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February 7, 2011

Board of Finance of the
City Council
City of Burlington
Burlington, Vermont 05401

Attached is our response to the questions related to the Larkin report that you have requested us to complete.

We are disappointed that the public and the press were given the impression that we were not cooperating or were stalling in preparing this response. On the day I received the request, I immediately contacted the City Council President who told me to be prepared to answer the specific questions and any other questions that may arise at an upcoming Board of Finance meeting. I never indicated that I would not respond in writing and, in fact, will utilize the opportunity to explain our professional responsibilities.

One of those responsibilities is confidentiality. Even though most information at the City is public, it is not from us. Every CPA is required to treat all client information as confidential. We cannot respond to any individual request for information. Therefore, I had to confirm with the Council President that it was appropriate to respond. Other than being told by the Council President that we could respond at a Board of Finance meeting, we did not receive official notification that we were to prepare a written response until I was contacted by the Assistant CAO, Rich Goodwin, on Tuesday, February 1. I told him we would try to respond by the end of the week, however, meeting the City's printer deadline for the audit took precedence.

In light of the numerous requests for information that we receive on a regular basis, we suggest that the City have the proposed Audit Committee establish communication policies between the City and its independent auditor. These policies should establish a process for communicating requests to the City's auditors and timelines for the responses. These communication guidelines can be best created by an independent Audit Committee who have an understanding of our standards and professional responsibilities.

We hope that you are mindful of the damage to our reputation and our business that can result from the impression that we were not cooperating in preparing this response. We have always been and continue to be responsive to any requests by the City.

Respectfully submitted,

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Board of Finance of the
City Council
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This letter is in response to your questions related to the Larkin report (Larkin).

As stated in our contract for services with the City, our responsibility, as described by professional standards, is to express opinions about whether the financial statements prepared or approved by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of your responsibilities.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in "Government Auditing Standards", issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

In planning and performing our audit, we considered the City of Burlington, Vermont's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide assurance on the internal control over financial reporting.

Also, as part of obtaining reasonable assurance about whether the City of Burlington, Vermont's financial statements are free of material misstatement, we are required to determine it's compliance with any provisions of laws, regulations, contracts, and grants that could have a <u>direct and material</u> effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions is not an objective of our audit.

Our responsibility is to plan and perform the audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement. We are responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures specifically to identify such matters.

We performed the audits according to the standards as previously communicated to and agreed to by you in our engagement letter.

Two of many specific concerns we had to address as part of our audit of Burlington Telecom (Telecom) was the City's possible violation of the CPG and the ability of Burlington Telecom to replenish the negative balance in the City's pooled cash account.

The Larkin report notes that in a workpaper referenced PP1203 dated January, 2008 and titled "Telecom Planning" that there is a comment that says "Cash in pooled account is very negative which a violation of the CPG is. No current plans to fund this negative". Unfortunately and inaccurately, Larkin chose to add the word "is" before the words "a violation". This was not our intent at this point in the audit. As titled, this is a planning document that was prepared as we began our audit of Telecom.

The comment referenced to by Larkin was included in a list of a number of items that we needed to follow up on or to ask City staff about. There are no conclusions in this workpaper as it is a checklist of planning issues we may need to address in order for us to fulfill our contractual responsibilities under generally accepted auditing standards.

Our first task, as described by professional standards, was to determine if any non-compliance with the CPG could have a <u>direct and material</u> effect on the determination of financial statement amounts. This inquiry was in regards to any and all violations of the CPG from a direct and material financial statement impact. We were not aware that the violation of any specific condition could result in a different amount of financial penalties being imposed.

After discussion with Telecom staff and subsequent confirmation by the City's attorneys, it was believed that the Department of Public Service would not impose fines on the City as this would only have the impact of penalizing the ratepayers. In fact, to date, the Department has not imposed any fines. In addition, we have been informed by the City's attorneys that there are statutory maximum fines for each material violation, which, assuming no further violations are found, could be $80,000. Even if the maximum fines were imposed, this is not material to Telecom's financial statements and, therefore, we did not need to address this issue again. As it was determined that the violation of the CPG could not have a direct and material effect on the determination of any financial statement amount, we did not need to determine whether the City was, in fact, in violation of the CPG. If we had needed this determination, we would have consulted with the City's attorneys as this is a legal, not an accounting issue.

However, through our inquiries of Telecom staff during the audit as of June 30, 2007, it appeared the City did not have a system to document its monitoring of compliance. We included this other recommendation in our management letter as of June 30, 2007 and repeated it in our 2008 and 2009 management letters as well.

The more critical issue was Telecom's ability to replenish the negative balance in the City's "pooled" cash account. It was our responsibility to evaluate the City's assertion related to their ability and intent to replenish the account.

For the audits as of June 30, 2005 and 2006, the Telecom Fund had net positive cash balances.

For the audit as of June 30, 2007, as was indicated in that same planning workpaper PP1203, the City refinanced its debt and received more than an additional eleven million dollars subsequent to the end of that year. For the audit as of June 30, 2008, the City again asserted that it had the ability and intent to replenish the pooled cash account. Since there was no subsequent refinancing, we asked the City to specifically confirm that to us, which they did, and we also received a confirmation from Municipal Leasing Consultants, who has placed a number of City leases over the past few years, that they were confident they could secure financing for the project.

For the audit as of June 30, 2009, since the City had rejected the Piper Jaffrey proposal, the City was not able to assert that it had the ability to replenish the pooled cash account. As a result of this, we had to qualify our opinion on the financial statements related to this issue. This is not the result of the violations of the CPG but rather that generally accepted accounting principles require the City to determine if it can repay any due to other funds balance within a reasonable period of time. After consultation with the Governmental Accounting Standards Board, reasonable period can be as long as the useful life of the project being financed. As a result of this, it wasn't until the City rejected the Piper Jaffrey proposal, and was not actively pursuing alternative financing, that it became, and continues to be, unclear as to how or when Burlington Telecom can replenish the pooled cash deficit.

In addition, during our discussion with the CAO related to the City's ability and intent to replenish the pooled cash account for the 2008 audit, he asked that we provide him with a list of any concerns we had and what the accounting implications would be if Telecom cannot replenish the pooled cash account. We provided that letter dated April 3, 2009. As a result of our concern in the letter related to the pooled cash account, I believe he indicated there is some question as to the reimbursement requirements. As a result, we included an other recommendation in the June 30, 2008 management letter that the City obtain a legal determination related to this issue.

I believe the preceding paragraphs address a number of your questions. Once we had the two concerns resolved, we did not need to address them further as it would not be germane to our responsibilities in our contract for services and under generally accepted auditing standards. There may be other agreed upon procedures you would like us to perform, but these are beyond the scope of our current engagement and would have no impact on our opinion on the financial statements.

The following paragraphs are in response to other specific questions related to the information in the Larkin report.

The Larkin report indicates that the accounting records have understated the amount of Telecom's monthly balance in the pooled cash account on numerous occasions because of its failure to record in a timely manner costs it was incurring. Our audits are on the financial statements as of the end of each fiscal year. The balances we audited had all the activity recorded. If the balances were inaccurate during the year, the only financial statement impact would be on the calculation of interest charged on the pooled cash deficit but these differences would not be material to the financial statements.

The Larkin report also indicates, "Larkin attempted to determine through discovery the amount Burlington Telecom actually borrowed from the City. This determination was complicated by the City's unconventional accounting practices... The general ledgers provided showed only year end balances but did not show year to date balances by month as would be expected in a commercial venture with reasonable and appropriate accounting practices". Unfortunately, this statement is inaccurate. The City provides us read only access to the accounting system and we routinely print the reports described by Larkin with monthly balances. We were not asked about this or any other specific accounting issues referred to in the report by Larkin. We do not believe Larkin distributed a draft of their report before it was issued. This would have helped to eliminate any inaccurate statements in the report.

In response to your question related to period 13 accounting, we know this is a standard feature of the City's Pentamation software. If used as intended, for year end accruals and adjustments, it has no impact on the year end balances we are provided or our ability to audit them.

The Larkin report also indicates, "The fact that the City is charging interest on the funds owed by BT is a clear indication that the advance constitutes a loan". The City charges or credits other funds of the City who participate in the pooled cash account with interest. This is a standard practice in many municipalities. There is virtually no distinction between a due to/from or an interfund loan other than repayment terms.

The Larkin report also indicates it "cannot be readily determined how much of the $16.9 million is borrowed and how much is interest?" The amount of interest charged can be readily determined by the general ledger detail or the pooled cash interest spreadsheets. Every fund that has positive balances has been credited with their interest earnings. We are not sure what Larkin is referring to with this statement.

As to the statement, in the Letter of Representation dated June 26, 2009, the City states that, "There have been no communications from regulatory agencies concerning noncompliance with, or deficiencies in, financial reporting practices". We are not aware of any communications related to deficiencies in financial reporting practices as of that date, however, it is possible that there was a communication that was not provided to us.

As to Larkin's conclusions regarding condition 60, Larkin indicates that their " ... opinion is based on our (Larkin's) interpretation of what Condition No. 60 states". We do not know what their interpretation is or if it coincides with that of the City or the Department of Public Service. As indicated previously, we are not attorneys and do not provide legal interpretations.

As to Larkin's conclusions related to the accounting issues, as indicated previously, some of their criticisms are inaccurate. Others are speculative with very few specific examples to respond to. We would need more information to be able to respond fairly.

The Larkin report also indicates that the "... improper use of the City's pooled cash fund by BT not only violates Condition 60, it places the General Fund and the taxpayers of Burlington at risk".

Because of the current uncertainty related to how much or when Telecom can repay the pooled cash deficit, it appears it has, however, we do not know what other alternatives the City had at that point in time. As discussed previously, refinancing the debt may have replenished the pooled cash account but without knowing the terms and conditions of that debt, we could not evaluate whether the taxpayers would still be at risk. Alternatively, the City could have halted construction and/or operation of the Telecom system but may still have been responsible for costs and contractual commitments to date.

And lastly, the City has contracted with us to prepare a separate audit report for Telecom as of June 30, 2010 and, therefore, we did need to determine if going concern was an issue that had to be addressed. After consultation with the Governmental Accounting Standards Board, it was determined that going concern is a concept at the entity level only and, in fact, the standards specifically indicate we should not address it at the fund or department level.

Respectfully submitted,

Sullivan, Powers & Company

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