City of Fort Worth, Texas

Report to Management
Year Ended September 30, 2011

Deloitte.

Deloitte & Touche LLP
Suite 1501
201 Main Street
Fort Worth, TX 76102-3134
USA
Tel: +1 817 347 3300
Fax: +1 817 336 2013
www.deloitte.com

March 20, 2012

The Honorable Mayor and City Council Members
City of Fort Worth
Fort Worth, Texas

Dear Mayor and City Council Members:

In planning and performing our audit of the financial statements of the City of Fort Worth (the "City") as of and for the year ended September 30, 2011 (on which we have issued our report dated March 20, 2012, which included an emphasis paragraph related to the implementation of GASB Statement No. 54, and which included a reference to other auditors), in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, in connection with our audit, we have identified, and included in the attached Appendix, certain matters involving the City's internal control over financial reporting that we consider to be material weaknesses or significant deficiencies under standards established by the American Institute of Certified Public Accountants.

We have previously communicated certain matters noted during our audit of the financial statements of the City for the year ended September 30, 2010, which we considered to be material weaknesses or significant deficiencies, in our report to management and those charged with governance dated March 22, 2011. As of the date of this report, we believe the City has not remediated certain of these material weaknesses or significant deficiencies. We have outlined in the attached Appendix those previously reported matters which we believe have not yet been remediated.

We have also identified, and included in the attached Appendix, other deficiencies involving the City's internal control over financial reporting and other matters as of September 30, 2011 that we wish to bring to your attention.

This report does not include the communications of the other auditors on internal control over financial reporting and other matters that are reported on separately by those auditors.

The definitions of a deficiency, a material weakness, and a significant deficiency are also set forth in the attached Appendix.

A description of the responsibility of management for establishing and maintaining internal control over financial reporting and of the objectives of and inherent limitations of internal control over financial reporting, is set forth in the attached Appendix and should be read in conjunction with this report.

Although we have included management's written response to our comments in the attached Appendix, such responses have not been subjected to the auditing procedures applied in our audit and, accordingly, we do not express an opinion or provide any form of assurance on the appropriateness of the responses or the effectiveness of any corrective actions described therein.

This report is intended solely for the information and use of management, the City Council, others within the organization, and federal and state awarding agencies and is not intended to be, and should not be, used by anyone other than these specified parties.

Yours truly,

Deloitte & Touche LLP

APPENDIX

SECTION I — MATERIAL WEAKNESSES OR SIGNIFICANT DEFICIENCIES IDENTIFIED IN A PREVIOUS AUDIT THAT HAVE NOT YET BEEN REMEDIATED

We identified and previously communicated the following deficiencies that were considered to be a material weakness or significant deficiency in the City's internal control over financial reporting during our audit of the financial statements of the City for the year ended September 30, 2010. As of the date of this report, we believe these deficiencies have not yet been remediated by the City:

Material Weakness: Accounting for Capital Assets (updated from fiscal years 2004-2010)

Criteria – Proper accounting for capital assets requires the maintenance of an accurate, detailed listing of all expenditures that meet the City's criteria for capitalization – those that are long-lived and meet the City's capitalization threshold.

Condition – A significant amount of effort has been made by the City over the past several years to improve the practices used to account for and report the City's investment in capital assets. For fiscal years 2008 through 2011, we did not note the level of errors that were noted in previous years related to capital assets. Audit adjustments for fiscal years 2008 through 2011 related to capital assets were generally isolated to specific areas of the accounting process. However, there are certain matters that remain unresolved; and when considered cumulatively, we believe these matters represent a potential risk of material error and therefore warrant continued attention by City management. These matters include:

- The need for the City to upgrade its current Excel-based approach to accounting for capital assets to a more controlled database environment, such as a module to the planned ERP system
- A lack of consistent application of the City's formalized written policies for capital assets by all departments of the City
- A lack of proper communication between the Financial Management Services Department and other City departments regarding Construction-in-Progress ("CIP"), resulting in improper classification of certain completed projects within CIP and improper timing of reclassification of CIP to capital assets in use
- A lack of timely reporting of disposals of capital assets by City departments to the Financial Management Services Department
- An inadequate assessment for the existence of capital leases

Context – Capital assets represent the City's single largest asset. As of September 30, 2011, the City has over $4 billion in net book value of capital assets and has over 2,000 projects set up to track and manage CIP costs.

Cause – The City has multiple departments and contractors managing construction projects and capital assets without consistent, complete application of the proper procedures to account for transactions or purchases. Formal procedures are not in place to establish timely communication regarding capital asset transactions between the various departments and the Financial Management Services Department.

Effect – Inconsistent practices have developed throughout the City for accounting for CIP. Errors in accounting for capital assets could have a material effect on the City's financial statements. We believe that the City's current system of accounting for capital assets (both electronic and manual) is not sufficiently designed or implemented to prevent or detect potential material errors in capital assets without a significant effort made at year-end to review transactions for the existence of such errors. In the current year testing we noted the following errors that required adjustment:

- CIP projects were not transferred out to depreciable capital assets when the project was complete
- CIP projects were transferred out to depreciable capital assets before the project was complete
- Costs related to all phases of CIP projects with multiple phases were transferred out to depreciable capital assets as a whole when only the first phase was completed
- Prepaid amounts were incorrectly capitalized as CIP
- Repairs and maintenance costs were incorrectly capitalized as CIP
- Design costs were capitalized as CIP for projects that were never started
- Land was incorrectly recorded in CIP
- Capital assets related to projects managed by a state agency were not recorded
- Donations of land were not recorded
- Capital leases were not properly recorded
- Capital assets were removed from the database for correction of description columns but were never added back
- Capital assets were transferred between funds but the transfer was not recorded properly in both funds
- Retainage payable was not recorded or was recorded for incorrect amounts
- Assets were purchased to replace old capital assets, but the remaining net book value of the old assets were not removed from the records

Recommendation – The following recommendations should be considered by City management.

- Implement a more sophisticated system of accounting for capital assets. Such a system should contain automated controls to ensure proper accounting and reconciliation of capital assets. However, consider the importance of fully integrating an electronic capital asset system with the City's general ledger system and plan appropriate timing for the implementation of any new capital asset system relative to the City's overall ERP implementation time-table.
- Implement and provide training on the City's policy that defines when CIP projects are considered complete and should be transferred to completed assets. Communicate and implement the City policy that defines the date on which developer contributions should be added to capital assets. In addition, develop consistent application of City policies on accounting for capital assets in general and the related reconciliation processes. Ensure that such policies are implemented and enforced.
- On an overall basis, improve communication between the operating departments and the Financial Management Services Department related to capital assets.

- Implement a policy that requires the physical count of the fixed assets of each department on a rotation basis. Ensure that each asset is physically inspected at least biennially, in order to comply with the requirements established for Federally-funded assets. Require timely communication of all disposals or impairments of capital assets from the City departments to the Financial Management Services Department.
- Review the City's policies and procedures related to capitalization of intangible assets, particularly those related to the capitalization of ERP system implementation costs.

Views of Responsible Officials – Concur. To better improve communications with departments, Financial Management Services Department's (FMS) Accounting Division will meet with all fixed asset and grant coordinators within the City before the end of the third quarter of each fiscal year to review the City's policies and procedures related to capital assets. Emphasis will be placed on when CIP projects are considered complete and should be transferred to completed assets as well as when developer contributions should be added to capital assets.

On a quarterly basis, FMS's Accounting Division will send to each City department a listing of all assets (i.e. improvements, buildings, infrastructure, etc.) pertaining to their group. Each department will be required to compare its assets with the listing from FMS and work with the Accounting Division to resolve any differences.

Improved communications between the City departments and FMS and quarterly reconciliations of the City's assets should result in improved identification, accounting and reporting of the City's capital assets. This includes:

1) Properly classifying and accounting for costs related to capital assets;
2) Properly capturing and accounting for contributed assets;
3) Reconciling detailed capital asset records to the general ledger;
4) Assessing if all assets are accounted for (i.e. counting assets on a rotation basis);
5) Evaluating the useful life and salvage values for classes or types of capital assets;
6) Identifying potential impairments;
7) Complying with grant requirements for federally funded assets; and
8) Ensuring proper internal controls for City capital assets.

The abovementioned will be facilitated with the selection and implementation of an Enterprise Resource Planning (ERP) financial system. This system will provide the means to better administer and enforce policies and procedures for overall accounting operations, inclusive of capital assets. Planning, requirements gathering and system selection is in the initial stage, with system implementation scheduled after Fiscal Year 2013.

Significant Deficiency: Grant Management (updated from fiscal year 2010)

Criteria – Each grant program should be reconciled at least annually to ensure that the activity is accurately recorded and that the ending payable to or receivable from the granting agency accurately reflects that City's position. Grant agreements should be reviewed to ensure proper accounting treatment for specific items such as investment income earned on advances, receipts of program income, and expenditures from the City's matching funds. In addition, there are a number of revenue recognition matters that must be considered in preparation of the annual financial statements.

Condition – Numerous errors were noted in the City's accrual and deferral of grant revenues and the related receivables, which required adjustments in the accounting records and in the Schedule of Expenditures of Federal and State Awards ("SEFA"). Although not material to the City financial statements as a whole or to the SEFA, these errors required substantial effort to research and correct.

Context – For the year ended September 30, 2011, the City managed more than 300 different Federal, State and local grant projects. The funding methods and provisions for these grant awards vary, requiring the Financial Management Services Department to evaluate proper accounting and reporting for each grant award.

Cause – Large numbers of grants accounted for in multiple funds complicates the year-end closing process and the accumulation of the data for the SEFA. Grant accounting personnel did not properly research the requirements and accounting considerations surrounding non-standard grants.

Effect – Inaccurate accounting for both the receipts and expenditures of grant-related transactions can lead to errors in the SEFA and errors in the related grant revenue recognition.

Recommendation – Develop standard policies and procedures for identifying and reporting grants in the general ledger. Continue to educate personnel in all departments on the requirements related to proper accounting and reporting for grants. This information should also include guidance on the nature of grants, both monetary and non-monetary. Use standard funds for accounting for such grants and perform periodic reviews of all departments to ensure that grant accounting standards and compliance requirements are met.

Views of Responsible Officials – Concur. The following steps are continually being implemented to improve and strengthen controls over grant management:

- Financial Management Services Department ("FMS") will continue to provide training opportunities to both grant management and grant accountants to improve skills and understanding of grant reporting and accounting requirements;
- As grant awards vary and therefore, the accounting requirements vary, FMS will continue to review and evaluate current grant accounting procedures and processes so that grants are accounted for based upon the specific requirements of each grant award.

Significant Deficiency: Computer System Access Controls (updated from fiscal years 2006-2010)

Criteria – Access controls are key controls to the City's financial systems to protect financial data from improper accounting and reporting. The City is currently reestablishing and documenting policies and procedures related to controls.

Condition and Cause – Although improvements continue to be made in this area during fiscal year 2011, the following deficiencies were still noted during the performance of our procedures over general computer controls related to the City's financial system and the water billing system:

- On the Mainframe: 6 users (4 Police Department personnel, 1 former Help Desk person, and 1 Finance IT person) have inappropriate access to the Mainframe RACF toolkit, which allows these users access to create shell Mainframe accounts and perform password resets.

- On the Mainframe: 1 Help Desk Supervisor has access to migrate changes to production for the Mainframe environment.
- On the SQL database supporting CourtView: the Builtin Administrator group is assigned SYSADMIN access, which inappropriately grants privileged database access to members of the Platform Technology group.

Context - Management is ultimately responsible for ensuring that all systems are secure and that unauthorized users do not have access to sensitive data. As such, access should be reviewed periodically and security strengthened to minimize such risks.

Effect- Unauthorized access to an entity's information systems can potentially compromise the integrity of the system or information maintained in the system.

Recommendation - Privileged access should be restricted to authorized administrators. Inappropriate user's access including programmers should be removed.

Views of Responsible Officials – Concur. The identified deficiencies will be remediated by May 1, 2012 Per Administrative Regulation D-5, dated February 8, 2010, Information Technology Security requires both restricted access to privileged accounts and periodic reviews of user access privileges.

SECTION II — OTHER DEFICIENCIES

We identified the following other deficiencies involving the City's internal control over financial reporting for the year ended September 30, 2011 that we wish to bring to your attention:

Human Resources/ Payroll Controls

Criteria – Appropriate controls are necessary in all aspects and at all levels of the preparation, calculation and reporting of payroll expenditures.

Condition – The following control and documentation deficiencies were noted during our testing of the system for the fiscal year ended September 30, 2011:

- 3 of 187 departmental employee timesheets tested contained data (employee ID number, employee name, fund, pay period, and hours charged) that did not agree to the PeopleSoft payroll data.
- 37 of 187 personnel files tested contained data (approved pay rate, effective date, fund, and/or cost center) that did not agree to the PeopleSoft payroll data.
- 2 of 187 recalculations performed on individual payroll expenditure amounts did not agree to the expenditure detail per the general ledger.

Context – The City implemented its new ERP system for payroll to be effective in fiscal 2011. Numerous implementation matters were addressed and resolved throughout the year. Our audit testing was performed after year-end, but covered fiscal 2011.

Effect – Improper controls or documentation increase the risk of error for calculation and recording of the City's payroll expenditures.

Cause – We believe that the matters noted here are results of the implementation process. As management continues to refine its procedures and address these matters, controls should settle into the normal course of business for the City if continued attention is given to this area.

Recommendation – Continue to work to address all control and documentation matters resulting from the system implementation.

SECTION III — OTHER MATTERS

Our observations concerning other matters related to operations, compliance with laws and regulations, and best practices involving internal control over financial reporting that we wish to bring to your attention are as follows:

Financial Management Services Department Staffing

Criteria – The current complexity of governmental accounting and reporting, combined with the size and activity of the City of Fort Worth, require a Financial Management Services Department that is staffed and trained to a high level of expertise and competency.

Condition and Context – Because of certain material errors and issues in the City's financial records, the City's annual financial reporting was delayed for the 2004 through 2008 fiscal years. Beginning with the 2007 fiscal year, the City contracted an outside firm to augment the City accounting staff to enable the City to address the accounting and reporting issues and to put the City's annual reporting back onto a normal timetable. The restoration of a timely reporting process was accomplished in fiscal 2009. However, this outsourcing of the annual closing and reporting process has resulted in a lack of development of City staff in the skills necessary to perform these functions without outside assistance. City staff should have strong analytical skills to appropriately record and review financial activity throughout the year and not only at year-end in preparation for the preparation of the financial statements and the annual audit.

Cause – City personnel in the Financial Management Services Department have suffered a certain amount of turnover and change to their department such that the current staff have not been responsible for the closing and reporting process for several years.

Effect – Although the accounting and reporting function can certainly be outsourced on a permanent basis, we understand that it is the City's desire to bring this function back into the Financial Management Services Department. However, the skills necessary to do so have not been developed among the current City staff. Therefore we do not believe the current Financial Management Services Department personnel have the background, training, experience and analytical skills necessary to accomplish the financial reporting responsibilities without assistance from an outside consultant.

Recommendation – We commend the City for the significant improvements that have been made in recent years in financial accounting and reporting, and we further commend the City for its efforts to upgrade and modernize the City's IT systems through the ERP system implementation under way. We recommend the City now focus on completing the ERP implementation and training. Additional support should be provided to the Financial Management Services Department personnel to ensure that, as the outside contractor begins withdrawing from full responsibility for the closing and reporting process, the City staff will be capable and prepared to take on the role. This is critically important to ensure a smooth transition back to full Financial Management Services Department responsibility for these processes, without reverting back to prior practices that at one time caused financial reporting errors and delays in financial reporting.

Recently Issued Statements Of The Governmental Accounting Standards Board ("GASB")

GASB 57*: OPEB Measurements by Agent Employers and Agent Multiple Employer Plans*

GASB Statement No. 57, OPEB Measurements by Agent Employers and Agent Multiple Employer Plans, clarifies that when actuarially determined OPEB measures are reported by an agent multiple-employer OPEB plan and its participating employers, those measures should be determined as of a common date and at a minimum frequency to satisfy the agent multiple-employer OPEB plan's financial reporting requirements. This Statement is effective for the City in fiscal year 2012.

GASB 60: *Accounting and Financial Reporting for Service Concession Arrangements*

GASB Statement No. 60, Accounting and Financial Reporting for Service Concession Arrangements, was issued in December 2010 to improve financial reporting by addressing issues related to service concession arrangements (SCAs), which are a type of public-private or public-public partnership. The standard addresses SCAs in which there is an arrangement between a transferor (a government) and an operator (governmental or nongovernmental entity) in which (1) the transferor conveys to an operator the right and related obligation to provide services through the use of infrastructure or another public asset (a "facility") in exchange for significant consideration and (2) the operator collects and is compensated by fees from third parties. The statement also includes required disclosures about the SCAs. This standard becomes effective for the City in fiscal year 2013.

GASB 61: *The Financial Reporting Entity: Omnibus—an amendment of GASB Statements No. 14 and No. 34*

GASB Statement No. 61, The Financial Reporting Entity: Omnibus—an amendment of GASB Statements No. 14 and No. 34, was issued in November 2010 to improve financial reporting for a governmental reporting entity. The standard modifies certain requirements for inclusion of component units, amends criteria for blending, and clarifies the reporting of equity interests in legally separate entities. This standard becomes effective for the City in fiscal year 2013.

GASB 62: *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*

GASB 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements, was issued in December 2010 to incorporate into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the following pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements:

1. Financial Accounting Standards Board (FASB) Statements and Interpretations

2. Accounting Principles Board Opinions
3. Accounting Research Bulletins of the American Institute of Certified Public Accountants' (AICPA) Committee on Accounting Procedure.

This standard becomes effective for the City beginning in fiscal year 2013.

GASB 63: *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*

GASB Statement No. 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position, was issued in June 2011 to improve financial reporting for a governmental reporting entity. The standard provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. Concepts Statement No. 4, *Elements of Financial Statements,* introduced and defined those elements as a consumption of net assets by the government that is applicable to a future reporting period, and an acquisition of net assets by the government that is applicable to a future reporting period, respectively. This standard becomes effective for the City in fiscal year 2013.

GASB 64: *Derivative Instruments: Application of Hedge Accounting Termination Provisions—an amendment of GASB Statement No. 53*

GASB Statement No. 64, Derivative Instruments: Application of Hedge Accounting Termination Provisions—an amendment of GASB Statement No. 53, was issued in June 2011 to improve financial reporting for a governmental reporting entity. The standard clarifies whether an effective hedging relationship continues after the replacement of a swap counterparty or a swap counterparty's credit support provider. This Statement sets forth criteria that establish when the effective hedging relationship continues and hedge accounting should continue to be applied. This standard becomes effective for the City in fiscal year 2012.

<u>Recommendation</u> – Review all GASB Statements listed above and their implications to determine the potential impact on the District's financial statements.

SECTION IV — DEFINITIONS

The definitions of a deficiency, a material weakness, and a significant deficiency that are established in AU 325, *Communicating Internal Control Related Matters Identified in an Audit*, are as follows:

A *deficiency* in internal control over financial reporting 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 deficiency in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in operation exists when (a) a properly designed control does not operate as designed, or (b) the person performing the control does not possess the necessary authority or competence to perform the control effectively.

A *significant deficiency* is a deficiency, or combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

A *material weakness* is a deficiency, or combination of deficiencies, in internal control over financial reporting, 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.

SECTION V — MANAGEMENT'S RESPONSIBILITY FOR AND THE OBJECTIVES AND LIMITATIONS OF INTERNAL CONTROL

The following comments concerning management's responsibility for internal control over financial reporting and the objectives and inherent limitations of internal control over financial reporting are adapted from auditing standards generally accepted in the United States of America.

Management's Responsibility

The City's management is responsible for the overall accuracy of the financial statements and their conformity with generally accepted accounting principles. In this regard, management is also responsible for establishing and maintaining effective internal control over financial reporting.

Objectives of Internal Control over Financial Reporting

Internal control over financial reporting is a process affected by those charged with governance, management, and other personnel and designed to provide reasonable assurance about the achievement of the entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. Internal control over the safeguarding of assets against unauthorized acquisition, use, or disposition may include controls related to financial reporting and operations objectives. Generally, controls that are relevant to an audit of financial statements are those that pertain to the entity's objective of reliable financial reporting (i.e., the preparation of reliable financial statements that are fairly presented in conformity with generally accepted accounting principles).

Inherent Limitations of Internal Control over Financial Reporting

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

* * * * *