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October 12, 2011

County Commission
Atchison County, Kansas

We have audited the statutory basis financial statements of Atchison County, Kansas for the year ended December 31, 2010. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards (and, if applicable, *Government Auditing Standards* and OMB Circular A-133), as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated January 5, 2011. Professional standards also require that we communicate to you the following information related to our audit.

Significant Audit Findings

Qualitative Aspects of Accounting Practices
Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by Atchison County, Kansas are described in Note A to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during 2010. We noted no transactions entered into by the governmental unit during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Difficulties Encountered in Performing the Audit
We encountered no significant difficulties in dealing with management in performing and completing 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. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to each opinion unit's financial statements taken as a whole.

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

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Management Representations

We have requested certain representations from management that are included in the management representation letter dated October 10, 2011.

Management Consultations with Other Independent 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 auditor's 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.

Communication of Significant Deficiencies and/or Material Weaknesses
See the attached Appendix A for our discussion regarding significant deficiencies and material weaknesses.

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 governmental unit's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Appendix B has been provided as additional recommendations and discussion to assist in improving accounting, administrative, and operation controls and procedures. Cost effectiveness may not warrant the implementation of any or all of the items, but the County should consider the suggestions and prioritize as needed.

(Other Information in Documents Containing Audited Financial Statements)

With respect to the supplementary information accompanying the financial statements, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with the accounting principles accepted in the *Kansas Municipal Audit Guide* for statutory basis reporting. 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.

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

Very truly yours,

Reese & Novelly PA

Reese & Novelly, PA CPA's

APPENDIX A: SIGNIFICANT DEFICIENCIES AND MATERIAL WEAKNESSES

In planning and performing our audit of the statutory basis financial statements of Atchison County, Kansas as of and for the year ended December 31, 2010, in accordance with auditing standards generally accepted in the United States of America and the *Kansas Municipal Audit Guide*, we considered Atchison County, Kansas's internal control over financial reporting (internal control) as a basis for designing our auditing procedures 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 County's internal control. Accordingly, we do not express an opinion on the effectiveness of Atchison County, Kansas's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and therefore there can be no assurance that all such deficiencies have been identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

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.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the following deficiencies in Atchison County, Kansas's internal control to be significant deficiencies. We did not identify any material weaknesses.:

1. Preparation of Financial Statements and Note Disclosures (Required per audit standards):

   The County prepares its financial statements in accordance with accounting practices prescribed by the State of Kansas to demonstrate compliance with the cash basis and budget laws of the State of Kansas, in accordance with the reporting and formatting requirements displayed in the *Kansas Municipal Audit Guide (KMAG).*

   Our firm has been asked to assist in the preparation of the financial statements and related note disclosures for the County. Current auditing standards require us to discuss our assistance with the governing body as to management's ability to prepare and understand the financial statements and related notes. County personnel do have the skill and knowledge to process all of the basic financial transactions and the ability to issue the internal financial statements needed to provide appropriate budget and operating information to the County Commission on an as needed basis. The County does not have a policy implemented as it relates to the preparation of external financial statements to ensure accuracy and completeness of the external financial statements, which in accordance with required audit standards is considered to be a significant deficiency.

Recommendations: We understand that it may not be cost effective to hire full-time professional staff with the knowledge and expertise to prepare the external financial reports, including the note disclosures as required per KMAG. There are, however some procedures the County can consider implementing to mitigate the County's risk associated with external financial reporting:

a. Maintain a current copy of the Kansas Municipal Audit Guide (KMAG), prescribed by Director of Accounts and Reports Department of Administration. The KMAG can be purchased through the Kansas Society of Certified Public Accounts at www.kscpa.org
b. Use the checklist provided in the KMAG to compare to the County's policies and procedures and review the draft of all audit reports provided by auditor prior to completion.
c. Participate in training on financial statement presentation.
d. Adopt a policy in which the governing body and management will review annual financial statements prior to being subjected to audit. This should include a reconciliation of the beginning balances to the prior year ending audited balances.

2. <u>Reconciliation from Audit to the County General Ledger (Prior Period Restatement):</u>

As part of our audit process, in the initial year of an audit we must be able to substantiate the beginning balances and agree them to the previous year end audit, which can be done either through affirmation from previous auditor of prior year's audited financial statement balances and the work that was performed and/or reconciling the balances using only the client records in order to obtain sufficient appropriate audit evidence regarding the opening balances. We incurred difficulties in reconciling the County's general ledger's opening uneucumbered cash balances and encumbrances as of January 1, 2010 to prior year's audited ending balances for the year ended Deceember 31, 2009 (2009). The 2009 audit excluded year end encumbrances which were chargeable to the year ended December 31, 2009, but paid in the 2010. In addition several of the year end equity transfers approved by the Commission were incorrectly recorded as encumbrances, causing the year end transfers to not balance. Therefore funds for the year ended December 31, 2009 did not reflect the correct ending unencumbered cash and encumbrance balances. This was discussed with management and we have determined that there are no procedures in place to reconcile the County's general ledger to the ending audit, prior to issuance of the audit.

Note I, to the financial statements describes the differences and the adjustments made in the current year audit to restate the beginning unencumbered balances. The net effect of the adjustments will result in the following changes to Expenditures chargeable to 2009 for the following funds. Had the expenditures below been properly stated in the previous year, three funds including: General Fund, Road and Bridge, and Senior Village could have resulted in budget violations for the 2009 audit year.

We were unable to determine why the audit excluded certain encumbrances, as some but not all encumbrances were excluded from the audit balances, even though the County's general ledger accurately reflected these expenditures as encumbrances and expenditures chargeable to the 2009 year end.

Reconciliation of Restated Expenditures chargeable to 2009 for the year ended December 31, 2009:

Fund	Ending Expenditures Chargeable to 2009 - Prior Audit	Warrants Isseud Jan & Feb 2010	Year End Transfers	Correction of Additional Errors	Net Change in Correction of Encumbrances	Restated Expenditures Chargeable to 2009
General Fund	1,795,925	80,658			80,658	1,876,583
Road & Bridge	2,143,451	100,606			100,606	2,244,057
Law Enforcement	1,374,239	51,473	(140,000)		(88,527)	1,285,712
Election	62,299	342	(10,000)		(9,658)	52,641
Noxious Weed	175,807	364	(30,000)		(29,636)	146,171
Capital Improvement	449,701	791			791	450,492
Community Corrections	357,354	6,901		(4,704)	2,197	359,551
Senior Village	2,678,787	44,615			44,615	2,723,402
Solid Waste	871,281	37,800			37,800	909,081
Emergency Tax	42,307	2,520			2,520	44,827
Joint Communications	658,926	2,675			2,675	661,601
Payroll Clearing	9,703,419			(291,833)	(291,833)	9,411,586
Net Effect on the Prior Year Statements		**328,745**	**(180,000)**	**(296,537)**	**(147,792)**	

***Recommendations*:**

At the end of the audit, management and the governing body are required to provide a management representation letter (MRL) which is representation from responsible officials (RO) as part of an audit performed in accordance with generally accepting auditing standards (as per AU 333). In this letter a responsible official makes specific representations, including management's responsibility for the financial statements and the information provided in the audit. It is imperative that management and the governing body fully understand the MRL and what is being represented as accurate and truthful information. These representations (MRL), are a factor in our issuance of an independent auditor's report with an unqualified opinion.

The following are required elements of the MRL which it is possible in the prior year representations were not accurately stated (if a letter was provided). We have provided our findings and recommendations in *italics* after each comment:

a. The RO must acknowledge that "management has considered the financial statement misstatements aggregated by the auditor and has concluded that any uncorrected misstatements are immaterial, both individually and in the aggregate, to the financial statements." A summary of uncorrected misstatements should be included or attached to the MRL.

   The County must obtain a listing of all passed audit adjustments, or proposed adjustments in which the County has determined to be immaterial to record in the financial statements. In addition the County must acknowledge their acceptance of those adjustments not being recorded.

b. "The financial statements referred to above are fairly presented in conformity with the statutory basis of accounting (*Kansas Municipal Audit Guide)* and include all properly classified funds and other financial information of the primary government and all component units required by *Kansas Municipal audit Guide* to be included in the financial reporting entity."

"The financial statements include all component units as well as joint ventures with an equity interest, and properly disclose all other joint ventures and other related organizations."

The prior year audit (Note 1) refers to Component Units being included in the audit however, the only units included were those that were taxing funds in which the County collects the taxes and remits to the entity their appropriation. The separate entities financial data is not included in the audit. We recommend that the County review the requirements of GASB 14 for the inclusion of Component Units in the reporting entity and determine if a change is needed to the note disclosures.

c. "There are no material transactions that have not been properly recorded in the accounting records underlying the financial statements"

"As part of your audit, you (Auditor) assisted with the preparation of the financial statements and related notes. We (County) have designated an individual with suitable skill, knowledge, or experience to oversee your services and have made all management decisions and performed all management functions. We have reviewed, approved and accepted responsibility for those financial statements and related notes.

We have not determined whether the effects of the above adjustments would have been material to the previous year. However, it is the County's responsibility to review the audited financial statements and determine if they are accurate. We recommend that procedures be implemented to reconcile the audited balances to the County's general ledger, significant differences should be understood. If the auditor proposes audit adjustments, the County must review and then approve or reject those adjustments. The County would be responsible for determining if those differences are material to the financial statements (see additional discussion above in 2.a), in addition to the recommendation discussed above in Comment #1 regarding preparation of financial statements.

3. Violations of Kansas Statutes:

Budget Violation: K.S.A. 79-2935: Expenditures, including encumbrances, in any lawfully budgeted fund should not exceed the adopted budget of expenditures plus any reimbursements (budget credits) of current year expenditures for such fund for that budget year.

We noted one fund in violation of K.S.A. 79-2935. Joint Communications, a general government special revenue fund, exceeded its legal budget by $2,268. Two additional funds in which the expenditures exceeded the budget authority, were not statutorily required to be included in the budget (Special Machinery, K.S.A. 68-141g and Special Parks and Recreation).

APPENDIX B: OTHER CONTROL MATTERS

The following recommendations are submitted to assist in improving accounting, administrative and operational controls and procedures. Cost effectiveness may not warrant the implementation of the items listed, but the County should consider the suggestions and prioritize as needed.

1. Internal controls: Internal controls are established to provide reasonable assurance that specific objectives related to the maintenance of County assets and the financial reporting are reliable. In other words there should be proper checks and balances in place to: (1) Prevent loss or theft of the County's assets; (2) Minimize the opportunities for employees to steal, misuse, or accidentally destroy assets or records of the County; (3) Provide timely and accurate information to management, County Commission, and other users of financial information; (4) Ensure compliance with laws and regulations.

   During our discussions with management, department heads, and staff, we noted that there are inconsistencies between departments in how internal controls have been established and implemented. In addition, there are no County-wide standard operational procedures which address how each department should handle receipts, separate bank accounts, and reporting to the Clerk's and Treasurer's offices. Therefore, the information that flows to the County Clerk and County Treasurer is not prepared in a consistent manner which can create opportunity for errors, confusion, and inefficiencies amongst the departments. We have identified the following areas we consider in need of minor improvements to increase controls over the cash receipts and financial reporting processes:

   a. *Payroll Timecards*: Employees are not required to acknowledge their time records or changes made thereof.

   b. *Decentralized Receipts*: Several departments within the County collect cash receipts outside of the Treasurer's office (example: Sheriff, Appraisers Office, Senior Living Center, etc) to which they turn in their receipts to the County Treasurer. The Treasurer's office deposits the receipts into the County's bank and records in the County's financial records. The Treasurer has adequate requirements and procedures in place within the Treasurer's office for receiving the paid-ins and paid-outs and supporting documentation from each department. It appears, the information being provided by the department to the Treasurer's office is not accurate and does not necessarily provide the correct general ledger coding for receipts based on the nature of the transaction. The lack of standardization for posting to general ledger accounts, leads to mis-posting, inconsistancies, and erroneous financial statements. In some cases where a separate bank account is maintained an independent bank reconciliation is not being performed. The County lacks the appropriate segregation of duties and oversight over the bank accounts which are not maintained by the Treasurer's office.

   c. *Grants Management*: The County does not have an individual who has responsibility for grants management for all County grants. In addition there is no tracking of grant applications, grant awards, grant receipts and expenditures. The County may not be aware of instances in which they expend more then $500,000 in federal dollars and would require the County to have a Single Audit in accordance with *Government Auditing Standards* and OMB Circular A-133. There is also no oversight to determine that the County is and remains in compliance with all federal and state grant requirements, including properly expending the funds and reporting of the grant expenditures.

d. *Segregation of Duties*: We noted in some departments in which cash is collected, the limited staff could perform all functions of the cash receipts process. Staff collects cash, records the activity in department records, and deposit the funds with the County Treasurer. In addition, as mentioned in b. above, there are no reconciliations performed, which further exposes the County to additional risk due to errors or theft.

Recommendations: The following are recommendations to consider in relation to the County's overall general controls over financial reporting and asset safeguarding.

Segregation of duties and Decentralized Receipts: Financial transactions should not be handled from start to finish by one staff member, to help reduce the risk that an error can be made and concealed. Small organizations like the County departments often lack the staff to permit optimal or ideal segregation of duties and to restrict access to assets. Accounting duties can be effectively segregated by involving other staff outside the department (clerk's office staff or other staff outside the function of receiving the funds) in the accounting function and assigning accounting tasks to non-accounting personnel. In addition, a closer involvement in the day-to-day affairs by management often compensates for having a small staff. Regardless of size of staff, it is imperative that the County and all its Departments have controls in place to help deter, detect and/or prevent fraud. The following are minimum controls that should be implemented:

a. All cash should be kept secure at all times, allowing only those access that need access to perform their duties.
b. Checks should be restrictively endorsed upon receipt to ensure that only the County is able to cash the checks.
c. A policy should be considered requiring deposits to be made based on a threshold amount set by management and at a minimum, deposits should be made weekly to the Treasurer (regardless of the amount). These measures will help to reduce the risk of loss of cash by reducing the time between receiving and depositing cash.
d. It is imperative that reconciliations are performed on a timely basis comparing the department's record of receipts to the actual deposit with County Treasurer and further comparing to the posting in the County's general ledger for accuracy. A daily reconciliation of the cash drawer should be required which should include two individuals (if possible), one to count the receipts immediately at days end and the second to compare the cash collected to the amount of sales for the day. This reconciliation should be maintained with the receipt of deposit received from the County Treasurer and should be signed and dated by the individual who performed the reconciliation.
e. We further recommend that standard operating procedures be developed and implemented across all departments with regards to how the receipts are turned into the County Treasurer, including a standard form that indicates the total amounts being deposited and the proper accounting codes for ensuring accurate reporting for each department.

f. This documentation can then be used by the Clerk to record the receipts into the general ledger. It is imperative that reconciliations be performed on a timely basis comparing the department records of receipts to what is deposited with the County Treasurer and reconciliation of cash drawers maintained within that department. In addition having employees initial the acceptance of those funds and reconciliation on a periodic basis will help to track those that have access to those funds and will make it easier to find errors.
g. The department heads should also review reports provided by the Clerk and/or Treasurer's office comparing the revenues collected to budget and estimated revenues based on usage on a regular basis. It is difficult when collections are not centralized and numerous variables are present to be assured that all collected revenues are being reported. However, implementing a timely review and follow-up on discrepancies and reducing the amount of un-deposited cash should reduce the potential for theft and misappropriation of cash.
h. For bank accounts maintained outside of the County Treasurer's office, the bank reconciliation must be performed on a timely basis. If the same individual is responsible for receiving money, depositing the receipts, and reconciling the bank account then an independent review by management and/or another department should be performed on a periodic basis in addition to the review of reports by management as discussed in g. above.

Cross-training and rotation of duties: Anytime there is an opportunity to train more than one County staff member on certain duties, generally duties that can be rotated, a reduction in risk of errors can be achieved. This also helps operations continue to run smoothly in the event that there is an emergency and the responsibilities can not be performed by the normal staff person assigned to the duties.

Payroll Time Records: We recommend that the County implement a policy that all employees will sign their time sheets. If changes or corrections are made to the employee's time records, the employee should be notified and required to initial their acknowledgement of the changes.

Grants Management: We recommend that a County-wide policy be established setting the protocol of applying for grants, notification of awards, financial reporting of the grant receipts and grant expenditures, and all required reporting to federal and state agencies, and grant compliance. In addition, the County should consider assigning staff or department with responsibility for accumulating centralized grant records. The individual does not have to be the one to prepare the grant applications or even maintain the grants as it relates to reporting. However, they should be responsible for ensuring that adequate records are being maintained and tracked in order to ensure compliance with all federal and state grant requirements, including the County's responsibility for preparation of the Statement of Federal Expenditures as well as determining when the County has met the threshold for Single Audit requirements. It is imperative that the County Commission is aware of all grants applications, grant awards, grant funds received and expended as it is the overall responsibility for the County to maintain compliance with the granting agencies.

2. <u>Training on Use of Reports/Financial Statements</u>: During our discussion with department heads we noted numerous comments concerning their confusion and understanding of the monthly reports from the Clerks office. Staff have not been trained on the reporting system and do not know how to read the reports and reconcile the information to their records. This lack of reconciliation within the

departments may lead to posting errors and inaccurate financial statements. (see discussion above in 1b).

Recommendation: It is imperative that all management, department heads and Commission have a good understanding of the financial reports distributed in order to have an understanding of how their department and/or County as a whole have been operating and be able to effectively budget the departments. If there is not a clear understanding this can lead to budget overruns, budget violations, cash violations, in addition to other risks of material misstatements in the financial statements whether due to error or fraud. We recommend that all department heads and Commissioners receive training on the County's general ledger system and how to read and understand the reports that are generated from the system. This would also open the lines of further communication between the departments and allow for discussion and sharing of idea on how each department operates and potentially implement changes to cause the County as a whole to operate more efficiently.

3. Reimbursements: In addition to the confusion in reading the financial statements as discussed above, it is clear that there is also confusion amongst the departments as to what constitutes a reimbursement and/or transfer vs. revenue (sale of product, fee for services, etc). In some instances fees collected for services in departments, such as the Sheriff's office are being reported as reimbursements, rather then service fee revenues. Another example is when grant revenues are used to purchase equipment and are recorded as reimbursements instead of grant revenue. Because departments record transactions differently ie; revenue as reimbursements, there is no consistency in posting transactions to the general ledger. This creates a discrepancy in the financial reporting and introduces confusion as to what is considered to be a qualifying budget credit which would allow the County to exclude those expenditures as being part of the expenditures for budgetary purposes. Qualifying budget credits may include inter-fund reimbursements as defined below, reimbursements and grants received from outside entities for the purpose of a specific project or purchase of equipment; insurance proceeds received as reimbursement on damaged property or equipment, etc. A budget credit does not include fees collected for services or products (chemicals, rock, etc) sold by the County.

   Definition of Inter-fund Reimbursements: As described in 2011 KMAG (page C3), "The Governmental Accounting, Auditing and Financial Reporting (GAAFR) defines reimbursement as "an expenditure or expense initially made in one fund, but properly attributable to another. For example, the general fund may pay a utility bill, portions of which are to be reimbursed by other funds."

   Reimbursements can be accounted for in one of two ways. Whichever option is chosen, should be used consistently from year to year, transaction to transaction:

   a. Record expenditure in the reimbursing fund (debit to expenditure) and a reduction of expenditures in the reimbursed fund (credit to expenditure). Thereby netting the expenditure to zero for the fund that originally paid the expenditures that was attributable to the reimbursing fund. *Grants, federal or state payments or other outside reimbursements received for payment of projects, equipment, insurance proceeds, etc should not be recorded as reimbursements in this manner, they should be reported as grant revenue or reimbursement revenue.*

Or

b. Record reimbursable expenditures in the fund that makes the disbursement and record reimbursements as revenue to the fund receiving the reimbursement. For purposes of budgetary comparisons, the expenditures (or expenses) are properly offset by the reimbursements (budget credits).

Recommendation: Option b is generally preferred by auditor's as the reimbursements are easily traceable and determined. However option a, reduces expenditures and helps in determining available budget balances. Regardless of which option is chosen, grants, federal or state payments or other outside reimbursements received for payment of projects, equipment, insurance proceeds, etc should not be recorded as reimbursements in the manner discussed in a., they should be reported as grant revenue or reimbursement revenue. The above is the accounting treatment for reimbursements between funds within the County only.

Inter-fund Transfers: A transfer is not the same as a reimbursement; it is typically a transfer of fund balance from a taxing (budgeted) fund to non-budgeted fund or a release of funds from budget restriction. Transfers between funds are only allowed between certain government funds. Therefore all inter-fund transfers must be supported and permitted in accordance with applicable Kansas statutes and should be made within the fund's budget and cash basis authority. K.S.A. 79-2934 states no part of any fund shall be diverted to any other fund whether before or after distribution of taxes by the county treasurer, except as provided by law.

Recommendation: All transfers recorded between funds should be documented with (1) the appropriate Kansas statute authorizing the transfer; (2) the governing body's approval of the transfer amount and the funds that be affected; and (3) the transferring fund's budget and cash basis authority. The transferring fund should record a debit to a transfer expenditure account and the fund receiving the funds should record a credit to transfer revenue account. Transfers should be reconciled on a periodic basis to ensure accurate reporting.