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COUNTY OF ERIE

DAVID J. SHENK
COMPTROLLER

August 30, 2012

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, 2011.

Please be advised that although the Management Letter is dated June 27, 2012, this represents the date that the external auditors completed their audit and field work for the 2011 audit. The letter was actually issued today by Drescher & Malecki.

If you have any questions regarding the 2011 Management Letter, please contact me at 858-8400.

Very truly yours,

David J. Shenk
Erie County Comptroller

DJS/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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Cheektowaga, New York 14227
Telephone: 716.565.2299
Fax: 716-565-2201

Certified Public Accountants

June 27, 2012

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, 2011, on which we have issued our report dated June 27, 2012 (which report refers to other auditors), in accordance with auditing standards generally accepted in the United States of America, 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 County's internal control. Accordingly, we do not express an opinion on the effectiveness of the County's internal control.

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 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 significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control that we considered to be material weaknesses, as defined above.

We outlined certain observations and developed the recommendations included in Exhibit I on other accounting, administrative, and operating matters.

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.

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

We will be pleased to further discuss these recommendations with you.

Yours truly,

Drescher & Malecki LLP

Economic Environment

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:

- Medicaid and Medicare—Uncertainty in the Medicaid and Medicare reimbursement formulas.
- Decreasing interest rates—Interest rates have fallen drastically over the last few years, resulting in significantly lower interest revenue.
- Sales tax—While the County has met its budget goal, the County has potential for declines should the economy go into a recession.
- Health insurance—Rates for health insurance have significantly increased, as a result of increased healthcare costs.
- General insurance—Rates for general insurance have significantly increased as a result of the poor economy.
- Retirement system—The New York State Retirement System has significantly increased employer contributions.
- General wage increases—Personnel expenditures account for a significant portion of total expenditures. 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., reimbursement rates, 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.

Succession Planning

The County faces the challenge of ensuring continuity and consistency of service delivery due to employee turnover. Certain key accountants will soon be eligible to retire. In order to ensure that there are enough qualified or available workers 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.
- Develop written policies and procedures to facilitate knowledge transfer.
- Development of leadership skills should be a key component of any succession planning initiative.

Succession Planning (continued)

- 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 how those agreements fit in with the overall succession plan.
- Consider non-traditional hiring strategies.

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.

Journal Entry Policy

During our testing of controls surrounding journal entries, we noted that the County currently does not have a formal policy detailing the procedures for the preparation/recording of journal entries. Although, the County's financial software contains underlying controls surrounding the preparation/recording of journal entries, a formal journal entry policy aides in the day to day operations of the County and ensures consistency is maintained in the event of a change in personnel or type of transactions that are made.

We recommend that the County adopt and implement a formalized journal entry policy.

Information Technology Risk Assessment, Monitoring and Policies

During testing of the County's Information Technology ("IT") environment, we noted that the County does not regularly perform and document an IT risk assessment. The County may be unaware of potential IT risks, which could potentially harm the financial system. Additionally, the County currently has no formalized disaster recovery plan, backup policy or remote access policy in place. Without a disaster recovery plan, resuming operations after an emergency may not occur as quickly and efficiently as possible. Lack of a remote access policy may allow users to abuse remote access privileges for non-county related purposes. Lack of a backup policy could allow for backups to go unperformed or untested, which may cause a loss of information.

We recommend that the County perform an IT risk assessment to identify risky areas that may pose a threat to the operation and physical security of the County's IT. Additionally, we recommend that the County develop and formalize the aforementioned policies. Written policies will make users aware of what steps they should take and what their individual responsibilities are in case of an emergency and of what type of behavior and use of IT assets is appropriate.

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. 57—The County is required to implement GASB Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans* for the fiscal year ending December 31, 2012. This Statement amends Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions,* to permit an agent employer that has an individual-employer OPEB plan with fewer than 100 total plan members to use the alternative measurement method, at its option, regardless of the number of total plan members in the agent multiple-employer OPEB plan in which it participates.

GASB Statement No. 60—The County is required to implement GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements* for the fiscal year ending December 31, 2012. This statement improves financial reporting by addressing issues related to service concession arrangements (SCAs).

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* for the fiscal year ending December 31, 2013. The objective of this Statement is to improve financial reporting for a governmental financial reporting entity. The requirements of Statement No. 14, *The Financial Reporting Entity*, and the related financial reporting requirements of Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments,* were amended to better meet user needs and to address reporting entity issues that have arisen since the issuance of those Statements.

GASB Statement No. 62—The County is required to implement GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* for the fiscal year ending December 31, 2012. The objective of this Statement is to incorporate into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the following pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements:

1. Financial Accounting Standards Board (FASB) Statements and Interpretations
2. Accounting Principles Board Opinions
3. Accounting Research Bulletins of the American Institute of Certified Public Accountants' (AICPA) Committee on Accounting Procedure.

GASB Statement No. 63—The County is required to implement GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position* for the fiscal year ending December 31, 2012. This statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. Concepts Statement No. 4, Elements of Financial Statements, introduced and defined those elements as a consumption of net assets by the government that is applicable to a future reporting period, and an acquisition of net assets by the government that is applicable to a future reporting period, respectively. Previous financial reporting standards do not include guidance for reporting those financial statement elements, which are distinct from assets and liabilities.

GASB Statement No. 64—The County is required to implement GASB Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions-an amendment of GASB Statement No. 53* for the fiscal year ending December 31, 2012. The objective of this Statement is to clarify whether an effective hedging relationship continues after the replacement of swap counterparty or a swap counterparty's credit support provider. This Statement sets forth criteria that establish when the effective hedging relationship continues and hedge accounting should continue to be applied.

GASB Statement No. 65—The County is required to implement GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities* for the fiscal year ending December 31, 2013. The objective of this Statement is to establish accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities.

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* for the 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.*