the Wisconsin statutes, the City issues bond and notes for the benefit of the Milwaukee Public Schools (MPS), of which certain issues are required to be repaid to the City. We noted there are no written intergovernmental agreements for several of the debt issues which clearly define the terms of the borrowing arrangements including the principal amounts, interest rates, and repayments terns.

Since the initial borrowings, there have been several refinancings of the underlying debt that was originally issued by the City to finance the intergovernmental borrowings to MPS. MPS is making payments to the City based on the debt service schedules of the original debt. However, there is no written agreement that clearly identifies whether MPS should be repaying the intergovernmental borrowings based on the terms of the old (refinanced) debt or the new debt.

We recommend the City establish written intergovernmental agreements for all debt issues with MPS that clearly define all significant terms of the intergovernmental borrowings including principal amounts, interest rates, repayment terms, and conditions for refinancing the debt.

Management's Response:

Office of the Comptroller:

We concur with the auditor's recommendation. The Comptroller's Office continues to work with the City Attorney's Office and Milwaukee Public Schools to establish written intergovernmental agreements for all debt issued for MPS.

Reporting Component Units

The Housing Authority of the City of Milwaukee, the Redevelopment Authority of the City of Milwaukee, and the Neighborhood Improvement Development Corporation are reported as component units in the City's comprehensive annual financial report (CAFR). These component units are legally separate organizations for which the elected officials of the City are accountable.

During preparation of the City's comprehensive annual financial report, we have encountered problems with the timely preparation of the financial statements of these component units. These organizations do not have a controller. Additionally, they do not appear to be adequately staffed or supervised to enable the timely preparation of accurate financial statements and schedules needed for audit. Untimely and inaccurate financial statements delay the issuance of the agencies financial statements and in turn could jeopardize the timely issuance of   City's comprehensive annual financial report. If the City is late with this report, the City could be penalized by the State up to 10% of the state highway aids ($2,400,000).

We recommend an evaluation be performed of the finance department of the component units including organizational structure, appropriate staffing levels, and consideration of the need for a controller.

Management's Response:

Department of City Development:

Over the past year, the Department of City Development (DCD) has worked vigorously to improve the management of its financial and accounting operations for both City and component units.

The most significant activity undertaken over the past year was the separation of the Housing Authority of the City of Milwaukee (HACM) and the Redevelopment Authority of the City of Milwaukee (RACM) accounting systems and accounting staffs. The financial activities for each organization are processed and accounted for separately. The department has closed all joint or treasury accounts and established separate accounts for HACM and RACM purposes. In addition, the department has assigned the financial management and accounting staff exclusively to either HACM or RACM activities - improving the focus and attention given to each organization's financial management through the more efficient, consistent, and systematic review of all accounting matters. The implementation of this split did have an impact on the timely completion of the 2006 financial statements for both organizations. However, these accomplishments will aid in the preparation of future financial statements by eliminating the confusion between HACM and RACM revenues, expenditures and activities.

The department has also conducted a thorough analysis of its financial and accounting staff and is working to address the needs identified by this review. The 2007 budget included the creation of two additional positions within DCD's Finance and Administration Division. Our new Director of Finance and Administration, who joined the staff, July 2007, is reviewing and modifying staff job descriptions, establishing supervisory and reporting relationships within the division, and working to improve accounting and financial reporting procedures, schedules and closing deadlines. The Accounting Manager position, to be filled October 22, 2007, will act as the department's internal "auditor" and "reconciler" ensuring that schedules are followed and working with the accounting staff to address any issues. Division management staff will also meet with the department's external auditors at the end of October 2007 to discuss the reasons for the audit delays (both internal and external) and work to promptly address these issues before work on the 2007 audits begin. Finally, division management will engage the external auditors in 2007 to review the department's accounting procedures and separation of duties.

Improving the financial management and reporting of DCD's component units has been an area of concern for the department over the past several years. It is believed that the items outlined in this response communicate the department's dedication to addressing these issues. It is DCD's intent to fully implement these tasks and move forward in meeting the goal of providing accurate financial reports for the component units to the City in a timely manner.

Documentation of Internal Control Structure

Organizations are placing greater emphasis on their control environment and the specific controls in place to ensure transactions recorded are complete and accurate. Although control procedures have been developed and employees appear to be familiar with these procedures, we noted the City has not formally documented the specific internal controls in place to help ensure reliable financial reporting, compliance with laws and regulations, and safeguarding of assets.

While not required by current accounting practices, we recommend the City consider performing an in-depth written assessment of the City's control environment which would include internal controls over the City's key transaction processes including cash receipts, cash disbursements and procurement, investment management, risk management, and human resources. This assessment and documentation should consider all aspects of internal control as defined by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) including the control environment, risk assessment, control activities, information and communication, and monitoring. Documentation of internal controls can be performed in numerous ways including narratives, flowcharts, policies and procedures manuals, written job descriptions, operating instructions, etc. We also recommend that all significant members of management be involved in the risk assessment process and identification and evaluation of internal controls. This documentation should be reviewed periodically to identify any changes required to provide an accurate reflection of the current system of internal control.

Formal internal control documentation will provide a tool for training accounting personnel in new positions, increased standardization of the control efforts, clarification of accounting responsibilities and consistent application of management's policies and procedures.

Management's Response:

Office of the Comptroller:

We agree with the auditor's recommendation. A manual to include all the individual documented internal controls into one complete reference book should help to ensure reliable financial reporting, compliance with laws and regulations and safeguard assets. While we agree this recommendation is not a requirement under the currently accounting practices, it is indeed a project we will work to accomplish. We believe such a manual should be part of the accounting policies and procedures manual also recommended by the auditors.

Accounting Policies and Procedures

The City does not have a comprehensive accounting policy and procedures manual. The current policy and procedures manual is brief and most sections have not been updated for several years. Procedures should be documented and updated so that all employees know the appropriate accounting procedures to be performed at their respective positions.

Documenting the procedures enhances the procedures and provides better internal control structure. The procedure manual can be used to codify the City's accounting procedures and to set forth job responsibilities, lines of authority and supervision for all the various City's functions. Further, once the procedures are documented they can be a useful tool for replacement employees and can also be used in the employee evaluation process. The advantages of an accounting procedures manual are that it can:

- Provide documentation, in one location, of the entire financial operations of the City, thereby facilitating an overall understanding of those operations by management and provide detailed guidance to all personnel involved in the financial function.

- Dictate the necessary internal controls to adequately safeguard the City's assets.

- Facilitate the training of new personnel.

We recommend that the City undertake a process to document and establish a comprehensive accounting procedures manual. Such a manual, which could be completed over the next two years, would provide invaluable information to all employees and encompass any of the comments discussed above.

Management's Response:

Office of the Comptroller:

We concur with the auditor's recommendation. The City's current "Accounting Procedures and Controls Manual" needs to be updated. Staff had been conducting preliminary research on this project; and, we are committed to accomplishing this major undertaking.

Actuarial Review

The City is self-insured for workers' compensation benefits. The City estimates the claims liability for the worker's compensation claims at year-end based on past payment experience, specific estimates (reserves) of the liability for reported claims, and the estimated lag between the time a claim is initially reported and ultimately paid.

We recommend the City obtain an actuarial estimate of the claims liability on a semi-annual basis to determine the reasonableness of managements estimate.

Management's Response:

Department of Employee Relations (DER):

The Department of Employee Relations (DER) has reviewed the Workers Compensation budget projections and the total expenditures over the past ten years.   The need for contingency fund transfers were in the amount of $6.2M over the past ten years, or 7% of the total budget.

The (DER) is interested in reducing any variance between the projected worker's compensation budget and the actual worker's compensation expenditures. While we recognize the volatile nature of claims and actual expenditures, we believe that a better recording/reporting application will generate enhanced data and data analysis to facilitate cost projections.

In 2008, a new claims management system will allow the department to record, retrieve, and analyze injury claim data and expenditure categories to better project future expenditures. Once the system is up and running, we will explore the cost and value of an annual actuarial estimate of these costs.

Estimating Compensated Absences Liability

During our testwork for compensated absences, we noted the City uses historical data to establish estimates of the liability recorded in the financial statements. This historical data has not been updated for several years and may not be representative of the current environment.

We recommend the City conduct an analysis of the historical data used in establishing the estimated liability for compensated absences and revise the estimate as considered necessary based on current data.

Management's Response:

Office of the Comptroller:

The methodology to determine the liability for compensated absences was developed prior to the implementation of the City's PeopleSoft Human Resource Management System (HRMS). For the 2007 financial statements, the Comptroller's Office will perform an analysis of compensated absences to determine if a change is needed to the procedures for estimating compensated absences.