



**Virchow Krause
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June 28, 2007

Transit and Parking Commission
City of Madison
210 Martin Luther King, Jr. Blvd., Room 406
Madison, WI 53710

Dear Commissioners:

This letter is to inform you of any comments or recommendations as part of our financial and single audits of the Metro Transit System for 2006 and 2005. The following recommendations we believe can improve the financial reporting and control systems of the transit system.

CURRENT YEAR COMMENTS

NEW AUDITING STANDARD – STATEMENT ON AUDITING STANDARDS (SAS) No. 103

As part of our audit of your financial statements for the year ended December 31, 2006, we were required to follow a significant new auditing standard, or rule.

The new standard establishes standards and provides guidance to an auditor on audit documentation. Audit documentation is an essential element of audit quality. Although audit documentation alone does not guarantee audit quality, the process of preparing sufficient and appropriate audit documentation contributes to the quality of an audit.

How does this impact your organization? As auditors, we still have the same responsibility as we did in the past. Now we are required to document our efforts in new ways. For example, the new rule requires that we date our audit opinion when we are ready to release the final reports. In the past, we were required to date the opinion as of the last day we did fieldwork at your office. You will notice that the date at the lower left of our opinion is now later in the year than it used to be. This change is significant because we are also required to do many of our audit procedures through the date of our opinion. The new rule requires us to perform a number of inquiries and do procedures for several weeks to several months past the old date. This, of course, requires more time to do the audit, and may cause some timing problems with issuing the final audited documents.

The new standard is supposed to benefit you and the public with financial statements that have less risk of unidentified significant events occurring after year end, but not being disclosed in the statements.

CURRENT YEAR COMMENTS (cont.)

NEW INTERNAL CONTROL AUDIT TESTING FOR 2007

In March of 2006, the American Institute of Certified Public Accountants issued eight new auditing standards (#104-111) that will change the way auditors approach the audit process. These changes are a direct result of the major frauds that have occurred in the United States in the past several years. The new standards are intended to improve the auditors' understanding of you, the client, the environment in which you operate, your internal controls, and the risks involved in the audit. The auditor will be required to make a more rigorous assessment of the risk of material misstatements based on that understanding. The result will be improved linkage between the assessed risks, and the nature, timing, and extent of our audit procedures.

One of the concepts that affects most units of governments is the level of documentation of their internal controls. Most of our clients do not have adequate written documentation of the various internal control processes that take place within their organization. We, as auditors, have done some amount of high level documentation of your processes for our files. You, on the other hand, should theoretically have all of your major processes contained in written documents in enough detail that another person could come in and fulfill the requirements of a particular process by following the explanations.

The major areas that should be documented are:

Cash Receipts	Capital Assets – Additions and Retirements
Cash Disbursements	Capital Assets – Depreciation
Investment Transactions	Debt Transactions
Receivables – Billings	Financial Reporting
Receivables – Collections	Information Technology
Purchasing	Grant Accounting
Receiving	Revenue Recognition
Interfund Transactions	Records Retention
Inventories	DBE Policies
Payroll	Charter Bus Policy

Other than the computer software instruction manual, most of our clients have little written documentation covering these areas. We understand that Metro has documented many of these processes; however we feel this is an ideal time for this documentation to be evaluated, revised and expanded as needed given recent staffing changes.

For the current and past audits, we have been able to complete your audit without asking for such documentation. However, beginning with your calendar year 2007 audit, we will be required to ask you for complete documentation of your internal control systems, due to the new auditing standards. Therefore, you should plan now to complete that documentation during 2007, so that we can evaluate your compliance with the new rules during our audit of your 2007 financial statements. We will be able to provide you with forms and other resources to assist you with meeting the new requirements.

CURRENT YEAR COMMENTS (cont.)

MATERIALS AND SUPPLIES YEAR END ADJUSTMENT

For each of the past three years there has been a significant adjustment to the financial records balance in materials and supplies at year end in order to reconcile the financial records with the physical records of parts on hand. This indicates that parts used are not consistently recorded and charged out. As the parts inventory may be financed with grant funding it is imperative that Metro have controls in place to ensure that parts used are charged appropriately and are used for Metro operations. We understand that management is aware of this and intends to look into this issue in 2007 with the implementation of a new inventory tracking program.

SIGNIFICANT GRANT RECEIVABLES AT YEAR END

As of December 31, 2006, we noted significant grant receivables outstanding, resulting in a large cash deficit which was implicitly financed by the city. This was due to a delay in the submittal of draw reports to FTA. We understand that Metro had turnover this year, but timely receipt of funds is imperative to the stable financial position of Metro and the city.

INTERNAL CONTROLS

In planning and performing our audit of the financial statements of the Metro Transit System as of and for the year ended December 31, 2006, in accordance with auditing standards generally accepted in the United States of America, we considered its 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 its internal control. Accordingly, we do not express an opinion on the effectiveness of its internal control.

Our consideration of the Metro's 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, as discussed below, we identified certain deficiencies in internal control that we consider to be material weaknesses.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. We believe that the following deficiencies constitute material weaknesses.

INTERNAL CONTROLS (cont.)

- *Financial Reporting* – management did not provide the annual financial statements and footnotes such that the auditor had no significant changes to them. (see further information below)

Financial Reporting

Recently a new auditing standard was issued that focuses on internal control, and what we communicate to you regarding your controls. Those requirements are set out in Statement on Auditing Standards No. 112, "*Communicating Internal Control Matters Identified in an Audit.*"

The new standard clarifies some definitions and will promote more consistency in how weak areas in internal control are communicated by auditors to their clients.

The new standard makes it clear that the definition of a material weakness in internal control should now include consideration of the year end financial reporting process. To avoid the auditor reporting a material weakness in internal control, your system of controls would need to be able to prepare a complete set of year end financial statements with a very high level of accuracy. The new standard requires that the level of accuracy be such that there is only a remote likelihood that the auditor will discover a material change to the statements or footnotes. While a number of our clients prepare their own statements, it may not be cost beneficial to scrutinize those statements internally to the same degree that the auditor will do later. If the auditor, therefore, discovers a material change to the statements, by definition, the system of internal control over financial reporting must have a material weakness.

To accomplish such a high level of internal control over financial reporting is a difficult task for most governments. Many large organizations, such as SEC companies, have been required by law to prepare their own statements for years, and are staffed appropriately to do so. Most governments operate with only enough staff to process monthly transactions and reports, and so rely on us to prepare certain year end audit entries and handle the year end financial reporting. Under the new auditing standards, we must, therefore, inform you that these are material weaknesses in your internal control.

If you have any questions on these new disclosures, please contact your audit team.

COMMUNICATIONS TO AUDIT COMMITTEE (TRANSIT COMMISSION)

We have audited the financial statements of the Metro Transit System of Madison, Wisconsin for the years ended December 31, 2006 and 2005, and have issued our report thereon dated June 28, 2007. Professional standards require that we provide you with the following information related to our audit.

COMMUNICATIONS TO AUDIT COMMITTEE (TRANSIT COMMISSION) (cont.)

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

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

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

As part of obtaining reasonable assurance about whether Metro Transit System of Madison's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit. Also, in accordance with OMB Circular A-133 and the State Single Audit Guidelines, we examined, on a test basis, evidence about Metro Transit System of Madison's compliance with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* and the State Single Audit Guidelines applicable to each of its major federal and state programs for the purpose of expressing an opinion on Metro Transit System of Madison's compliance with those requirements. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on Metro Transit System of Madison's compliance with those requirements.

SIGNIFICANT ACCOUNTING POLICIES

Management has the responsibility for selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the Metro Transit System are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during 2006. We noted no transactions entered into by the Metro Transit System during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

COMMUNICATIONS TO AUDIT COMMITTEE (TRANSIT COMMISSION) (cont.)

ACCOUNTING ESTIMATES

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected.

AUDIT ADJUSTMENTS

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the Metro Transit System's financial reporting process. Matters underlying adjustments proposed by the auditor could potentially cause future financial statements to be materially misstated. All audit and bookkeeping adjustments prepared during the audit were included in your financial statements. Copies of these adjustments are available from management.

DISAGREEMENTS WITH MANAGEMENT

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

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 utilities' financial statements or a determination of the type of auditors' opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

ISSUES DISCUSSED PRIOR TO THIS YEAR'S AUDIT

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Metro Transit System's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

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COMMUNICATIONS TO AUDIT COMMITTEE (TRANSIT COMMISSION) (cont.)

DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

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

This report is intended solely for the information and use of the audit committee and management, and is not intended to be, and should not be, used by anyone other than these specified parties.

CLOSING COMMENT

Thank you for allowing us to be of service to the City of Madison and its transit system. We also wish to thank your staff for their cooperation and assistance during the audit process. If you have any questions on our comments and recommendations, please contact us.

Sincerely,

VIRCHOW, KRAUSE & COMPANY, LLP

Virchow Krause & Company LLP

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