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# COUNTY OF ERIE

## STEFAN I. MYCHAJLIW
### COMPTROLLER

October 8, 2015

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 (M/L) for Erie County for the year ended December 31, 2014.

Please be advised that although the M/L is dated June 19, 2015, this represents the date that the external auditors completed their audit and field work for the 2014 audit. The letter was actually issued October 8, 2015 by Drescher & Malecki.

If you have any questions regarding the 2014 M/L, please contact me at 858-8400.

Very truly yours,

Stefan I. Mychajliw
Erie County Comptroller

SIM/jm
Enclosure
c: Robert W. Keating, Director, Budget and Management
Erie County Audit Committee Members
Drescher & Malecki LLP (without Enclosure)

**Drescher & Malecki LLP**
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*Certified Public Accountants*

June 19, 2015

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, 2014, 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 audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions 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.

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 19, 2015 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 appropriate members of management, are intended to improve the internal control or result in other operating efficiencies. 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 19, 2015

***Level of Fund Balance Policy***

Fund balance, also referred to as reserves, provides the County with the ability to respond to unexpected issues and to ensure stable tax rates. Fund balance provides the necessary resources to respond to unexpected issues – weather related disasters, infrastructure breakdowns, other emergency expenditures, revenue shortfalls, etc. It also provides for cash flow needs until major revenues are received. Real property taxes are not due until forty-five days after year end and the receipt of other revenues such as state aid and sales tax have substantial lag factors. Possessing adequate cash reserves reduces or eliminates the need for cash flow borrowing.

Reserves are usually viewed favorably by investors, rating agencies, and local banks with which the County does business. However, opposing pressures often come from unions, elected officials and taxpayer groups. The level of fund balance is and will continue to be a critical component of the County's future.

As a means to keep municipalities more focused on providing structural balance in their operations, with less dependence on one-time reserves, and to minimize political considerations of adequate reserve levels, many, including the Government Finance Officers Association (the "GFOA") recommend that governments establish a formal policy on the level of unrestricted unassigned fund balance that should be maintained in the General Fund.

We commend the County for having a policy in place. The County's Charter provides that General Fund unrestricted unassigned fund balance be equal to or greater than five percent of the appropriations amount contained in the adopted budget of the General Fund of the County's last audited financial statements. Further, it should be noted that the General Fund unrestricted unassigned fund balance has consistently increased over the last five years, from $74 million at December 31, 2009 to $92 million at December 31, 2014. However, the County's policy does not cite the rationale for the five percent threshold.

The GFOA states that the adequacy of unrestricted unassigned fund balance in the General Fund should be assessed based upon the County's own specific circumstances. Risk factors such as the predictability of future revenues, the volatility of expenditures, exposure to significant one-time outlays (disasters, immediate capital needs, and state budget cuts), legal claims and liquidity concerns need to be considered when developing such a policy.

As noted above, calculating a reserve requires estimating highly uncertain events like natural disasters and economic downturns. To develop an adequate response the GFOA incorporates the "Triple A" (1) approach. That approach utilizes the following guidance:

- **Accept.** First, the County must accept that they are subject to uncertainty, including events that they haven't even imagined.
- **Assess.** Next, the County must assess the potential impact of uncertainty. Historical reference cases are a useful baseline.
- **Augment.** The range of uncertainty the County really faces will almost always be greater than they assess it to be, so they should augment that range. Historical reference cases provide a baseline, but that baseline may not be adequate to account for all future possibilities.

We recommend that the County revisit its fund balance policies to provide support for the current five percent threshold or suggest an updated level. The County should act on the GFOA's recommendation to formally assess its financial risks and cash flow needs, analyze and quantify those risks and needs, and incorporate its findings into the formal policy outlining the level of unrestricted unassigned fund balance in the County's General Fund.

***Planning for Infrastructure Costs***

The County has recorded capital assets at their original cost or estimated cost at acquisition. It has $1.7 billion of capital assets recorded, of which, a large majority of this investment represents infrastructure type assets such as roads, bridges, and sewer and water systems. It is also important to note that the replacement value of these assets is significantly higher than the $1.7 billion original cost.

The GFOA acknowledges that:

> "...budgetary pressures often impede capital program expenditures or investments for maintenance and replacement, making it increasingly difficult to sustain the asset in a condition necessary to provide expected service levels. Ultimately, deferring essential maintenance or asset replacement could reduce the organizations ability to provide services and could threaten public health, safety and overall quality of life. In addition, as the physical condition of the asset declines, deferring maintenance and/or replacement could increase long-term costs and liabilities."

As noted in a recent Office of the New York State Comptroller report, New York State municipalities are spending less than a third of what is necessary to keep up with deteriorating assets. The report refers to a recent study that cites 48% of local roads were estimated to be in poor to fair condition and that more than one-third of local bridges were rated as deficient.

Competing needs for operations and infrastructure continue to represent significant challenges. The Comptroller's report cites that certain municipalities point to their desire to comply with the tax cap as preventing them from adequately investing into their infrastructure as the revenue needed to fund the projects cannot be raised while complying with the tax cap.

Based on the County's current inventory of capital assets, without regard to the increased cost of replacement and, assuming a 20 year average asset life, the County should be reinvesting nearly $87 million per year into its infrastructure.

We note the County has been committed to reinvesting into its capital assets. In fact, over the last five years the capital budgets have averaged nearly $70 million. However, based on the financial significance of future capital asset reinvestment coupled with the political pressure of the State's tax cap, we recommend that the County identify funding sources such as real property taxes or new fees that would be dedicated for future infrastructure repair and replacement. While the tax cap is certainly a consideration in budgeting for capital and replacement needs, it should not be a deterrent.

***Shared Services***

Over the past year the County took the lead in identifying shared services between the County and other local municipalities. We commend the County as well as all of our local governments for their efforts in this area. While the sharing of services is not a new concept, we believe it warrants continued attention. Certain services performed by local governments and financed by those communities' annual budget may be more effectively and efficiently performed by a countywide structure where the local governments are charged a fee for such services.

Areas that could be further evaluated include countywide assessing services and the County providing financial systems for accounting/bookkeeping.

Towns in Erie County are currently responsible for assessing their properties. Over the past several years many have begun sharing assessors with other communities because of cost constraints and the general supply of qualified assessors. The County should consider conducting a study to evaluate whether further consolidation, a countywide assessment function, is more effective and cost efficient.

Whereby assessors would be employees of the County and the County could chargeback the service to the Towns. It may result in a reduced workforce, reduced costs and more consistent assessed values/equalization rates throughout the County.

All municipalities are required to account for their respective financial transactions. There are numerous accounting software packages utilized by Erie County municipalities usually determined by the size and complexity of the entity. Additionally, the level of sophistication in accounting personnel varies between municipalities. Based on these two factors the recording of similar transactions often varies between municipalities. The County should consider studying what accounting alternatives it could provide local communities.

Further areas to study include countywide dispatching services, human resources (H.R.) administration, and information technology support as well as any area that could result in a more consistent service delivery throughout the County at a more favorable overall cost to the taxpayer.

***Capital Asset Policy***

The County should periodically review its capital asset policies and evaluate whether procedures being performed are in compliance with those established within the adopted policies. During our audit, we noted the County's financial reporting software, SAP, was not depreciating certain assets in accordance with their adopted policy. Accordingly, the County is at risk of misstating particular assets due to the depreciation discrepancy between SAP and the adopted policy.

We recommend that the County evaluate the most appropriate method for depreciating each asset category, and update the policy and SAP to avoid any discrepancies.

Endnotes:

(1) The Triple-A approach is adapted from: Spyros Makridakis, Robin Hogarth, and Anil Gaba. Dance with Chance: Making Luck Work for You (Oneworld Publications: Oxford, England, 2009).

**APPENDIX A**

**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. 68***—The County is required to implement GASB Statement No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27*, effective for the 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. 71***—The County is required to implement GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date—an amendment of GASB Statement No. 68*. The provisions of this Statement should be applied simultaneously with the provisions of Statement 68. The objective of this Statement is to address an issue regarding application of the transition provisions of Statement No. 68, *Accounting and Financial Reporting for Pensions.* The issue relates to amounts associated with contributions, if any, made by a state or local government employer or nonemployer contributing entity to a defined benefit pension plan after the measurement date of the government's beginning net pension liability.

***GASB Statement No. 72***—The County is required to implement GASB Statement No. 72, *Fair Value Measurement and Application*, effective for the fiscal year ending December 31, 2016. The objective of this Statement is to provide guidance for determining the fair value measurement for financial reporting purposes and for disclosures related to all fair value measurements.

***GASB Statement No. 73***—The County is required to implement GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements No. 67 and 68*, effective for fiscal year ending December 31, 2016. The requirements of this Statement establish new reporting requirements for those pensions and pension plans that are not administered through a trust meeting the requirements of GASB Statements No. 67 and 68.

***GASB Statement No. 74***—The County is required to implement GASB Statement No. 74, *Financial Reporting for Post-employment Benefit Plans Other than Pension Plans*, effective for the fiscal year ending December 31, 2017. The requirements of this statement address the financial reports of defined benefit OPEB plans that are administered through trusts that meet certain criteria. This Statement replaces GASB Statement No. 43, *Financial Reporting for Post-employment Benefit Plans Other than Pension Plans*.

***GASB Statement No. 75***—The County is required to implement GASB Statement No. 75, *Accounting and Financial Reporting for Post-employment Benefits Other than Pensions*, effective for the fiscal year ending December 31, 2018. This Statement replaces GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Post-employment Benefits Other than Pensions*, and will require more extensive note disclosures and required supplementary information about their OPEB liabilities.