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FINANCE & RECORDS

MEMO

To: Gregg Mandsager, City Administrator

From: Nancy A. Lueck, Finance Director

Date: July 10, 2014

Re: Request for Approval of the Letter of Understanding with McGladrey LLP for the Fiscal Year 2013/2014 Audit

Introduction:

In 2009 the City entered into an agreement with McGladrey LLP for audit services for a five-year period from Fiscal Year 2008/2009 through 2012/2013. In January of 2014 City Council approved a one-year extension to this agreement for the audit for the 2013/2014 fiscal year.

Background

Audit procedures require that a Letter of Understanding be signed by the Auditor and the City documenting responsibilities for specific areas of the audit including (1) the Objective and Scope of the Audit of the Financial Statements, (2) the responsibilities of the Auditor, (3) the responsibilities of the Management of the City and Identification of the Applicable Financial Reporting framework, (4) the City's Records and Assistance with the audit, and (5) Other Relevant Information. The attached Letter of Understanding includes this information and reflects the fee of \$42,750 for the basic audit for 2013/2014. An additional \$2,650 will be paid to McGladrey for the Housing Program REAC audit. These two amounts total \$45,400 which is the same total fee as that for the audit for 2012/2013.

Recommendation:

Please include this request to approve the Letter of Understanding with McGladrey LLP on the agenda for the July 17, 2014 meeting and authorize the Mayor, City Administrator, and Finance Director to sign this document. If you have any questions or need additional information, please contact me.



July 7, 2014

Honorable Mayor and Members of City Council
City of Muscatine, Iowa
City Hall, 215 Sycamore Street
Muscatine, Iowa 52761

Attention: Nancy Lueck, Finance Director

The Objective and Scope of the Audit of the Financial Statements

You have requested that we audit the financial statements of City of Muscatine, Iowa's (the City), governmental activities, business-type activities, aggregate discretely presented component units, each major fund and aggregate remaining fund information as of and for the year ended June 30, 2014 which collectively comprise the basic financial statements. Our audit will include the general fund and you acknowledge that we are the group auditor of City's basic financial statements as of and for the year ended June 30, 2014. We will not audit the financial statement of Muscatine Power & Water, a discretely presented component unit. Those financial statements will be audited by component auditors.

Our audit will be conducted with the objective of our expressing an opinion on the financial statements. We will also report on whether certain supplemental information (combining nonmajor fund financial statements) is fairly stated in all material respects in relation to the financial statements as a whole. The accounting principles generally accepted in the United States of America require that the management's discussion and analysis, the budgetary comparison schedule of revenues, expenditures and changes in fund balance budget to GAAP reconciliation and other postemployment benefit information be presented to supplement the basic financial statements. We will apply certain limited procedures to this required supplementary information but will not express an opinion or provide any assurance on this information. In addition, you have informed us that you intend to prepare a Comprehensive Annual Financial Report (CAFR) and submit it for evaluation by the Government Finance Officers Association's Certificate of Achievement for Excellence in Financial Reporting. Our association with the CAFR is to consist of technical review. The accompanying introductory and statistical sections of the CAFR are presented for the purpose of additional analysis and are not a required part of the basic financial statements. Accordingly, we will not express an opinion on this supplemental information.

We will also perform the audit of the City as of June 30, 2014, so as to satisfy the audit requirements imposed by the Single Audit Act and the U.S. Office of Management and Budget (OMB) Circular No. A-133.

We are pleased to confirm our acceptance and our understanding of this audit engagement by means of this letter.

The Responsibilities of the Auditor

We will conduct our audit in accordance with auditing standards generally accepted in the United States of America (GAAS); *Government Auditing Standards* issued by the Comptroller General of the United States; the provisions of the Single Audit Act, OMB Circular A-133 and OMB's Compliance Supplement. Those standards, circulars, supplements or guides require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

Because of the inherent limitations of an audit, together with the inherent limitations of internal control, an unavoidable risk that some material misstatements may not be detected exists, even though the audit is properly planned and performed in accordance with GAAS. Also, an audit is not designed to detect errors or fraud that are immaterial to the financial statements. The determination of abuse is subjective; therefore, *Government Auditing Standards* do not expect us to provide reasonable assurance of detecting abuse.

In making our risk assessments, we consider internal control relevant to the City's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. However, we will communicate to you in writing concerning any significant deficiencies or material weaknesses in internal control relevant to the audit of the financial statements that we have identified during the audit.

We will also communicate to the City Council (a) any fraud involving senior management and fraud (whether caused by senior management or other employees) that causes a material misstatement of the financial statements that becomes known to us during the audit, and (b) any instances of noncompliance with laws and regulations that we become aware of during the audit (unless they are clearly inconsequential).

The funds that you have told us are maintained by the City and that are to be included as part of our audit are listed in the June 30, 2013 financial report.

The component units whose financial statements you have told us are to be included as part of the City's basic financial statements are Muscatine County Solid Waste Agency, Muscatine Convention & Visitors Bureau and Muscatine Power & Water.

The federal financial assistance programs and awards that you have told us that the City participates in and that are to be included as part of the single audit are listed in the June 30, 2013 compliance section of the financial report.

Our report(s) on internal control will include any significant deficiencies and material weaknesses in controls of which we become aware as a result of obtaining an understanding of internal control and performing tests of internal control consistent with requirements of the standards and circulars identified above. Our report(s) on compliance matters will address material errors, fraud, abuse, violations of compliance obligations, and other responsibilities imposed by state and federal statutes and regulations or assumed by contracts, and any state or federal grant, entitlement, or loan program questioned costs of which we become aware, consistent with requirements of the standards and circulars identified above.

The Responsibilities of Management and Identification of the Applicable Financial Reporting Framework

Our audit will be conducted on the basis that management and when appropriate, those charged with governance, acknowledge and understand that they have responsibility:

- a. For the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America;
- b. 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;
- c. For establishing and maintaining effective internal control over financial reporting and for informing us of all significant deficiencies and material weaknesses in the design or operation of such controls of which it has knowledge;

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- d For (a) making us aware of significant vendor relationships where the vendor is responsible for program compliance, (b) following up and taking corrective action on audit findings, including the preparation of a summary schedule of prior audit findings, and a corrective action plan, and (c) report distribution including submitting the reporting package(s); and
- e. To provide us with:
 - (1) Access to all information of which management is aware that is relevant to the preparation and fair presentation of the financial statements such as records, documentation, and other matters;
 - (2) Additional information that we may request from management for the purpose of the audit;
 - (3) Unrestricted access to persons within the entity from whom we determine it necessary to obtain audit evidence;
 - (4) When applicable, a summary schedule of prior audit findings for inclusion in the single audit reporting package; and
 - (5) If applicable, responses to any findings reported on the schedule of findings and questioned costs.

As part of our audit process, we will request from management and when appropriate, those charged with governance, written confirmation concerning representations made to us in connection with the audit including among other items:

- a. That management has fulfilled its responsibilities as set out in the terms of this letter; and
- b. That it believes the effects of any uncorrected misstatements aggregated by us during the current engagement and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

Management is responsible for identifying and ensuring that the City complies with the laws and regulations applicable to its activities, and for informing us about all known material violations of such laws or regulations. In addition, management is responsible for the design and implementation of programs and controls to prevent and detect fraud or abuse, and for informing us about all known or suspected fraud or abuse affecting the entity involving management, employees who have significant roles in internal control, and others where the fraud or abuse could have a material effect on the financial statements or compliance. Management is also responsible for informing us of its knowledge of any allegations of fraud or abuse or suspected fraud or abuse affecting the entity received in communications from employees, former employees, analysts, regulators, or others.

Management is responsible for the preparation of the required supplementary information (RSI) and supplementary information in accordance with accounting principles generally accepted in the United States of America. Management agrees to include the auditor's report on the RSI and supplementary information in any document that contains the supplementary information and that indicates that the auditor has reported on such RSI and supplementary information. Management also agrees to present the supplementary information with the audited financial statements or, if the supplementary information will not be presented with audited financial statements, to make the audited financial statements readily available to the intended users of the supplementary information no later than the date of issuance of the supplementary information and the auditor's report thereon.

The City Council is responsible for informing us of its views about the risks of fraud or abuse within the entity, and its knowledge of any fraud or abuse or suspected fraud or abuse affecting the entity.

You have informed us that you may issue public debt in the future and that you may include our report on your financial statements in the offering statement. You have further informed us that you do not intend that we be associated with the proposed offering.

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We agree that our association with any proposed offering is not necessary, providing the City agrees to clearly indicate that we are not associated with the contents of any such official statement or memorandum. The City agrees that the following disclosure will be prominently displayed in any such official statement or memorandum:

McGladrey LLP, our independent auditor, has not been engaged to perform, and has not performed, since the date of its report included herein, any procedures on the financial statements addressed in that report. McGladrey LLP also has not performed any procedures relating to this official statement.

Because McGladrey LLP will rely on the City and its management and City Council to discharge the foregoing responsibilities, the City holds harmless and releases McGladrey LLP, its partners, and employees from all claims, liabilities, losses, and costs arising in circumstances where there has been a knowing misrepresentation by a member of the City's management which has caused, in any respect, McGladrey LLP's breach of contract or negligence. This provision shall survive the termination of this arrangement for services.

City of Muscatine Iowa's Records and Assistance

If circumstances arise relating to the condition of the City's records, the availability of appropriate audit evidence, or indications of a significant risk of material misstatement of the financial statements because of error, fraudulent financial reporting, or misappropriation of assets, which in our professional judgment, prevent us from completing the audit or forming an opinion, we retain the unilateral right to take any course of action permitted by professional standards, including declining to express an opinion, issue a report, or withdraw from the engagement.

During the course of our engagement, we may accumulate records containing data that should be reflected in the City's books and records. The City will determine that all such data, if necessary, will be so reflected. Accordingly, the City will not expect us to maintain copies of such records in our possession.

The assistance to be supplied by City personnel, including the preparation of schedules and analyses of accounts, has been discussed and coordinated with you. The timely and accurate completion of this work is an essential condition to our completion of the audit and issuance of our audit report.

In connection with our audit, you have requested us to perform certain non-audit services necessary for the preparation of the financial statements, including drafting the financial statement footnotes. The independence standards of the *Government Auditing Standards* issued by the Comptroller General of the United States GAS require that the auditor maintain independence so that opinions, findings, conclusions, judgments, and recommendations will be impartial and viewed as impartial by reasonable and informed third parties. Before we agree to provide a non-audit service to the City, we determine whether providing such a service would create a significant threat to our independence for GAS audit purposes, either by itself or in aggregate with other non-audit services provided. A critical component of our determination is consideration of management's ability to effectively oversee the non-audit service to be performed. The City has agreed that Nancy Lueck, Finance Director, possesses suitable skill, knowledge or experience and that the individual understands the financial statement footnotes sufficiently to oversee them. Accordingly, the management of the City agrees to the following:

1. The City has designated Nancy Lueck, Finance Director, a senior member of management, who possesses suitable skill, knowledge and experience to oversee the services.
2. Nancy Lueck, Finance Director, will assume all management responsibilities for subject matter and scope of the financial statement footnotes.
3. The City will evaluate the adequacy and results of the services performed.
4. The City accepts responsibility for the results and ultimate use of the services.

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GAS further requires we establish an understanding with the management and those charged with governance of the City of the objectives of the non-audit service, the services to be performed, the entity's acceptance of its responsibilities, the auditor's responsibilities and any limitations of the non-audit service. We believe this letter documents that understanding.

Other Relevant Information

From time to time and depending upon the circumstances, we may use third-party service providers to assist us in providing professional services to you. In such circumstances, it may be necessary for us to disclose confidential client information to them. We enter into confidentiality agreements with all third-party service providers and we are satisfied that they have appropriate procedures in place to prevent the unauthorized release of your confidential information to others. In addition, we may utilize financial information you have provided to us in connection with this engagement for purposes of creating benchmarking data to be used by McGladrey LLP professionals and other clients. This benchmarking data is aggregated with data from a minimum of five other entities so that users of the data are unable to associate the data with any single entity in the database.

In accordance with *Government Auditing Standards*, a copy of our most recent peer review report is enclosed, for your information.

Fees, Costs and Access to Workpapers

Our fees for the audit and accounting services described above are based upon the value of the services performed and the time required by the individuals assigned to the engagement. Our fee estimate and completion of our work is based upon the following criteria:

- a. Anticipated cooperation from City personnel.
- b. Timely responses to our inquiries.
- c. Timely completion and delivery of client assistance requests.
- d. Timely communication of all significant accounting and financial reporting matters.
- e. The assumption that unexpected circumstances will not be encountered during the engagement.

If any of the aforementioned criteria are not met, then fees may increase. Interim billings will be submitted as work progresses and as expenses are incurred. Billings are due upon submission. Our fee for the services described in the letter will not exceed \$42,750 for the financial statement audit and \$2,650 for the certification of the audited financial statements of the City's Section 8 Housing Program Special Revenue Fund and Public Housing Enterprise Fund with the Real Estate Assessment Center.

Our professional standards require that we perform certain additional procedures, on current and previous years' engagements, whenever a partner or professional employee leaves the firm and is subsequently employed by or associated with a client in a key position. Accordingly, the City agrees it will compensate McGladrey LLP for any additional costs incurred as a result of the City's employment of a partner or professional employee of McGladrey LLP.

In the event we are requested or authorized by the City or are required by government regulation, subpoena, or other legal process to produce our documents or our personnel as witnesses with respect to our engagement for the City, the City will, so long as we are not a party to the proceeding in which the information is sought, reimburse us for our professional time and expenses, as well as the fees and expenses of our counsel, incurred in responding to such requests.

The documentation for this engagement is the property of McGladrey LLP. However, you acknowledge and grant your assent that representatives of the cognizant or oversight agency or their designee, other government audit staffs, and the U.S. Government Accountability Office shall have access to the audit documentation upon their request and that we shall maintain the audit documentation for a period of at least three years after the date of the report, or for a longer period if we are requested to do so by the cognizant or oversight agency. Access to requested documentation will be provided under the supervision of McGladrey LLP audit personnel and at a location designated by our Firm.

Claim Resolution

The City and McGladrey LLP agree that no claim arising out of services rendered pursuant to this agreement shall be filed more than two years after the date of the audit report issued by McGladrey LLP or the date of this arrangement letter if no report has been issued. The City waives any claim for punitive damages. McGladrey LLP's liability for all claims, damages and costs of the City arising from this engagement is limited to the amount of fees paid by the City to McGladrey LLP for the services rendered under this arrangement letter.

If any term or provision of this Agreement is determined to be invalid or unenforceable, such term or provision will be deemed stricken and all other terms and provisions will remain in full force and effect.

Reporting

We will issue a written report upon completion of our audit of the City's financial statements. Our report will be addressed to the City Council of the City. We cannot provide assurance that an unmodified opinion will be expressed. Circumstances may arise in which it is necessary for us to modify our opinion, add an emphasis-of-matter or other-matter paragraph(s) or withdraw from the engagement.

In addition to our report on the City's financial statements, we will also issue the following types of reports:

- A report on the fairness of the presentation of the City's schedule of expenditures of federal awards for the year ended June 30, 2014.
- Reports on internal control related to the financial statements and major programs. These reports will describe the scope of testing of internal control and the results of our tests of internal controls.
- Reports on compliance with laws, regulations, and the provisions of contracts or grant agreements. We will report on any noncompliance which could have a material effect on the financial statements and any noncompliance which could have a material effect, as defined by OMB Circular No. A-133, on each major program.
- A schedule of findings and questioned costs.
- Certification of the City of Muscatine's audited financial statements with the Real Estate Assessment Center. The responsibility we are to take for the material included in this report will be the same as that we assume for other supplementary information accompanying the financial statements.

This letter constitutes the complete and exclusive statement of agreement between McGladrey LLP and the City, superseding all proposals, oral or written, and all other communications, with respect to the terms of the engagement between the parties.

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Please sign and return the attached copy of this letter to indicate your acknowledgment of, and agreement with, the arrangements for our audit of the financial statements including our respective responsibilities.

McGladrey LLP



Heidi Hobkirk, Director

Confirmed on behalf of City of Muscatine, Iowa:



Mayor

7-18-14

Date



City Administrator

Date



Finance Director

7-18-14

Date



System Review Report

To the Partners of
McGladrey LLP
and the National Peer Review Committee
of the American Institute of Certified
Public Accountants Peer Review Board

We have reviewed the system of quality control for the accounting and auditing practice of McGladrey LLP (the "firm") applicable to non-SEC issuers in effect for the year ended April 30, 2013. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants. As a part of our peer review, we considered reviews by regulatory entities, if applicable, in determining the nature and extent of our procedures. The firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Our responsibility is to express an opinion on the design of the system of quality control and the firm's compliance therewith based on our review. The nature, objectives, scope, limitations of and the procedures performed in a System Review are described in the standards at www.aicpa.org/prsummary.

As required by the standards, engagements selected for review included engagements performed under *Government Auditing Standards*, audits of employee benefit plans, audits performed under FDICIA, and audits of carrying broker-dealers, and examinations of service organizations [Service Organizations Control (SOC) 1 and 2 engagements].

In our opinion, the system of quality control for the accounting and auditing practice of McGladrey LLP applicable to non-SEC issuers in effect for the year ended April 30, 2013, has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Firms can receive a rating of *pass*, *pass with deficiency(ies)* or *fail*. McGladrey LLP has received a peer review rating of *pass*.

BKD, LLP

December 4, 2013