COUNTY OF ERIE

STEFAN I. MYCHAJLIW
COMPTROLLER

August 13, 2013

The Erie County Legislature
92 Franklin Street
Buffalo, New York 14202

Honorable Mark C. Poloncarz
Erie County Executive
95 Franklin Street
Buffalo, New York 14202

Dear Honorable Members and County Executive Poloncarz:

Enclosed is a copy of the external auditor's (Drescher & Malecki LLP) Management Letter for Erie County for the year ended December 31, 2012.

Please be advised that although the Management Letter is dated June 25, 2013, this represents the date that the external auditors completed their audit and field work for the 2012 audit. The letter was actually issued today by Drescher & Malecki.

If you have any questions regarding the 2012 Management Letter, please contact me at 858-8400.

Very truly yours,

Gregory G. Gach
Deputy Erie County Comptroller

GGG/nr
Enclosure
c: Robert W. Keating, Director, Budget and Management
Michael Breeden, Chief Information Officer, Information & Support Services
Erie County Audit Committee Members
Drescher & Malecki LLP (without Enclosure)

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Certified Public Accountants

June 25, 2013

Honorable County Legislature
County Executive and County Comptroller
County of Erie, New York

In planning and performing our audit of the basic financial statements of the County of Erie, New York (the "County") as of and for the year ended December 31, 2012, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, we considered the County'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 entity's internal control. Accordingly, we do not express an opinion on the effectiveness of the County's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

In addition, during our audit we identified certain matters involving the internal control and other operational matters that are presented for your consideration. This letter does not affect our report dated June 25, 2013 on the financial statements of the County. We will review the status of these comments during our next audit engagement. Our comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve the internal control or result in other operating efficiencies. We will be pleased to discuss these comments in further detail at your convenience or perform any additional study of these matters. Our comments are summarized in Exhibit I.

We also summarized new reporting requirements in Appendix A. These should be evaluated to determine the extent the County will be impacted in the future years.

The purpose of this communication, which is an integral part of our audit, is to describe, for management and those charged with governance, the scope of our testing of internal control and the results of that testing. Accordingly, this communication is not intended to be and should not be used for any other purpose.

Drescher & Malecki LLP

June 25, 2013

Network Monitoring

Erie County's Division of Information & Support Services ("DISS") should regularly monitor attempts to access the network and web filter logs. While discussing monitoring activities with DISS, it was noted that the County does not regularly review web filter logs, nor the logs of successful and unsuccessful attempts at accessing the County's network.

The web filter reduces the amount of websites network users can access. In addition, reviewing the logs routinely will help DISS monitor how well users are complying with the computer use policy and possibly suggest other websites to block. Although the County has an annual intrusion detection test performed, routinely reviewing the log of user access to the network would allow for increased awareness of user logs at unusual times or if there are numerous logged error messages, which could indicate a problem or an attempted attack by an intruder.

Journal Entry Policy

A formal journal entry policy aids in the day to day operations of the County and will ensure consistency is maintained in the event of a change in personnel or the types of transactions that occur. During our testing of controls surrounding journal entries, we noted that the County has drafted a formal policy detailing the procedures for the preparation and recording of journal entries; however, this policy was not yet incorporated in their Accounting Policies Manual for the year ended December 31, 2012.

We recommend that the County adopt and implement their drafted formal journal entry policy.

Bank Reconciliations

During our audit we noted one Agency Fund bank account for which the December 31, 2012 bank reconciliation was not completed until May 2013. However, once completed, no operating statement or fund balance accounts were affected. In addition, we noted reconciling items that had not been posted to SAP to adjust the 2012 cash control balances. The County should make an effort to perform bank reconciliations on a monthly basis and address, investigate and resolve all reconciling items in a timely manner.

We recommend that all bank accounts be reconciled monthly to the general ledger and that all reconciling items be promptly investigated and resolved.

Accounts Payable Procedures

The County should review its year-end accounts payable procedures to ensure accurate reporting of expenses to the appropriate fiscal year. During our testing of subsequent disbursements, we noted several instances where goods and/or services purchased in 2012 were not properly accrued at December 31, 2012.

We recommend the County implement a procedure that assists employees to better identify and account for year-end accruals.

Internal Control Assessment/ Fraud Prevention

Similar to prior year, the County currently has not performed an enterprise-wide assessment of risks facing the County, including fraud risks. The enterprise risk management framework of the Committee of Sponsoring Organizations of the Treadway Commission includes five interrelated components of internal controls, one of which is risk assessment. A formal risk assessment is the cornerstone to an effective internal control program and provides the framework by which internal controls can be designed, implemented, and evaluated for effectiveness. As part of a risk assessment process, the consideration of the risk of fraud is essential to evaluating whether or not the appropriate controls are in place.

We understand that management, along with professional advisors, have continued to review insurance-related risks facing the County. Additionally, the County Comptroller's Office maintains an internal audit function, which assists in mitigating risk related to the absence of an overall risk assessment by ensuring appropriate and effective controls are established throughout the County's accounting cycles. The County also has an independent audit committee charged with oversight of the County's audit and control functions. County management has demonstrated a tone at the top that establishes expectations and provides a working environment which promotes quality and integrity in their performance.

We recommend that the County further consider formalizing its risk assessment process.

Economic Environment

As mentioned in our prior letter, the events within the overall economy have resulted in many challenges that have affected municipalities. Rising costs and lost revenues have contributed to an environment in which municipalities are facing both current and future economic difficulties. Some of these economic events include: Sales tax—while the County has met its budget goal, it has potential for declines, should the economy experience a shrinking period; Retirement system—the New York State Retirement System has doubled employer contributions from a few years ago; General wage increases—personnel expenditures account for a significant portion of total expenditures. Any raises provided to employees will result in an overall increase in personal expenditures, and will impact certain employee benefits as well.

While there are certain areas noted above where the County has no control and cannot be proactive to address the situation (i.e., sales tax, mandates, etc.), we recommend the County to continue identifying areas where options may be available and costs may be reduced, such as: consolidation of services, elimination of services, utilization of user fees, and wage concessions.

User Charges and Fees

The County may want to consider expanding the utilization of user charges and fees. User charges offer several advantages over taxes. One, they potentially provide the same information to public-sector decision makers that prices provide to private-sector producers: what to produce, and for whom to produce it. Two, user charges can lessen the possibility of oversupply or waste of public goods and services. Charges allow the consumer to see the link between the price paid and service provided, a disconnect that exists with taxes. Three, fees and charges represent another source of revenue that is often more accepted than taxes. Four, absent subsidies, users of services are the only ones that must pay for services financed by user charges. Five, charges and fees reduce subsidies to nonresidents and tax-exempt properties. Financing goods and services through general taxation excludes those who do not pay taxes but may utilize certain services.

In order for the County to evaluate the appropriateness of additional user charges, we recommend they implement the following steps:

- Identify services or activities that could be appropriate for user-charge financing.
- For those services and activities identified as candidates for user charges, cost data should be collected.
- A pricing approach should be selected.
- The County should attempt to determine the public's reaction to the imposition and address appropriately.

Succession Planning

The County continues to face the challenge of ensuring continuity and consistency of service delivery due to employee turnover. Certain key accountants will soon be eligible to retire. While we applaud the County's actions to add accountants to the Comptroller's Office, the County should consider the following key issues and develop strategies concerning succession planning recommended by the Government Finance Officers Association:

➢ Develop an integrated approach to succession management.

➢ Continually assess potential employee turnover.

➢ Provide a formal, written succession plan as a framework for succession initiatives.

➢ Continually develop written policies and procedures to facilitate knowledge transfer.

➢ Development of leadership skills should be a key component of any succession planning initiative.

➢ Encouragement of personal professional development activities should be a key part of the succession planning effort.

➢ Design of better recruitment and retention practices may aid in the succession process.

➢ Consideration must be given to collective bargaining agreements and civil service requirements and how those agreements fit in with the overall succession plan.

➢ Consider non-traditional hiring strategies.

NEW REPORTING REQUIREMENTS

The Governmental Accounting Standards Board ("GASB") has adopted several new pronouncements, which may have a future impact upon the County:

GASB Statement No. 61—The County is required to implement GASB Statement No. 61, *The Financial Reporting Entity: Omnibus—an amendment of GASB Statements No. 14 and No. 34*, effective for the fiscal year ending December 31, 2013. This statement amends Statement No. 14, *The Financial Reporting Entity* and Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments,* to better meet user needs and to address reporting entity issues that have arisen since the issuance of those statements.

GASB Statement No. 66—The County is required to implement GASB Statement No. 66, *Technical Corrections—2012—an amendment of GASB Statements No. 10 and No. 62,* effective for fiscal year ending December 31, 2013. The objective of this Statement is to improve accounting and financial reporting for a governmental financial reporting entity by resolving conflicting guidance that resulted from the issuance of two pronouncements, Statements No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions,* and No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements.*

GASB Statement No. 67—The County is required to implement GASB Statement No. 67, *Financial Reporting for Pension Plans*, effective for fiscal year ending December 31, 2014. The objective of this Statement is to improve financial reporting by state and local governmental pension plans.

GASB Statement No. 68—The County is required to implement GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, effective for fiscal year ending December 31, 2015. The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for pensions.

GASB Statement No. 69—The County is required to implement GASB Statement No. 69, *Government Combinations and Disposals of Government Operations,* effective for fiscal year ending December 31, 2014. This Statement establishes accounting and financial reporting standards related to government combinations and disposals of government operations.

GASB Statement No. 70—The County is required to implement GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*, effective for the fiscal year ending December 31, 2014. The objective of this Statement is to enhance comparability among governments and information disclosed about a government's obligations and risk exposure from extending nonexchange financial guarantees.