



October 29, 2007

To the Finance Committee
Southwest Wisconsin Workforce Development Board, Inc.
Platteville, Wisconsin

In planning and performing our audit of the financial statements of Southwest Wisconsin Workforce Development Board, Inc. as of and for the year ended June 30, 2007, in accordance with auditing standards generally accepted in the United States of America, we considered Southwest Wisconsin Workforce Development Board, Inc.'s internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Organization's internal control. Accordingly, we do not express an opinion on the effectiveness of the Organization's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, we identified a certain deficiency in internal control that we consider to be a significant deficiency that we reported to management of Southwest Wisconsin Workforce Development Board, Inc. in a separate letter dated October 29, 2007.

In addition, during our audit, we noted certain matters involving the internal control and other operational matters that are presented for your consideration. This letter does not affect our report dated October 19, 2007 on the financial statements of Southwest Wisconsin Workforce Development Board, Inc. We will review the status of these comments during our next audit engagement. Our comments and recommendations, all of which have been discussed with appropriate members of management, are intended to improve the internal control or result in other operating efficiencies. We will be pleased to discuss these comments in further detail at your convenience, perform any additional study of these matters, or assist you in implementing the recommendations. Our comments are summarized as follows:

Financial Reporting Process

As mentioned previously, we identified a certain deficiency in internal control that we consider to be a significant deficiency and reported that deficiency to management in a separate letter. That deficiency related to controls over the period-end financial reporting process, which includes preparation of the Organization's financial statements in accordance with and appropriate disclosures required by generally accepted accounting principles. In our letter, we included options for addressing this deficiency. One option was hiring an employee with or training an employee in the appropriate skills to prepare the financial statements. The following paragraphs discuss select generally accepted accounting principles that we believe the Organization should become familiar with should it choose this option.

Contributions Versus Exchange Transactions (as Related to Government Grants)

The Statements of Financial Accounting Standards (SFAS) issued by the Financial Accounting Standards Board (FASB) avoid the use of terms such as *awards*, *grants*, and *appropriations* because those terms are broadly used to refer not only to contributions but also to exchange transactions (reciprocal transfers in which each party receives and sacrifices approximately equal value). Thus, there has been significant



discussion among accountants regarding the appropriate classification of government grants as contributions or exchange transactions. Some accountants believe that the government is purchasing goods or services and conclude that government grants are reciprocal in nature. Other accountants conclude that government grants are nonreciprocal in nature (i.e., contributions) because the goods or services provided by the grant recipients are delivered to individuals or organizations other than the government.

The American Institute of Certified Public Accountants (AICPA) *Audit and Accounting Guide, Not-for-Profit Organizations* (Audit Guide), presents factors that may be helpful in determining whether a grant is an exchange transaction, a contribution, or a combination of both. The factors indicative of a contribution tend to describe transactions where the value, if any, returned to the resource provider is incidental to potential public benefits. The factors indicating an exchange tend to describe transactions where the potential public benefits are secondary to the potential proprietary benefits to the resource provider.

Some accountants also use guidance from the Internal Revenue Service (IRS) when classifying government grants. Although tax regulations are not authoritative for financial reporting purposes, they can provide additional insight. The IRS distinguishes between government grants that are contributions and those that are program service revenue. Grants received from government entities are reported as contributions if their primary purpose is to allow the organization to provide a direct benefit or service to the public, even if the grantor specifies how the grant is to be used. Likewise, if a grant's primary purpose is to directly benefit the general public by furthering the general functions of government, the grant is a contribution. If the grant is primarily directed toward producing an economic benefit to the government, the grant revenue is program service revenue rather than a contribution.

Distinguishing between whether a transaction is a contribution or an exchange transaction is important for several reasons, including the potential for overstating revenues and expenses, the timing of revenue recognition, the classification of revenues to net assets categories, and the classification of related expenses to functional categories. We will be pleased to discuss these reasons in further detail at your request.

Functional Expense Reporting

A nonprofit organization's expenses may be grouped (or classified) in a number of ways. For example, the natural (or object) classification indicates the type of expense, such as salaries, employee benefits, occupancy, postage and shipping, etc. The natural classification tells *what* was purchased. The functional classification of expenses involves grouping natural expense classifications by function, such as major classes of program services and supporting activities. The functional classification tells *why* an expense was incurred.

SFAS No. 117, *Financial Statements of Not-for-Profit Organizations*, requires all nonprofit organizations to report information about expenses by their functional classifications. This information may be presented either on the statement of activities or in the notes to the financial statements. However, certain types of organizations are also required to report expense information by both functional and natural classifications in a separate financial statement using a matrix format (usually referred to as the statement of functional expenses). Other organizations are encouraged, but not required, to also report expense information by natural classifications. The primary functional classifications are as follows:

Program services—An organization's program services are activities carried out to fulfill its mission or purpose that result in goods or services being distributed to beneficiaries, customers, or members. Program services are the major purpose for, and output of, an organization. Program services expenses include both direct and indirect costs related to providing the organization's programs or social services.

Supporting activities—Supporting activities expenses are expenses for activities not directly related to the purpose for which the organization exists. Supporting activities expenses are broadly categorized under SFAS No. 117 as management and general expenses, fundraising

expenses, and membership development expenses. Although many organizations report using those categories, the Audit Guide neither encourages nor discourages the use of those or any other functional classifications. For example, many organizations refer to the management and general classification by a similar descriptive term such as *administrative*. The following paragraphs describe the management and general and fundraising categories and some of the costs typically associated with those categories:

- *Management and general*—Management and general activities relate to the overall direction of the organization. They are not identifiable with a particular program, fundraising, or membership development activity, but they are indispensable to the conduct of those activities and are essential to the organization. Management and general expenses typically include expenses for activities of the governing board, business management, finance, general recordkeeping, budgeting, soliciting revenue from exchange transactions, informing the public about the organization's stewardship (such as through the annual report), and other administrative activities.

Management and general expenses often include board expenses and the salaries of the executive director and support staff. Costs related to time spent by the executive director or support staff working on programs or other functions should be allocated to those functions, however. In addition, management and general expenses typically include costs of disseminating information to the public about the organization's use of donated funds.

- *Fundraising*—Fundraising expenses are costs of all activities that constitute an appeal for financial support. In other words, fundraising expenses include the costs incurred to induce others to contribute money, securities, time, materials, or facilities to the organization. Fundraising expenses may include related personnel costs, professional consultants, printing, postage, telephone, direct mail list maintenance, direct contact solicitations, unsolicited merchandise sent to encourage contributions, special fundraising events, or preparation and distribution of fundraising manuals and other materials

Some expenses relate directly to a single program service or supporting activity, while others do not. Expenses that can be directly attributed to a particular program service or supporting activity should be assigned or charged to that program service or supporting activity. Expenses that relate to more than one program service or supporting activity, however, will require allocation among those functions.

Functional allocations may be used by organizations for different purposes. The purpose of the functional allocation often affects the method used to perform the allocation. Organizations commonly allocate expenses for purposes of government grant reporting, evaluation of program viability, and external financial reporting (i.e., reporting in accordance with generally accepted accounting principles). A functional allocation performed for grant reporting or program evaluation purposes may or may not be appropriate for external financial reporting. For example, a cost allocation to determine program viability may include all costs as program costs, even though some costs by nature should be classified as supporting activities (such as administrative salaries and accounting fees). In addition, government grant allocation may allow the organization to pool all indirect costs and charge them to the program based on a computed indirect cost rate. Such methods might not result in a reasonable allocation of indirect costs in accordance with generally accepted accounting principles.

We will be pleased to discuss functional expense reporting in further detail at your request.

Statement of Cash Flows

As amended by SFAS No. 117, SFAS No. 95, *Statement of Cash Flows*, requires a statement that shows a nonprofit organization's cash receipts and payments during a period, classified by principal sources and uses, to be presented as a basic external financial statement when (a) the financial statements are prepared in accordance with generally accepted accounting principles and (b) both a statement of financial position and a statement of activities are presented.

The primary purpose of a statement of cash flows is to provide relevant information about the cash receipts and cash payments of an organization during a period. A statement of cash flows has five basic elements: (1) cash flows from operating activities, (2) cash flows from investing activities, (3) cash flows from financing activities, (4) the net change in cash during the period, and (5) supplemental disclosure of noncash investing and financing activities (such as acquiring assets by assuming liabilities).

The statement of cash flows is typically the most difficult statement to prepare, partly because many accounting systems do not have the capacity to generate the statement automatically. As a result, the amounts presented on the statement are often computed separately outside the system. Furthermore, the internal financial statements that an organization prepares monthly, quarterly, etc. often do not consist of a complete set of financial statements like those found at year end. Thus, an organization's accounting staff typically does not have experience preparing the statement.

We will be pleased to discuss the elements of the statement of cash flows in further detail at your request and assist in developing a step-by-step cash flow worksheet that you may use when computing the amounts to be presented in the statement.

Risk Assessment Standards

In March 2006, the Auditing Standards Board (ASB) of the AICPA issued eight new Statement on Auditing Standards (SAS), collectively referred to as the risk assessment standards, which bring sweeping changes and provide guidance for the conduct of audits of non-public companies. The primary objective of these standards is to enhance auditors' application of the audit risk model by requiring auditors to obtain a more in-depth understanding of an entity in order to better identify risks of material misstatement of financial statements. The risk assessment standards are effective for audits of financial statements for periods beginning on or after December 15, 2006 (generally calendar year 2007), with early adoption permitted.

Some of the key provisions and changes in the audit process through the application of the risk assessment standards include improvements in the quality and depth of the required understanding of the entity and its environment. In addition to the components of internal control, the guidance specifies aspects of the entity and its environment about which the auditor should obtain an understanding to identify and assess where material misstatements could occur. These aspects include industry, regulatory, and other external factors; the nature of the entity, including the entity's application of accounting principles; objectives and strategies and the related business risks, including the entity's risk assessment process; and measurement and review of the entity's financial performance.

The risk assessment standards also expand the risk assessment process. The risk assessment standards eliminate the concept of assessing control risk at the maximum by default. Risk assessment, at whatever level, should be supported by the auditor's understanding of the entity and its environment and internal controls. As a result, auditors will most likely require assistance from the entity in documenting internal controls associated with significant processes. Auditors may also perform a walk-through of each significant process to confirm that internal controls have been implemented as depicted in the process documentation. As part of the walk-through, the auditor may observe functions being performed by the entity's employees and the records produced. During this time the auditor may also ask the employee about the nature of the procedures being performed and their purpose.

Process documentation includes points where transactions are initiated, authorized, processed, recorded, and reported. At such point, the auditor assesses the risk that misstatements may not be prevented or detected. In other words, the auditor asks "what could go wrong" questions or otherwise considers what could go wrong. The auditor then evaluates the likelihood that a misstatement would occur without regard to internal controls. Because the number of "what could go wrong" questions or potential misstatements is limitless, experience and knowledge of the entity are used to focus on the most important potential misstatements specific to the entity. The auditor then identifies the internal controls that may either prevent or detect such misstatements and evaluates the design of those controls.

The entity may (and should) perform its own evaluation of the design of its internal controls by asking "what could go wrong" questions. Some examples of "what could go wrong" questions for a purchases, cash disbursements, and accounts payable process are included in the attached appendix.

We believe that the implementation of these recommendations will provide Southwest Wisconsin Workforce Development Board, Inc. with a stronger system of internal control while also making its operations more efficient. We will be happy to discuss the details of these recommendations with you and assist in any way possible with their implementation.

This communication is intended solely for the information and use of management, the finance committee, board membership, and others within the Organization and is not intended to be and should not be used by anyone other than these specified parties.

Sincerely,

Wegner LLP
CPAs & Consultants

A handwritten signature in black ink, appearing to read "Scott R. Haumersen". The signature is written in a cursive style with a horizontal line underneath the name.

Scott R. Haumersen, CPA
Partner

Appendix—What Can Go Wrong Questions

Some examples of what could go wrong questions taken from a small company's internal control documentation for its purchases, cash disbursements, and accounts payable process follow:

- What ensures that invoices and purchase orders are coded to the correct accounts?
- What ensures that invoices reflect correct prices, quantities, and other valuation information?
- What ensures that purchases are recorded in the proper period?
- What ensures that accounts payable are recorded for all goods or services received or rendered?
- What ensures that receiving documents are generated for all goods received?
- What ensures that fictitious or duplicate purchases are not recorded?
- What ensures that cash disbursements are recorded in the proper period?
- What ensures that duplicate postings of cash disbursements are not made to the general ledger?
- What ensures that cash disbursements are real?
- What ensures that all cash disbursements are recorded?
- What ensures that all cash disbursements amounts recorded agree with the amounts paid?