CITY OF WAUKESHA

Waukesha, Wisconsin

COMMUNICATION TO THOSE CHARGED WITH GOVERNANCE
AND MANAGEMENT

As of and for the Year Ended December 31, 2015

CITY OF WAUKESHA

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REQUIRED COMMUNICATION OF INTERNAL CONTROL RELATED MATTERS IDENTIFIED IN THE AUDIT TO THOSE CHARGED WITH GOVERNANCE

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To the Common Council
City of Waukesha
Waukesha, Wisconsin

In planning and performing our audit of the financial statements of the City of Waukesha as of and for the year ended December 31, 2015, in accordance with auditing standards generally accepted in the United States of America, we considered its internal control over financial reporting (internal control) as a basis for designing our auditing 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 its internal control. Accordingly, we do not express an opinion on the effectiveness of its internal control.

Separate Communications to those Charged with Governance and Management were issued to the Waukesha Water Utility Commission and Waukesha Transit Commission. The information contained in those reports is not included in this report.

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 or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified a certain deficiency in internal control that we consider to be a material weakness.

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. We consider the following deficiency in the City of Waukesha's internal control to be a material weakness:

> Internal Control Over Financial Reporting

The City of Waukesha's written response to the material weakness and the comments and recommendations identified in our audit have not been subjected to auditing procedures applied in the audit of the financial statements, and accordingly, we express no opinion on them.

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

Baker Tilly Virchow Krause, LLP

Milwaukee, Wisconsin
July 18, 2016

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Auditing standards require that we perform procedures to obtain an understanding of your government and its internal control environment as part of the annual audit. This includes an analysis of significant transaction cycles and an analysis of the City's year-end financial reporting process and preparation of your financial statements, including the schedule of federal and state awards.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

Properly designed systems of internal control provides your organization with the ability to process and record monthly and year end transactions and prepare annual financial reports.

Our audit includes a review and evaluation of the City's internal controls relating to financial reporting. Common attributes of a properly designed system of internal control for financial reporting are as follows:

- There is adequate staffing to prepare financial reports throughout the year and at year-end.
- Material misstatements are identified and corrected during the normal course of duties.
- Complete and accurate financial statements, including footnotes, are prepared.
- Complete and accurate schedule of expenditures of federal and state awards is prepared.
- Financial reports are independently reviewed for completeness and accuracy.

Our evaluation of the internal controls over financial reporting has identified control deficiencies that are considered a material weakness surrounding the preparation of financial statements and footnotes and adjusting journal entries identified by the auditors.

Management has not prepared financial statements that are in conformity with generally accepted accounting principles. In addition, one material misstatement in the general ledger was identified during the financial audit.

This level of internal control over financial reporting can be a difficult task for governments that operate with only enough staff to process monthly transactions and reports, and often rely on their auditors to prepare certain year-end audit entries and financial statements

Management Response:

For the year ending 2015 statements, the City Finance department did review the Financial Statements thoroughly despite not preparing them. The material misstatement was in conjunction with not recognizing the funds relating to the US Hwy 18 Jurisdictional Transfer. This was researched with the State for reporting purposes and recorded properly in cooperation with Baker Tilly. The City Finance department is now fully staffed and is excited about taking over the preparation of the Financial Statements for the Year Ending 2016.

OTHER COMMUNICATIONS TO THOSE CHARGED WITH GOVERNANCE

TWO WAY COMMUNICATION REGARDING YOUR AUDIT

As part of our audit of your financial statements, we are providing communications to you throughout the audit process. Auditing requirements provide for two-way communication and are important in assisting the auditor and you with more information relevant to the audit.

As this past audit is concluded, we use what we have learned to begin the planning process for next year's audit. It is important that you understand the following points about the scope and timing of our next audit:

a. We address the significant risks or material misstatement, whether due to fraud or error, through our detailed audit procedures.

b. We will obtain an understanding of the five components of internal control sufficient to assess the risk of material misstatement of the financial statements whether due to error or fraud, and to design the nature, timing, and extent of further audit procedures. We will obtain a sufficient understanding by performing risk assessment procedures to evaluate the design of controls relevant to an audit of the financial statements and to determine whether they have been implemented. We will use such knowledge to:

   > Identify types of potential misstatements.
   > Consider factors that affect the risks of material misstatement.
   > Design tests of controls, when applicable, and substantive procedures.

   We will not express an opinion on the effectiveness of internal control over financial reporting or compliance with laws, regulations, and provisions of contracts or grant programs. For audits done in accordance with *Government Auditing Standards,* our report will include a paragraph that states that the purpose of the report is solely to describe the scope of testing of internal control over financial reporting and compliance and the result of that testing and not to provide an opinion on the effectiveness of internal control over financial reporting or on compliance and that the report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering internal control over financial reporting and compliance. The paragraph will also state that the report is not suitable for any other purpose.

c. The concept of materiality recognizes that some matters, either individually or in the aggregate, are important for fair presentation of financial statements in conformity with generally accepted accounting principles while other matters are not important. In performing the audit, we are concerned with matters that, either individually or in the aggregate, could be material to the financial statements. Our responsibility is to plan and perform the audit to obtain reasonable assurance that material misstatements, whether caused by errors or fraud, are detected.

d. We address the significant risks of material noncompliance, whether due to fraud or error, through our detailed audit procedures.

TWO WAY COMMUNICATION REGARDING YOUR AUDIT (cont.)

e. We will obtain an understanding of the five components of internal control sufficient to assess the risk of material noncompliance related to the federal and state awards whether due to error or fraud, and to design the nature, timing, and extent of further audit procedures. We will obtain a sufficient understanding by performing risk assessment procedures to evaluate the design of controls relevant to an audit of the federal and state awards and to determine whether they have been implemented. We will use such knowledge to:

   > Identify types of potential noncompliance.
   > Consider factors that affect the risks of material noncompliance.
   > Design tests of controls, when applicable, and other audit procedures.

   Our audit will be performed in accordance with U.S. generally accepted auditing standards, *Government Auditing Standards*, OMB's *Uniform Administrative Requirements, Cost Principles and Audit Requirements for Federal Awards* (Uniform Guidance), and the *State Single Audit Guidelines.*

   We will not express an opinion on the effectiveness of internal control over financial reporting or compliance with laws, regulations, and provisions of contracts or grant programs. For audits done in accordance with *Government Auditing Standards*, the Uniform Guidance, and the *State Single Audit Guidelines*, our report will include a paragraph that states that the purpose of the report is solely to describe (a) the scope of testing of internal control over financial reporting and compliance and the result of that testing and not to provide an opinion on the effectiveness of internal control over financial reporting or on compliance, (b) the scope of testing internal control over compliance for major programs and major program compliance and the result of that testing and to provide an opinion on compliance but not to provide an opinion on the effectiveness of internal control over compliance and, (c) that the report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering internal control over financial reporting and compliance and the Uniform Guidance and the *State Single Audit Guidelines* in considering internal control over compliance and major program compliance. The paragraph will also state that the report is not suitable for any other purpose.

f. The concept of materiality recognizes that some matters, either individually or in the aggregate, are important for reporting material noncompliance while other matters are not important. In performing the audit, we are concerned with matters that, either individually or in the aggregate, could be material to the entity's federal and state awards. Our responsibility is to plan and perform the audit to obtain reasonable assurance that material noncompliance, whether caused by error or fraud, is detected.

g. Your financial statements contain components, as defined by auditing standards generally accepted in the United States of America, which we also audit.

We are very interested in your views regarding certain matters. Those matters are listed here:

a. We typically will communicate with your top level of management unless you tell us otherwise.

b. We understand that the Common Council has the responsibility to oversee the strategic direction of your organization, as well as the overall accountability of the entity. Management has the responsibility for achieving the objectives of the entity.

c. We need to know your views about your organization's objectives and strategies, and the related business risks that may result in material misstatements.

d. Which matters do you consider warrant particular attention during the audit, and are there any areas where you request additional procedures to be undertaken?

e. Have you had any significant communications with regulators or grantor agencies?

TWO WAY COMMUNICATION REGARDING YOUR AUDIT (cont.)

f. Are there other matters that you believe are relevant to the audit of the financial statements or the federal or state awards?

Also, is there anything that we need to know about the attitudes, awareness, and actions of the City concerning:

a. The City's internal control and its importance in the entity, including how those charged with governance oversee the effectiveness of internal control?

b. The detection or the possibility of fraud?

We also need to know if you have taken actions in response to developments in financial reporting, laws, accounting standards, governance practices, or other related matters, or in response to previous communications with us.

With regard to the timing of our audit, here is some general information. We will perform preliminary financial audit work during the months of October-December, and sometimes early January. Our final financial audit fieldwork as well as our single audit fieldwork is scheduled during the spring to best coincide with your readiness and report deadlines. After fieldwork, we wrap up our financial audit and single audit procedures at our office and may issue drafts of our report for your review. Final copies of our reports and other communications are issued after approval by your staff. This is typically 6-12 weeks after final fieldwork, but may vary depending on a number of factors.

Keep in mind that while this communication may assist us with planning the scope and timing of the audit, it does not change the auditor's sole responsibility to determine the overall audit strategy and the audit plan, including the nature, timing, and extent of procedures necessary to obtain sufficient appropriate audit evidence.

We realize that you may have questions on what this all means, or wish to provide other feedback. We welcome the opportunity to hear from you.

COMMUNICATION OF OTHER CONTROL DEFICIENCIES, RECOMMENDATIONS AND INFORMATIONAL POINTS TO MANAGEMENT THAT ARE NOT MATERIAL WEAKNESSES OR SIGNIFICANT DEFICIENCIES

OTHER COMMENTS AND RECOMMENDATIONS

INFORMATION TECHNOLOGY CONTROLS

As part of our 2015 audit, we evaluated the information technology (IT) controls as they relate to financially significant applications. Our procedures primarily focused on documenting and evaluating general computer controls, including:

Logical access to data and applications
Change and incident management
Data backup and recovery

The following points contain suggestions for strengthening internal controls in the change and incident management area:

Access Review: Access should be reviewed once a year by management to ensure users don't have access beyond their job responsibilities. Segregation of duties conflicts should also be reviewed. Documentation of these reviews should be maintained and should include the network and all of the financially-significant applications. IT should be the "facilitator" of the access review process which includes generating system user listings and user rights and follow-up on reviews; however, the reviewers of access should be the application owners and/or department heads who know what type of access the users should/should not have in each in-scope system.

Financial System Administrative Access: Currently, the Finance Director is an administrator in the financial system (Munis). The City should have segregation of duties between system administration and users that are responsible for entering, reviewing, and approving transactions.

The following points contain suggestions for strengthening internal controls in the logical access area. It should be noted that the items noted below need to first be addressed adequately by human resources (HR) before IT can do what is needed in the actual system:

Account Management – Third Party Service Providers: We recommend that the City regularly request, receive and review Service Organization Control (SOC) reports from UtilPro and assess the controls for adequacy.

Account Management – Account Termination: The City continues to struggle to alert IT of terminations so that IT can remove the system access for the respective users. The City should be more proactive alerting IT of terminations and IT should consider a potential automated control for terminations such as linkage to payroll and/or HR system.

OTHER COMMENTS AND RECOMMENDATIONS (continued)

Management Response:

Internal Controls – The City takes internal controls very seriously. We appreciate the feedback in this area and will have further discussion regarding the opportunity to mitigate any weaknesses. There already has been a change made in how users are able to gain rights within the Munis software.

Account Management – The City Administrator, IT Director and HR Director will have discussions on how to better on board and off board personnel. The HR department will be informed of the importance of accesses the controls on the Ultipro system regularly.

OTHER COMMENTS AND RECOMMENDATIONS (continued)

IMPACT FEES

The City collects impact fees per State Statute 66.0617. Those impact fees are properly recorded on the financial statements as restricted cash. However, the actual cash is maintained with the City's commingled deposits. Statute 66.0617 specifies that impact fees should be maintained in segregated, interest bearing accounts. We recommend the City make this change going forward.

Management Response:

The City will look into creating a separate Impact fee account to be in compliance w/ 66.0617 (8).

UDPATE TO LANGUAGE IN FINANCIAL POLICIES AND PROCEDURES RELATED TO FUND BALANCE

The City successfully implement GASB statement No. 54 – *Fund Balance Reporting and Governmental Type Definitions* effective January 1, 2011. This changed some of the fund balance reporting terminology used by the City. However, as of December 31, 2015, the City's financial policies and procedures have not been updated to reflect these terminology changes. We recommend the City evaluates these policies and procedures and update them for the new terminology.

Management Response:

An overall Finance Policy review is needed and being discussed. It is important to note, that although policies haven't been updated, there have not been any reporting deficiencies.

OTHER COMMENTS AND RECOMMENDATIONS (continued)

DEPARTMENTAL CONTROLS

As part of our annual audit process, we focus our efforts on the primary accounting systems, internal controls, and procedures used by the City. This is in keeping with our goal to provide an audit opinion which states that the financial statements of the City are correct in all material respects.

In some cases, the primary system of accounting procedures and controls of the City are supported by smaller systems which are decentralized, and reside within a department or location. In many cases, those systems are as simple as handling cash collections and remitting those collections to the City Treasurer. In other cases, the department may send invoices or statements of amounts due, and track collections of those amounts in a standalone accounts receivable system.

Generally, the more centralized a function is, the easier it is to design and implement accounting controls that provide some level of checks and balances. That is because you are able to divide certain tasks over the people available to achieve some segregation of duties. For those tasks that are decentralized, it is usually very difficult to provide for proper segregation of duties. Therefore, with one person being involved in most or all aspects of a transaction, you lose the ability to rely on the controls to achieve the safeguarding of assets and reliability of financial records.

As auditors, we are required to communicate with you on a variety of topics. Since there is now more emphasis on internal controls and management's responsibilities, we believe it is appropriate to make sure that you are informed about the lack of segregation of duties that may occur at departments or locations that handle cash or do miscellaneous billing. Examples in your City that may fit this situation may include the following:

Recreation
Police department
Library

As auditors, we are required to focus on the financial statements at a highly summarized level and our audit procedures support our opinion on those financial statements. Departments or locations that handle relatively smaller amounts of money are not the primary focus of our audit. Yet, because of the lack of segregation of duties, the opportunity for loss is higher there than in centralized functions that have more controls.

Because management is responsible for designing and implementing controls and procedures to detect and prevent fraud, we believe that is important for us to communicate this information to you. We have no knowledge of any fraud that has occurred or is suspected to have occurred within the departments mentioned above. However, your role as the governing body is to assess your risk areas and determine that the appropriate level of controls and procedures are in place. As always, the costs of controls and staffing must be weighed against the perceived benefits of safeguarding your assets.

Without adding staff or splitting up the duties, your own day-to-day contact and knowledge of the operation are also important mitigating factors.

Management Response:

The City Finance department helps review the transactions of many departments and helps review internal controls of departments.

INFORMATIONAL POINTS

HIPAA Risk Assessment

With data breaches on the rise, the US Department of Health and Human Services (HHS) Office of Civil Rights (OCR) has ramped up auditing and enforcement of Health Insurance Portability and Accountability Act (HIPAA) compliance in recent years. What they have found is that many organizations are not doing enough to protect Electronic Protected Health Information (ePHI).

One of the most common findings identified by HHS OCR is the lack of a thorough and documented risk assessment. The HIPAA Security Rule requires that organizations in accordance with the Code of Federal Regulations 45 §164.308(a)(1)(ii)(A) "Conduct an accurate and thorough assessment of the potential risks and vulnerabilities to the confidentiality, integrity, and availability of electronic protected health information ...". HHS OCR has indicated this risk assessment should be documented and performed at least annually.

Breach notification to HHS OCR is required when ePHI is exposed. When HHS OCR investigates such breaches, the documentation for the organization's latest risk assessment is often one of the first requests by HHS OCR for their review.

We recommend you perform and document the required HIPAA risk assessment. We are available to assist you with this process.

INFORMATIONAL POINTS (continued)

GOVERNMENT FRAUD PREVENTION AND DETECTION: NOW IS THE TIME TO ACT

When it comes to preventing and detecting fraud in government, being proactive is critical. In fact, government is the second most likely industry to be impacted by fraud. According to the audit standards, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management. To get started, your government should conduct a fraud risk assessment to identify where and how fraud might occur and what individuals may be in a position to commit fraud. Once you've identified your entity's fraud risk areas, the next step is to develop a fraud risk assessment and investigation policy.

As you begin your fraud risk assessment or develop tools to prevent and detect fraud, it is important to keep in mind the following information provided by the Association of Certified fraud Examiners:

- Misappropriation of assets accounts for 80 percent of fraud
- The primary internal control weaknesses observed are lack of internal controls, lack of management review, override of existing internal controls and poor tone at the top
- A tip is the most effective tool to catch a fraudster followed by management review
- The professional requirements and objectives of a financial audit are different than a forensic audit. Due to the nature of a financial audit, less than 10 percent of frauds have been discovered as a result of a forensic audit conducted by an independent accounting firm.

If your government has not gone through a fraud risk assessment or does not have a plan to prevent and detect fraud, we recommend that this be done and then updated on a regular basis. We are available to assist you with this process.

NEW RESOURCES FOR STATE AND LOCAL GOVERNMENT BOARDS

In recent years, our clients have told us that the roles of their board members have become increasingly demanding. Expectations and accountability are at all-time high and the knowledge required to be an effective board member is substantial. For these reasons, we have compiled a number of resources dedicated to educating state and local government board members. Go to our website www.bakertilly.com and click on the State and Local Government page.

Included in the "insights" section at the bottom of the State and Local Government page are four quick-hitting, informative videos:

1. Government financial statements 101
2. Understanding your government's fraud risk
3. Financial ratios and benchmarks
4. Fund balance and other financial policies

Also included are links to other videos, case studies and news / events that you might find of interest.

We encourage you to subscribe to our complimentary newsletter "Government Connection" to stay abreast of the latest issues impacting state and local governments. You can do so by clicking on the "subscribe" button and indicating "State and Local Government" as an area of interest on the subscription form. Also, if you or your board members have suggested topics to feature on our Board Governance webpage or Government Connection newsletter, we invite you to submit your ideas in person or online.

INFORMATIONAL POINTS (continued)

INTERPRETING YOUR FINANCIAL STATEMENTS POST-GASB NO. 68

Now that your financial statements reflect the new pension requirements of GASB Statement No. 68, what has changed and how do you interpret this new information? In summary, GASB Statement No. 68 required governmental entities participating in the Wisconsin Retirement System (WRS) to report their proportionate share of the plan's activity and net pension asset.

As of the December 31, 2014 measurement date used for your 2015 financial statements, WRS reported total resources available to provide pension benefits of $92.1 billion. They also reported a total liability for pensions of $89.7 billion. This resulted in a net pension asset of $2.4 billion. Your government's proportionate share of the asset is $8,120,019 and is reported as a restricted asset. There are also pension-related deferred outflows or inflows due to timing of contributions and smoothing of activity.

Pension activity under GASB Statement No. 68 is report in the government-wide financial statements and proprietary fund financial statements, similar to long-term debt. The implementation of this new standard does not affect how you fund or pay for your pension contributions to the WRS.

The accounting and reporting of pensions has become more complex with the implementation of GASB Statement No. 68. We are available to answer any questions on how this new accounting standard affects your financial statements.

OTHER POST EMPLOYMENT BENEFIT (OPEB) REPORTING CHANGES ON THE HORIZON

GASB Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, addresses reporting by OPEB plans that administer benefits on behalf of governments. GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, addresses reporting by governments that provide OPEB to their employees and for governments that finance OPEB for employees of other governments. The new OPEB standards parallel the pension standards GASB Nos. 67 and 68. Together, the pension and OPEB standards provide consistent and comprehensive guidance for all postemployment benefits.

OPEB plans will implement the new standards beginning with the year end December 31, 2017. Governments that provide OPEB benefits to their employees will need to implement these standards beginning with the year end December 31, 2018.

This standard has similarities to the previous OPEB standards, most notably the definition of an OPEB and the option of the alternative measurement method for small governments. However, the calculation and reporting of the OPEB liability and various required disclosures will change under the new standards, becoming similar to the pension standards.

To implement this standard, your government will need to plan ahead for obtaining a new actuarial study. The selection of a measurement date and timing for the study will be important to consider well in advance of implementation. We are available to further discuss this standard, the timing, and impact on your government.

INFORMATIONAL POINTS (continued)

TAX INCREMENT FINANCING LAW CHANGES

In 2014, the Wisconsin Legislature appointed the Legislative Council Study Committee on the Review of Tax Increment Financing to study and review Wisconsin's Tax Incremental Financing (TIF) laws and to make recommendations for modifications and improvements. The Committee recommended eight bills, four of which were adopted by the Legislature and signed by the Governor in March 2016. Following is a summary of the new laws:

- 2015 Wisconsin Act 254 permits a Tax Incremental District (TID) project plan to be amended, or its maximum lifespan to be extended by an additional three years, or both, if at any time during the life of the TID, the annual and total amount of tax increments to be generated are adversely impacted by Wisconsin Act 145. Act 145 increased state aid to technical college districts in order to reduce the total statewide levy of technical college districts.

- 2015 Wisconsin Act 255 removes the restriction that vacant property may not comprise more than 25 percent of the area of a newly created TID and excludes all tax-exempt city-owned property from the calculation of a TID's initial tax incremental base value.

- 2015 Wisconsin Act 256 makes several technical changes to the TIF law, deleting certain obsolete provisions and clarifying/modifying others, such as maintenance of industrial zoning, public hearing notice for TID amendments and Joint Review Board review period. It also specifies that the municipality's equalized value for the preceding year, as used in the calculation of the levy limit exception for the year that a TID terminates, excludes the value of any TID value increments (TID OUT Value).

- 2015 Wisconsin Act 257 makes several changes to improve reporting and transparency regarding the performance of TIF districts, including requiring a community to submit an annual report by July 1 describing the status of each existing TID to each overlying taxing jurisdiction as well as to the Wisconsin Department of Revenue (DOR). There will be a $100 per day fine imposed for reports that are past due. In addition, the joint review board must meet annually to review the annual report and status of each TID. Baker Tilly will be working with the DOR in upcoming months to fully understand the impact of the reporting changes. We anticipate that there will be additional information your government will need to provide as part of this new reporting process. We will communicate additional information as it is known.

Acts 254, 255, 256 and certain sections of Act 257 are effective immediately and apply to all TIDs that are created or amended after October 1, 2015. The effective date for the annual reporting requirements stated in Act 257 is October 1, 2016. Accordingly, this new reporting requirement will be effective for your 2016 annual report due by July 1, 2017. More information related to these new laws is available on the DOR and Wisconsin State Statute's websites.

REQUIRED COMMUNICATIONS BY THE AUDITOR TO THOSE CHARGED WITH GOVERNANCE

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To the Common Council
City of Waukesha
Waukesha, Wisconsin

Thank you for using Baker Tilly Virchow Krause, LLP as your auditor.

We have completed our audit of the financial statements of the City of Waukesha for the year ended December 31, 2015 and have issued our report thereon dated July 18, 2016. This letter presents communications required by our professional standards.

Our Responsibility Under Auditing Standards Generally Accepted in the United States of America, Government Auditing Standards, the Uniform Guidance, and the State Single Audit Guidelines

The objective of a financial statement audit is the expression of an opinion on the financial statements. We conducted the audit in accordance with auditing standards generally accepted in the United States of America, *Government Auditing Standards,* OMB's *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance), and the *State Single Audit Guidelines.* These standards require that we plan and perform our audit to obtain reasonable, rather than absolute, assurance about whether the financial statements prepared by management with your oversight are free of material misstatement, whether caused by error or fraud. Our audit included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit does not relieve management or the Common Council of their responsibilities.

We considered the City of Waukesha's internal control over financial reporting to determine the 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 City of Waukesha's internal control over financial reporting. We also considered internal control over compliance with types of requirements that could have a direct and material effect on a major federal and major state program to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for a major federal and major state program and to test and report on internal control over compliance in accordance with the Uniform Guidance and the *State Single Audit Guidelines,* but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance.

As part of obtaining reasonable assurance about whether City of Waukesha's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit. Also, in accordance with the Uniform Guidance and the *State Single Audit Guidelines*, we examined, on a test basis, evidence about City of Waukesha's compliance with the types of compliance requirements described in the *OMB Compliance Supplement* and the *State Single Audit Guidelines* that could have a direct and material effect on each of its major federal and major state programs for the purpose of expressing an opinion on City of Waukesha's compliance with those requirements. While our audit provides a reasonable basis for our opinion on compliance, it does not provide a legal determination on City of Waukesha's compliance with those requirements.

We will issue a separate document which contains the results of our audit procedures to comply with the Uniform Guidance and the *State Single Audit Guidelines.*

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Other Information in Documents Containing Audited Financial Statements

Our responsibility does not extend beyond the audited financial statements identified in this report. We do not have any obligation to and have not performed any procedures to corroborate other information contained in client prepared documents, such as official statements related to debt issues.

Planned Scope and Timing of the Audit

We performed the audit according to the planned scope and timing previously communicated to you in our Communication to Those Charged with Governance and Management dated July 6, 2015.

Qualitative Aspects of the Entity's Significant Accounting Policies

Accounting Policies

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the City are described in Note I to the financial statements. As described in Note I to the financial statements, the City of Waukesha changed accounting policies related to financial reporting for pensions by adopting Statement of Governmental Accounting Standards (GASB) Statement No. 68, Accounting and Financial Reporting for Pensions – an Amendment of GASB Statement No. 27 and GASB Statement No. 71, Pension Transition for Contributions Made Subsequent to the Measurement Date – an Amendment of GASB Statement No. 68 in 2015. Accordingly, the accounting change has been retrospectively applied to prior periods presented as if the policy has always been used. We noted no transactions entered into by the City during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were:

- Management's estimate of the allowance for doubtful accounts is based on an analysis of the collectivity of individual accounts.
- Accrued compensated absences are based on anticipated future retirement levels and an average wage per hour based on the current retirees' salaries.
- Accrued claims for self-insurance is based on actual claims known at year end plus estimates of claims incurred but not reported.
- Post-employment life and healthcare insurance benefits' actuarial accrued liability which impacts the annual required contributions are based upon several key assumptions that are set by management with the assistance of an independent third party actuary. These assumptions include anticipated investment rate of return, health care cost trends, projected salary increases, mortality and certain cost amortization periods.
- The net pension asset and the deferred outflows of resources related to pensions which impact the reported pension expense are based on information provided by the Wisconsin Retirement System.

We evaluated the key factors and assumptions used to develop these estimates in determining that they are reasonable in relation to the financial statements taken as a whole.

QUALITATIVE ASPECTS OF THE ENTITY'S SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial Statement Disclosures

The disclosures in the notes to the financial statements are neutral, consistent, and clear.

DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

We encountered no difficulties in dealing with management in performing our audit.

CORRECTED AND UNCORRECTED MISSTATEMENTS

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management.

Management has corrected all such misstatements.

The following is a material financial statement misstatement (audit adjustment):

1. To record revenue for a state jurisdictional transfer - $1,202,816

In addition, we prepared GASB No. 34 conversion entries which are summarized in the "Reconciliation of the Balance Sheet of Governmental Funds to the Statement of Net Position" and the "Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities" in the financial statements.

DISAGREEMENTS WITH MANAGEMENT

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditors' report. We are pleased to report that no such disagreements arose during the course of our audit.

CONSULTATION WITH OTHER INDEPENDENT ACCOUNTANTS

In some cases, management may decide to consult with other accountants about auditing and accounting matters. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditors' opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

MANAGEMENT REPRESENTATIONS

We have requested certain representations from management that are included in the management representation letter. This letter follows this required communication.

INDEPENDENCE

We are not aware of any relationships between Baker Tilly Virchow Krause, LLP and the City that, in our professional judgment, may reasonably be thought to bear on our independence.

To the Common Council
City of Waukesha

INDEPENDENCE (continued)

Relating to our audit of the financial statements of the City of Waukesha for the year ended December 31, 2015, Baker Tilly Virchow Krause, LLP hereby confirms that we are, in our professional judgment, independent with respect to the City in accordance with the Code of Professional Conduct issued by the American Institute of Certified Public Accountants. We provided no services to the City other than audit services provided in connection with the audit of the current year's financial statements and the following nonaudit services which in our judgment do not impair our independence.

- Financial statement preparation
- Adjusting journal entries
- Compiled regulatory reports

None of these nonaudit services constitute an audit under generally accepted auditing standards, including *Government Auditing Standards.*

OTHER AUDIT FINDINGS OR ISSUES

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the City's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

OTHER MATTERS

We applied certain limited procedures to the required supplementary information (RSI) that supplements the basic financial statements. Our procedures consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We did not audit the RSI and do not express an opinion or provide any assurance on the RSI.

We were engaged to report on the supplementary information which accompanies the financial statements but is not RSI. With respect to the supplementary information, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

RESTRICTION ON USE

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

We welcome the opportunity to discuss the information included in this letter and any other matters. Thank you for allowing us to serve you.

Baker Tilly Virchow Krause, LLP

Milwaukee, Wisconsin
July 18, 2016

MANAGEMENT REPRESENTATIONS

City of Waukesha

FINANCE DEPARTMENT

201 DELAFIELD STREET
WAUKESHA, WISCONSIN 53188-3633
TELEPHONE 262/524-3560 FAX 262/524-3555

Richard Abbott, Finance Director
rabbott@ci.waukesha.wi.us

July 18, 2016

Baker Tilly Virchow Krause, LLP
777 E Wisconsin Ave
32nd Floor
Milwaukee, WI 53202

Dear Baker Tilly Virchow Krause, LLP:

We are providing this letter in connection with your audit of the financial statements of the City of Waukesha as of December 31, 2015 and for the year then ended for the purpose of expressing opinions as to whether the financial statements present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Waukesha and the respective changes in financial position and cash flows, where applicable, in conformity with accounting principles generally accepted in the United States of America. We confirm that we are responsible for the fair presentation of the previously mentioned financial statements in conformity with accounting principles generally accepted in the United States of America. We are also responsible for adopting sound accounting policies, establishing and maintaining internal control over financial reporting, and preventing and detecting fraud.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement. An omission or misstatement that is monetarily small in amount could be considered material as a result of qualitative factors.

We confirm, to the best of our knowledge and belief, the following representations made to you during your audit.

Financial Statements

1. We have fulfilled our responsibilities, as set out in the terms of the audit engagement letter.

2. The financial statements referred to above are fairly presented in conformity with accounting principles generally accepted in the United States of America. We have engaged you to advise us in fulfilling that responsibility. The financial statements include all properly classified funds of the primary government required by accounting principles generally accepted in the United States of America to be included in the financial reporting entity.

3. We acknowledge our responsibility for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

4. We acknowledge our responsibility for the design, implementation, and maintenance of internal control to prevent and detect fraud.

5. Significant assumptions we used in making accounting estimates, if any, are reasonable.

6. All events subsequent to the date of the financial statements and for which accounting principles generally accepted in the United States of America require adjustment or disclosure have been adjusted or disclosed. No other events, including instances of noncompliance, have occurred subsequent to the balance sheet date and through the date of this letter that would require adjustment to or disclosure in the aforementioned financial statements or in the schedule of findings and questioned costs.

7. All material transactions have been recorded in the accounting records and are reflected in the financial statements and the schedule of expenditures of federal and state awards.

8. All known audit and bookkeeping adjustments have been included in our financial statements, and we are in agreement with those adjustments.

9. The effects of all known actual or possible litigation, claims, and assessments have been accounted for and disclosed in accordance with accounting principles generally accepted in the United States of America.

10. Guarantees, whether written or oral, under which the City is contingently liable, if any, have been properly recorded or disclosed.

Information Provided

11. We have provided you with:

    a. Access to all information, of which we are aware, that is relevant to the preparation and fair presentation of the financial statements, such as financial records and related data , documentation, and other matters and all audit or relevant monitoring reports, if any, received from funding sources.
    b. Additional information that you have requested from us for the purpose of the audit.
    c. Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.
    d. Minutes of the meetings of Common Council or summaries of actions of recent meetings for which minutes have not yet been prepared.

12. We have not completed an assessment of the risk that the financial statements may be materially misstated as a result of fraud.

13. We have no knowledge of any fraud or suspected fraud that affects the entity and involves:

    a. Management,
    b. Employees who have significant roles in internal control, or
    c. Others where the fraud could have a material effect on the financial statements.

14. We have no knowledge of any allegations of fraud or suspected fraud affecting the entity received in communications from employees, former employees, regulators, or others.

15. We have no knowledge of known instances of noncompliance or suspected noncompliance with provisions of laws, regulations, contracts, or grant agreements, or abuse, whose effects should be considered when preparing financial statements.

16. There are no known related parties or related party relationships and transactions of which we are aware.

Other

17. There have been no communications from regulatory agencies concerning noncompliance with, or deficiencies in, financial reporting practices.

18. We have taken timely and appropriate steps to remedy fraud, noncompliance with provisions of laws, regulations, contracts or grant agreements, or abuse that you have reported to us.

19. We have a process to track the status of audit findings and recommendations.

20. We have identified to you any previous financial audits, attestation engagements, and other studies related to the audit objectives and whether related recommendations have been implemented.

21. We have provided our views on reported findings, conclusions, and recommendations, as well as our planned corrective actions, for our report.

22. The City has no plans or intentions that may materially affect the carrying value or classification of assets, liabilities, or equity.

23. We are responsible for compliance with federal, state, and local laws, regulations, and provisions of contracts and grant agreements applicable to us, including tax or debt limits, debt contracts, and IRS arbitrage regulations; and we have identified and disclosed to you all federal, state, and local laws, regulations and provisions of contracts and grant agreements that we believe have a direct and material effect on the determination of financial statement amounts or other financial data significant to the audit objectives, including legal and contractual provisions for reporting specific activities in separate funds.

24. There are no:

    a. Violations or possible violations of budget ordinances, federal, state, and local laws or regulations (including those pertaining to adopting, approving and amending budgets), provisions of contracts and grant agreements, tax or debt limits, and any related debt covenants whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency, or for reporting on noncompliance, except those already disclosed in the financial statement, if any.

    b. Other liabilities or gain or loss contingencies that are required to be accrued or disclosed by accounting principles generally accepted in the United States of America.

    c. Nonspendable, restricted, committed, or assigned fund balances that were not properly authorized and approved.

    d. Rates being charged to customers other than the rates as authorized by the applicable authoritative body.

    e. Violations of restrictions placed on revenues as a result of bond resolution covenants such as revenue distribution or debt service funding.

25. In regards to the nonattest services performed by you listed below, we have 1) accepted all management responsibility; 2) designated an individual with suitable skill, knowledge, or experience to oversee the services; 3) evaluated the adequacy and results of the services performed, and 4) accepted responsibility for the results of the services.

    a. Financial statement preparation
    b. Adjusting journal entries
    c. Compiled regulatory reports

    None of these nonattest services constitute an audit under generally accepted auditing standards, including *Government Auditing Standards*.

26. The City of Waukesha has satisfactory title to all owned assets, and there are no liens or encumbrances on such assets nor has any asset been pledged as collateral.

27. The City of Waukesha has complied with all aspects of contractual agreements that would have a material effect on the financial statement in the event of noncompliance.

28. The financial statements have no component units, joint ventures with an equity interest, or other joint ventures. The financial statements properly disclose the related organization.

29. The financial statements properly classify all funds and activities.

30. All funds that meet the quantitative criteria in GASB Statement No. 34 and No. 37 for presentation as major are identified and presented as such and all other funds that are presented as major are particularly important to financial statement users.

31. Components of net position (net investment in capital assets; restricted; and unrestricted) and components of fund balance (nonspendable, restricted, committed, assigned and unassigned) are properly classified and, if applicable, approved.

32. The City of Waukesha has no derivative financial instruments such as contracts that could be assigned to someone else or net settled, interest rate swaps, collars or caps.

33. Provisions for uncollectible receivables, if any, have been properly identified and recorded.

34. Expenses have been appropriately classified in or allocated to functions and programs in the statement of activities, and allocations have been made on a reasonable basis.

35. Revenues are appropriately classified in the statement of activities within program revenues and general revenues.

36. Interfund, internal, and intra-entity activity and balances have been appropriately classified and reported.

37. Deposits and investment securities are properly classified as to risk, and investments are properly valued. Collateralization agreements with financial institutions, if any, have been properly disclosed.

38. Capital assets, including infrastructure and intangible assets, are properly capitalized, reported, and, if applicable, depreciated/amortized. Any known impairments have been recorded and disclosed.

39. We have excluded certain short-term obligations from current liabilities because we intend to refinance/have refinanced the obligations on a long-term basis. This subsequent event is properly disclosed in the financial statements.

40. Tax-exempt bonds issued have retained their tax-exempt status.

41. We have appropriately disclosed the City of Waukesha's policy regarding whether to first apply restricted or unrestricted resources when an expense is incurred for purposes for which both restricted and unrestricted net position are available and have determined that net position were properly recognized under the policy. We have also disclosed our policy regarding which resources (that is, restricted, committed, assigned or unassigned) are considered to be spent first for expenditures for which more than one resource classification is available.

42. We acknowledge our responsibility for the required supplementary information (RSI). The RSI is measured and presented within prescribed guidelines and the methods of measurement and presentation have not changed from those used in the prior period. We have disclosed to you any significant assumptions and interpretations underlying the measurement and presentation of the RSI.

43. With respect to the supplementary information, (SI):

    a. We acknowledge our responsibility for presenting the SI in accordance with accounting principles generally accepted in the United States of America, and we believe the SI, including its form and content, is fairly presented in accordance with accounting principles generally accepted in the United States of America. The methods of measurement and presentation of the SI have not changed from those used in the prior period, and we have disclosed to you any significant assumptions or interpretations underlying the measurement and presentation of the supplementary information.

    a. If the SI is not presented with the audited financial statements, we will make the audited financial statements readily available to the intended users of the supplementary information no later than the date we issue the supplementary information and the auditor's report thereon.

44. We assume responsibility for, and agree with, the findings of specialists in evaluating the Other Post Employment Benefits Obligation and have adequately considered the qualifications of the specialists in determining the amounts and disclosures used in the financial statements and underlying accounting records. We did not give or cause any instructions to be given to specialists with respect to the values or amounts derived in an attempt to bias their work, and we are not otherwise aware of any matters that have had impact on the independence or objectivity of the specialists.

45. We agree with the restatement presented in the current year's financial statements.

46. We assume responsibility for, and agree with, the information provided by the Wisconsin Retirement System as audited by the Legislative Audit Bureau relating to the net pension asset/liability and related deferred outflows and deferred inflows and have adequately considered the reasonableness of the amounts and disclosures used in the financial statements and underlying accounting records. We also assume responsibility for the census data that has been reported to the plan.

47. With respect to federal and state award programs:

    a. We are responsible for understanding and complying with and have complied with the requirements of the Single Audit Act Amendments of 1996, *OMB's Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance), *State Single Audit Guidelines,* including requirements relating to preparation of the schedule of expenditures of federal and state awards (SEFSA).

    b. We acknowledge our responsibility for presenting the SEFSA in accordance with the requirements of the Uniform Guidance and the *State Single Audit Guidelines*, and we believe the SEFSA, including its form and content, is fairly presented in accordance with the Uniform Guidance and the *State Single Audit Guidelines*. The methods of measurement and presentation of the SEFSA have not changed from those used in the prior period and we have disclosed to you any significant assumptions and interpretations underlying the measurement and presentation of the SEFSA.

    c. If the SEFSA is not presented with the audited financial statements, we will make the audited financial statements readily available to the intended users of the SEFSA no later than the date we issue the SEFSA and the auditors' report thereon.

d. We have identified and disclosed to you all of our government programs and related activities subject to the Uniform Guidance and the *State Single Audit Guidelines* and included in the SEFSA, expenditures made during the audit period for all awards provided by federal agencies in the form of grants, federal cost reimbursement contracts, loans, loan guarantees, property (including donated surplus property), cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, and other direct assistance.

e. We are responsible for understanding and complying with, and have complied with the requirements of laws, regulations, and the provisions of contracts and grant agreements related to each of our federal and state programs and have identified and disclosed to you the requirements of laws, regulations, and the provisions of contracts and grant agreements that are considered to have a direct and material effect on each major federal and state program.

f. We are responsible for establishing and maintaining, and have established and maintained, effective internal control over compliance for federal and state programs that provide reasonable assurance that we are administering our federal and state awards in compliance with laws, regulations, and the provisions of contracts and grant agreements that could have a material effect on our federal and state programs. We believe the internal control system is adequate and is functioning as intended. Also, no changes have been made in the internal control over compliance or other factors to the date of this letter that might significantly affect internal control, including any corrective action taken with regard to control deficiencies reported in the schedule of findings and questioned costs.

g. We have made available to you all contracts and grant agreements (including amendments, if any) and any other correspondence with federal or state agencies or pass-through entities relevant to the programs and related activities.

h. We have received no requests from a federal or state agency to audit one or more specific programs as a major program.

i. We have complied with the direct and material compliance requirements (except for noncompliance disclosed to you), including when applicable, those set forth in the OMB Compliance Supplement and the *State Single Audit Guidelines,* relating to federal and state awards and have identified and disclosed to you all amounts questioned and any known noncompliance with the direct and material compliance requirements of federal and state awards.

j. We have disclosed any communications from grantors and pass-through entities concerning possible noncompliance with the direct and material compliance requirements, including communications received from the end of the period covered by the compliance audit to the date of the auditors' report.

k. We have disclosed to you the findings received and related corrective actions taken for previous audits, attestation agreements, and internal or external monitoring that directly relate to the objectives of the compliance audit, if any, including findings received and corrective actions taken from the end of the period covered by the compliance audit to the date of the auditors' report.

l. Amounts claimed or used for matching were determined in accordance with relevant guidelines in the Uniform Guidance.

m. We have disclosed to you our interpretation of compliance requirements that may have varying interpretations.

n. We have made available to you all documentation related to the compliance with the direct and material compliance requirements, including information related to federal and state program financial reports and claims for advances and reimbursements.

o. We have disclosed to you the nature of any subsequent events that provide additional evidence about conditions that existed at the end of the reporting period affecting noncompliance during the reporting period.

p. We are not aware of any instances of noncompliance with direct and material compliance requirements that occurred subsequent to the period covered by the auditors' report.

q. No changes have been made in internal control over compliance or other factors that might significantly affect internal control, including any corrective action we have taken regarding significant deficiencies or material weaknesses in internal control over compliance, subsequent to the date as of which compliance was audited.

r. Federal and state program financial reports and claims for advances and reimbursements are supported by the books and records from which the financial statements have been prepared.

s. The copies of federal and state program financial reports provided you are true copies of the reports submitted, or electronically transmitted, to the respective federal and state agency or pass-through entity, as applicable.

t. We have charged costs to federal and state awards in accordance with applicable cost principles.

u. We are responsible for and have accurately prepared the summary schedule of prior audit findings to include all findings required to be included by the Uniform Guidance and the *State Single Audit Guidelines* and we have provided you with all information on the status of the follow-up on prior audit findings by federal and state awarding agencies and pass-through entities, including all management decisions.

v. We are responsible for and have accurately prepared the auditee section of the Data Collection Form as required by the Uniform Guidance.

w. We have disclosed to you all contracts or other agreements with our service organizations, and we have disclosed to you all communications from the service organization relating to noncompliance at the service organizations.

Sincerely,

City of Waukesha

Signed: _____
Mr. Kevin M. Lahner, City Administrator

Signed: _____
Mr. Richard L. Abbott, Finance Director