

VILLAGE OF BELLEVILLE

Belleville, Wisconsin

COMMUNICATION TO THOSE CHARGED
WITH GOVERNANCE AND MANAGEMENT

As of and for the Year Ended December 31, 2012

VILLAGE OF BELLEVILLE

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**REQUIRED COMMUNICATION OF INTERNAL CONTROL RELATED MATTERS
IDENTIFIED IN THE AUDIT TO THOSE CHARGED WITH GOVERNANCE**

To the Village Board
Village of Belleville
Belleville, Wisconsin

In planning and performing our audit of the financial statements of the Village of Belleville as of and for the year ended December 31, 2012, and for the Belleville Utilities as of December 31, 2012, and for the year then ended 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 that are appropriate in the circumstances for the purpose of expressing our opinions 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 village's internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and, therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be material weaknesses.

A deficiency in internal control 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 material weakness is a deficiency or combination of deficiencies in internal control, 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. We consider the following deficiencies in the village's internal control to be material weaknesses:

- > Internal Control Over Financial Reporting
- > Internal Control Environment

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

Baker Tilly Virchow Krause, LLP

Madison, Wisconsin
March 13, 2013

INTERNAL CONTROL OVER FINANCIAL REPORTING

Auditing standards require that we perform procedures to obtain an understanding of your government and its internal control environment as part of the annual audit. This includes an analysis of the village's year-end financial reporting process and preparation of your financial statements. A properly designed system of internal control allows for the presentation of year-end financial data and financial statements without material errors. At this time, the village does not have internal controls in place that allow for the presentation of materially correct year-end financial statements. As a result, we consider this absence of controls to be a material weakness in internal control over the village's financial reporting.

To provide some perspective, establishment of such internal controls can be a difficult task for governments. Many governments do rely on their auditors to prepare certain year-end adjusting entries and prepare the year-end financial statements. Because the auditors are not involved with the village's day-to-day activities, it is important that management have the skills, knowledge, and experience to review the audit adjustments and financial statements prepared by the auditors to ensure completeness, accuracy, and consistency with management's knowledge of transactions impacting the village during the year.

INTERNAL CONTROL ENVIRONMENT

Auditing standards require that we perform procedures to obtain an understanding of your government and its internal control environment as part of the annual audit. This includes an analysis of significant transaction cycles. A properly designed system of internal control includes adequate staffing, policies, and procedures to properly segregate duties. This includes systems that are designed to limit the access or control of any one individual to your government's assets, and to achieve a higher likelihood that errors or irregularities in your processes would be discovered by your staff. At this time, the village does not have internal controls in place to achieve adequate segregation of duties. As a result, there is a material weakness related to the village's internal control environment.

There are also other key controls related to significant transaction cycles that are important in reducing the risk of errors or irregularities. At this time, the village does not have the following controls in place:

CONTROLS OVER ACCOUNTS PAYABLE/DISBURSEMENTS

1. Retainages and encumbrances need to be reviewed, approved, and recorded at year end.

CONTROLS OVER PAYROLL

1. There should be review and approval of changes in pay rates in the payroll system.

CONTROLS OVER PROPERTY TAXES

1. Taxes receivable and tax settlements should be reviewed and approved by someone independent of the process.
2. The bank account should be reconciled by someone independent of the tax collection process.

INTERNAL CONTROL ENVIRONMENT (cont.)

CONTROLS OVER UTILITY BILLING

1. The governing body should formally approve all write off's of accounts and adjustments to bills over an amount agreed upon by the board.
2. The process for generating utility bills and maintaining billing records is not independent of the collection function.
3. There should be a review of billing rates by someone independent of the billing function.

CONTROLS OVER FINANCIAL REPORTING

1. Account reconciliations should be prepared by someone independent of the processing of transactions in the account.
2. Adjusting journal entries should be reviewed and approved by someone independent of the transaction.

ENTITY WIDE AND INFORMATION TECHNOLOGY CONTROLS

The village has not undergone a formal risk assessment process. This type of evaluation can help to identify where the village is more susceptible to fraud, misappropriation of assets, or fraudulent financial reporting.

The general ledger software package allows equal access rights to all users. This creates opportunities for any user to create journal entries, post transactions and print checks. Ideally, the user's access should be limited to their corresponding job duties. In addition, there is no review of security logs indicating who has accessed the accounting system. This type of review should be performed to verify unauthorized users did not access the system.

The village runs back-ups of their data regularly, but stores the backup data onsite. The village should consider storing back-up data offsite.

The village does not have a formal password policy that requires users to create sophisticated passwords to prevent unauthorized users from accessing the system. We recommend the village adopt a password policy including length and character requirements. Passwords should be changed at least every 60 to 90 days, and password history and lockout requirements should also be addressed.

The village's present software system lacks certain security features that, if operated improperly, would not allow for the identification of changes made to financial data after the original entry of such data. This is a situation that exists in many database software packages, including Microsoft Office Access, which is the basis for your software. Many of the system users may not possess the technical knowledge to operate the system in a manner that would impair the system's control integrity. However, it is possible that some users may possess the knowledge to circumvent the system's controls. Therefore, it is our judgment that there is more than a remote possibility that an error could occur in amounts that are more than insignificant, and your controls would not detect them. Accordingly, we are required to communicate this fact to you.

The absence of these key controls is considered to be a material weakness.

Achieving adequate segregation of duties may not be cost beneficial to attain in all situations. However, it is very important that management and the governing body provide the appropriate level of financial oversight to the village's day-to-day activities. We recommend that the village consider the benefits of implementing additional policies and procedures to address key controls related to its significant transaction cycles, as noted above.

OTHER COMMUNICATIONS WITH THOSE CHARGED WITH GOVERNANCE

TWO WAY COMMUNICATION REGARDING YOUR AUDIT

As part of our audit of your financial statements, we are providing communications to you throughout the audit process. Auditing requirements provide for two-way communication and are important in assisting the auditor and you with more information relevant to the audit.

As this past audit is concluded, we use what we have learned to begin the planning process for next year's audit. It is important that you understand the following points about the scope and timing of our next audit:

- a. We address the significant risks of material misstatement, whether due to fraud or error, through our detailed audit procedures.
- b. We will obtain an understanding of the five components of internal control sufficient to assess the risk of material misstatement of the financial statements whether due to error or fraud, and to design the nature, timing, and extent of further audit procedures. We will obtain a sufficient understanding by performing risk assessment procedures to evaluate the design of controls relevant to an audit of financial statements and to determine whether they have been implemented. We will use such knowledge to:
 - > Identify types of potential misstatements.
 - > Consider factors that affect the risks of material misstatement.
 - > Design tests of controls, when applicable, and substantive procedures.

We will not express an opinion on the effectiveness of internal control over financial reporting or compliance with laws, regulations, and provisions of contracts or grant programs. For audits done in accordance with *Government Auditing Standards*, our report will include a paragraph that states that the purpose of the report is solely to describe (a) the scope of testing of internal control over financial reporting and compliance and the result of that testing and not to provide an opinion on the effectiveness of internal control over financial reporting or on compliance, (b) the scope of testing internal control over compliance for major programs and major program compliance and the result of that testing and to provide an opinion on compliance but not to provide an opinion on the effectiveness of internal control over compliance and, (c) that the report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering internal control over financial reporting and compliance. The paragraph will also state that the report is not suitable for any other purpose.

- c. The concept of materiality recognizes that some matters, either individually or in the aggregate, are important for fair presentation of financial statements in conformity with generally accepted accounting principles while other matters are not important. In performing the audit, we are concerned with matters that, either individually or in the aggregate, could be material to the financial statements. Our responsibility is to plan and perform the audit to obtain reasonable assurance that material misstatements, whether caused by errors or fraud, are detected.

TWO WAY COMMUNICATION REGARDING YOUR AUDIT (cont.)

We are very interested in your views regarding certain matters. Those matters are listed here:

- a. We typically will communicate with your top level of management unless you tell us otherwise.
- b. We understand that the village board has the responsibility to oversee the strategic direction of your organization, as well as the overall accountability of the entity. Management has the responsibility for achieving the objectives of the entity.
- c. We need to know your views about your organization's objectives and strategies, and the related business risks that may result in material misstatements.
- d. Which matters do you consider warrant particular attention during the audit, and are there any areas where you request additional procedures to be undertaken?
- e. Have you had any significant communications with regulators or grantor agencies?
- f. Are there other matters that you believe are relevant to the audit of the financial statements?

Also, is there anything that we need to know about the attitudes, awareness, and actions of the village concerning:

- a. The village's internal control and its importance in the entity, including how those charged with governance oversee the effectiveness of internal control?
- b. The detection or the possibility of fraud?

We also need to know if you have taken actions in response to developments in financial reporting, laws, accounting standards, governance practices, or other related matters, or in response to previous communications with us.

With regard to the timing of our audit, here is some general information. If necessary, we may do preliminary audit work during the months of October-December, and sometimes early January. Our final fieldwork is scheduled during the spring to best coincide with your readiness and report deadlines. After fieldwork, we wrap up our audit procedures at our office and may issue drafts of our report for your review. Final copies of our report and other communications are issued after approval by your staff. This is typically 6-12 weeks after final fieldwork, but may vary depending on a number of factors.

Keep in mind that while this communication may assist us with planning the scope and timing of the audit, it does not change the auditor's sole responsibility to determine the overall audit strategy and the audit plan, including the nature, timing, and extent of procedures necessary to obtain sufficient appropriate audit evidence.

We realize that you may have questions on what this all means, or wish to provide other feedback. We welcome the opportunity to hear from you.

**COMMUNICATION OF OTHER CONTROL DEFICIENCIES, RECOMMENDATIONS
AND INFORMATIONAL POINTS TO MANAGEMENT THAT ARE NOT
MATERIAL WEAKNESSES OR SIGNIFICANT DEFICIENCIES**

UTILITY RECOMMENDATIONS

WATER UTILITY

Earnings

2010 operating income increased to \$41,500 from \$4,600 in the prior year. The rate of return using the PSC's calculation was 0.3% compared to 2009 at (2%). This increase is due to the rate increase approved by the PSC, which became effective September 27, 2010. The new rates are designed to earn a rate of return of 2.75%, and additional revenues of \$72,600 once the rates are effective for a full year. The rate increase was much lower than what the PSC would allow in order to keep impacts on customers as low as possible. The rates only allow for a minimal amount of cash flows each year so the utility will need to keep costs low in order to maintain the financial health of the utility.

Status (12/31/12)

Operating income in 2012 improved by \$21,800 to \$103,500 due to a slight increase in water sold. The utility should qualify for a Simplified Rate Case (SRC) that would allow for a cost of living adjustment in water rates. We recommend that an application be filed with the PSC in March or April of 2013 to help rates keep pace with inflation. The SRC process would allow for a 3% increase in water rates.

LAND HELD FOR FUTURE USE

In the past, the Water Utility purchased land for a future well or tower. The value of this land is on the water utility books as land held for future use. We understand from management this land is located by Blaser Park and the certainty of when a well or tower would be constructed here is in question. We recommend the utility determine if this land is feasible for a water well or tower and if so, how far in the future may that be. If the land is unlikely to be used for water utility purposes, the value of the land needs to be eliminated from the utility books. In that case, the Village should consider the best use for the property, internal use or external sale, and account for the land in that manner.

Status (12/31/12)

This recommendation still pertains.

SEWER UTILITY

Earnings

The utility had operating income of \$31,000 in 2010, compared to \$62,200 in 2009. The decrease in operating income is due to the depreciation on the new WWTP. The utility is required to meet debt coverage requirements for the CWF loans. When the rates were developed, there was a reliance on connection fees to cover a portion of the debt service. Since collections will be dependent on growth, which is out of your control, the village will need to continue to monitor revenues closely to ensure debt coverage is met. Debt coverage for 2010 was not met by \$117,697. The utility used surplus funds to cover the shortfalls in 2010 and 2009. The village should continue to monitor the debt service and cash flow requirements to ensure these are being met in the future, as surplus funds won't be available long term.

UTILITY RECOMMENDATIONS (cont.)

SEWER UTILITY (cont.)***Status (12/31/12)***

Debt coverage for 2012 was not met by \$107,911. The utility used surplus funds to cover the shortfall in 2012. The utility should update the cash flow forecast to determine the timing of rate increases as the surplus funds begin to deplete. The above recommendation still pertains.

DEBT LIMIT RECOMMENDATION

As of December 31, 2009, the village was at 68% of its general obligation debt limit, established by state statutes as 5% of your equalized value. However, in 2010, the village is anticipating various increases in the G.O. debt outstanding as a result of refinancing the existing bond anticipation notes and borrowing for 2010 capital projects.

Based on these additional commitments, we are estimating the village's G.O. debt outstanding to grow to approximately \$8.4 million by the end of 2010. Assuming no change in equalized value, this will put the village at about 89% of the debt limit, with less than \$1 million of G.O. debt capacity. Additionally, this estimate does not include any borrowing for TIF district No. 4 and No. 5 as outlined in the project plans for the districts.

We strongly encourage the village to evaluate the current debt position, short and long-term borrowing plans, and future capital projects. We are happy to further assist you with this process.

Status (12/31/12)

As of December 31, 2012, the village was at 79% of its debt limit. We continue to recommend the village monitor its debt capacity and future borrowing needs.

DEPARTMENTAL CONTROLS

As part of our annual audit process, we focus our efforts on the primary accounting systems, internal controls, and procedures used by the village. This is in keeping with our goal to provide an audit opinion which states that the financial statements of the village are correct in all material respects.

In some cases, the primary system of accounting procedures and controls of the village are supported by smaller systems which are decentralized, and reside within a department or location. In many cases, those systems are as simple as handling cash collections and remitting those collections to the village treasurer. In other cases, the department may send invoices or statements of amounts due, and track collections of those amounts in a standalone accounts receivable system.

Generally, the more centralized a function is, the easier it is to design and implement accounting controls that provide some level of checks and balances. That is because you are able to divide certain tasks over the people available to achieve some segregation of duties. For those tasks that are decentralized, it is usually very difficult to provide for proper segregation of duties. Therefore, with one person being involved in most or all aspects of a transaction, you lose the ability to rely on the controls to achieve the safeguarding of assets and reliability of financial records.

DEPARTMENTAL CONTROLS (cont.)

As auditors, we are required to communicate with you on a variety of topics. Since there is now more emphasis on internal controls and management's responsibilities, we believe it is appropriate to make sure that you are informed about the lack of segregation of duties that may occur at departments or locations that handle cash or do miscellaneous billing. Examples in your village that fit this situation may include the following:

- Library
- Police Department

As you might expect, similar situations are common in most governments.

As auditors, we are required to focus on the financial statements at a highly summarized level and our audit procedures support our opinion on those financial statements. Departments or locations that handle relatively smaller amounts of money are not the primary focus of our audit. Yet, because of the lack of segregation of duties, the opportunity for loss is higher there than in centralized functions that have more controls.

Because management is responsible for designing and implementing controls and procedures to detect and prevent fraud, we believe that is important for us to communicate this information to you. We have no knowledge of any fraud that has occurred or is suspected to have occurred within the departments mentioned above. However, your role as the governing body is to assess your risk areas and determine that the appropriate level of controls and procedures are in place. As always, the costs of controls and staffing must be weighed against the perceived benefits of safeguarding your assets.

INFORMATIONAL POINTS

GENERAL FUND BALANCE

Following is the general fund balance of the village for the last five years:

	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
General Fund					
Nonspendable	\$ 90,567	\$ 118,047	\$ 127,392	\$ 238,096	\$ 395,040
Committed/Assigned	3,408	12,733	67,316	77,739	53,557
Unassigned	<u>490,949</u>	<u>456,974</u>	<u>340,204</u>	<u>282,234</u>	<u>100,258</u>
Totals	<u>\$ 584,924</u>	<u>\$ 587,754</u>	<u>\$ 534,912</u>	<u>\$ 598,069</u>	<u>\$ 548,855</u>

As evident in the numbers above, the general fund has experienced a significant shift in fund balance from unassigned to nonspendable in the last five years.

INFORMATIONAL POINTS (cont.)

GENERAL FUND BALANCE (cont.)

Nonspendable fund balance primarily includes funds that have been advanced (loaned) to other funds for cash flow purposes. The amount has grown considerably because of the increasing deficit of TIF District No. 3. At December 31, 2012, \$253,935 is advanced by the general fund to the TIF Districts (of which \$222,947 is TIF District No. 3). Also included in this amount is \$53,290 advanced to Storm water and \$76,456 advanced to Waste Management.

While it is intended these advances will be repaid, until they are able to be, the general fund cannot consider the funds available for use. As a result, the unassigned (available) fund balance has shrunk to \$100,258, or roughly 11% of the subsequent year's budgeted expenditures. That percentage is generally viewed as below levels recommended by financial advisors and debt rating agencies.

The village will need to closely monitor its financial results throughout 2013. The financial results of other funds are directly impacting the general fund balance, and therefore, monitoring the results of all funds is critical. Long range financial planning is also important. We are available to assist with this.

UNITED STATES AUDITING STANDARDS REVISIONS

In an effort to make US generally accepted auditing standards (GAAS) easier to read, understand, and apply, the American Institute of CPAs redrafted all of the auditing sections in the Codification of Statements on Auditing Standards. This is also known as the Clarity Project. The new standards are intended to more clearly specify the objectives of the auditor and the requirements with which the auditor must comply when conducting an audit in accordance with GAAS.

Generally speaking, the Clarity Project was not intended to change what auditors actually do. However, there were several areas that resulted in changes to audit procedures. The following outlines some of the changes / areas of emphasis affecting your audit:

- Consideration of Laws and Regulations – The clarified standards require auditors to perform procedures to identify instances of noncompliance with those laws and regulations that may have a material effect on the financial statements, including the inspection of correspondence with relevant licensing or regulatory authorities.
- Communicating Internal Control Related Matters – The clarified standards require auditors to include an explanation of the potential effects of significant deficiencies and material weaknesses identified and communicated to those charged with governance.
- Auditors' Reports – The Auditors' Report will now include the use of headings, expanded discussions of management's responsibility for the financial reporting process, and the introduction of two new terms: *emphasis-of-matter* and *other-matter* paragraphs. These changes became effective for the year ending December 31, 2012 and subsequent years.