MARATHON COUNTY

Marathon County, Wisconsin

REPORT ON INTERNAL CONTROL

(Including Memorandum on Accounting Procedures, Internal Controls and Other Matters)

December 31, 2004

MARATHON COUNTY

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To the Marathon County Board of Supervisors and the
Finance and Property Committee
Marathon County, Wisconsin

In planning and performing our audit of the basic financial statements of Marathon County, Wisconsin for the year ended December 31, 2004, we considered its internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control. Such consideration would not necessarily disclose all matters in the internal controls that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of the specific internal control elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal controls and their operations that we consider to be material weaknesses as defined above.

However, during our audit we became aware of opportunities for strengthening internal controls and operating efficiency. The following comments are related to procedural matters, which can be implemented by county staff. As always, you should consider the costs of making improvements to the expected benefits. This letter does not affect our report dated May 11, 2005 on the basic financial statements of Marathon County.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily disclose all matters that might be reportable conditions. In addition, because of inherent limitations in internal control, errors or fraud may occur and not be detected by such controls.

We will review the status of these comments during our next audit engagement. We have already discussed these comments and suggestions with various county personnel, and we will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations.

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

Madison, Wisconsin
May 11, 2005

Virchow, Krause & Company, LLP

MANAGEMENT POINT

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 County. This is in keeping with our goal to provide an audit opinion which states that the financial statements of the County are correct in all material respects.

In some cases, the primary system of accounting procedures and controls of the County 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 county treasurer. (For example, this would be the case in a typical municipal swimming pool.) 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. (For example, this would be the case in a typical municipal court.)

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 County that fit this situation may include the following:

ADRC
Clerk of Courts
Parks Department
Register of Deeds
Sheriffs Department

As you might expect, similar situations are common in most governments.

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.

MANAGEMENT POINT (cont.)

DEPARTMENTAL CONTROLS (cont.)

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.

STATUS OF PRIOR YEAR POINTS

COUNTY TRAVEL POLICY (PER 12/31/03 LETTER)

During our OMB Circular A-133 single audit testing, we selected employee expense reports for travel. During this process, we discovered that the county did not have a written policy addressing travel guidelines. In addition, it is our understanding that the department head travel was not approved by another individual in the county.

Recommendation

We recommend the county implement the following policies concerning employee travel expense reports:

- All employee expense reports should be approved by an appropriate level of management. We also recommend that department head expense reports be approved by either the County Administrator or respective board or committee overseeing the department.
- Significant travel should be approved in advance of registration.
- Cancelled travel arrangements should be avoided to the extent possible.
- Procedures should be developed to increase the controls surrounding the cancellation of travel when it is necessary, including airline credits and refund checks.

Status (12/31/04)

Management has implemented a travel policy which addresses the above issues. This policy was approved in December of 2004.

INFORMATIONAL DISCLOSURES

NEW INVESTMENT DISCLOSURE STANDARD

The Governmental Accounting Standards Board (GASB) has adopted new rules which may affect your financial statement disclosures for your next fiscal year.

In the past, you have been required to disclose in the notes to the financial statements summarized information about your bank deposits and other investments. Those disclosures focused on custodial credit risk, which is the risk that the custodian of your money, either the banks or brokerage firms, would fail to return your money. A table of three risk categories was used to present these risks.

The new requirements, known as GASB No. 40, will simplify the presentation of the custodial credit risk somewhat. However, GASB No. 40 requires significant new disclosures for investment securities. This would include investments such as commercial paper and U.S. government securities. A new required disclosure includes interest rate risk, which is the risk that changes in interest rates will adversely affect the fair value of the investment. There are several options on how to make this disclosure. Generally, it means grouping your investments by maturity dates and displaying those amounts and dates in the footnotes.

You will also be required to disclose concentration of credit risk, which occurs when more than 5% of your investments are in a single issuer.

The new disclosures also include overall credit risk, which is the risk that the issuers will not fulfill their obligations. You will need to disclose the current credit quality rating of your investments to fulfill this requirement. This requirement applies to debt securities, such as commercial paper, and also applies to money market funds and bond mutual funds. It does not apply to U.S. government securities, which are presumed to have little or no credit risk.

Finally, the new rules require disclosure of your investment policy as it relates to the items described above, or a statement that no such policy exists.

As you think ahead to your December 31, 2005 financial statements, these new requirements will require additional information from you and your staff and very likely take more time than the previous disclosures. We can assist you with these issues at your convenience.

GASB NO. 45: ACCOUNTING AND FINANCIAL REPORTING BY EMPLOYERS FOR POSTEMPLOYMENT BENEFITS OTHER THAN PENSIONS

The Governmental Accounting Standards Board (GASB) has issued Statement No. 45 that establishes standards for the measurement, recognition, and display of other post employment benefits (OPEB) expenditures and related liabilities (assets), note disclosures, and, if applicable, required supplementary information (RSI) in the financial reports of state and local governmental employers. The statement will improve reporting since the current financial reporting fails to:

GASB No. 45: Accounting And Financial Reporting By Employers For Postemployment Benefits Other Than Pensions (cont.)

- Recognize the cost of benefits in periods when the related services are received by the employer.
- Recognize information about the actuarial accrued liabilities from the promised benefits associated with past services and whether and to what extent those benefits have been funded.
- Provide information useful in assessing the potential demands on the employer's future cash flows.

We recommend that management assess the potential OPEB accounting and financial reporting requirements that will be required under this statement.

GASB No. 42: Capital Asset Impairments

The Governmental Accounting Standards Board (GASB) recently issued Statement No. 42 which establishes guidance for the accounting and reporting of capital asset impairments. An asset impairment is defined as the significant, unexpected decline in the service utility of a capital asset. This statement requires management to identify possible indicators of impairment and then test the identified assets for impairment. If an impairment exists, the carrying value of the asset must be reduced and an impairment loss recognized.

The statement does not require management to perform additional procedures to identify potential impairments of capital assets, but rather to be aware of prominent, conspicuous events or changes in circumstances that may affect a capital asset. Events or changes in circumstances that may indicate the impairment of a capital asset include:

- Physical damage to the asset
- Obsolescence
- Change in manner or duration of use of asset *(this is not an indicator of impairment for assets which are to be sold, but used as originally intended until sold)*
- Permanent construction stoppage
- New legislation
- New environmental or other regulations
- New technology

At this time, management needs to be aware of this new requirement, which is effective for your entity starting January 1, 2005. If you have any questions about how to test, measure, or record an asset impairment, please feel free to contact us.

REQUIRED COMMUNICATIONS WITH THE COUNTY BOARD

We are required to communicate with the County Board about the following issues:

OUR RESPONSIBILITY UNDER U.S. GENERALLY ACCEPTED AUDITING STANDARDS, OMB CIRCULAR A-133, AND THE STATE SINGLE AUDIT GUIDELINES

As stated in our engagement letter dated October 18, 2000, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance about whether the financial statements are free of material misstatement. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

In planning and performing our audit, we considered Marathon County's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. We also considered internal control over compliance with requirements that could have a direct and material effect on a major federal or state program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133 and the State Single Audit Guidelines.

As part of obtaining reasonable assurance about whether Marathon County's financial statements are free of material misstatement, we perform tests of its compliance with certain provisions of laws, regulations, contracts and grants, 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 is not an objective of our audit. Also, in accordance with OMB Circular A-133 and the State Single Audit Guidelines, we examine on a test basis, evidence about Marathon County's compliance with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* and the State Single Audit Guidelines applicable to each of its major federal and state programs for the purpose of expressing an opinion on Marathon County's compliance with those requirements. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on Marathon County's compliance with those requirements.

OTHER INFORMATION IN DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS

If the audited financial statements are included in a client-prepared document, such as an official statement for a bond offering, the following information should be communicated:

a. A statement that the auditors' responsibility for other information in documents containing the governmental unit's financial statements and report does not extend beyond the financial information identified in the report.

b. A statement that the auditor does not have an obligation to perform any procedures to corroborate other information contained in these documents.

Other Information in Documents Containing Audited Financial Statements (cont.)

c. A description of any procedures performed (such as reading the information)

d. The results of those procedures (for example, wording such as "nothing came to our attention that caused us to believe that such information, or its manner of presentation, is materially inconsistent with the information, or manner of its presentation, appearing in the financial statements").

Significant Accounting Policies

Management has the responsibility for 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 in the preparation of the financial statements are discussed in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during 2004. We noted no transactions entered into by Marathon County 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:

1. Management's estimate of the landfill closure and long-term care liabilities are based on engineering estimates of closure and post closure costs. We evaluated the key factors and assumptions used to develop the landfill closure and long-term care liabilities in determining that it is reasonable in relation to the financial statements taken as a whole.

2. Management's estimate of the self insured health, dental and worker's compensation claim liability is based on annual actuarial evaluations of the individual employee benefit programs. We evaluated the key factors and assumptions used to develop the claims liability in determining that is it reasonable in relation to the financial statements taken as a whole.

Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on Marathon County's financial reporting process (that is, cause future financial statements to be materially misstated). In our judgment, none of the adjustments we proposed indicate matters that could have a significant effect on the Marathon County's financial reporting process.

All audit and bookkeeping adjustments we prepared were included in your financial statements. Copies of these adjustments are available from management.

Disagreements with Management

For purposes of this letter, professional auditing 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 auditor's report. We are pleased to report that no such disagreements arose during our audit.

Consultations with Other Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. 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.

Issues Discussed Prior to This Year's Audit

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to performing the audit. These discussions occurred in the normal course of our professional relationship and our responses were not a condition to the services performed as your auditor.

Difficulties Encountered in Performing the Audit

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

CLOSING

In closing, we would like to thank you for allowing us to serve you. We are very interested in the long-term success of Marathon County, and our comments are intended to draw your attention to issues that need to be addressed for the county to meet its goals and responsibilities.

This letter, by its nature, focuses on improvements and does not comment on the many strong areas of the county's systems and procedures. The comments and suggestions in this report are not intended to reflect in any way on the integrity or ability of the personnel of the county. They are made solely in the interest of establishing sound internal control practices and improving the county's financial operations. The county's staff seemed genuinely concerned about maintaining the county's financial reporting system so that informed decisions can be made. They were receptive to our ideas, comments and suggestions.

We will review the status of these comments during our next audit engagement. We have already discussed the previous comments and suggestions with various county personnel and we would be pleased to discuss them with you in further detail.