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March 8, 2010

To Stoughton Utilities Committee  
600 South Fourth Street  
Stoughton, WI 53589

Dear Committee Members:

We are presenting for your consideration our comments and recommendations that are intended to improve the system of internal control or promote other operating efficiencies. These matters came to our attention during our audit of the financial statements of Stoughton Utilities (utilities) for the year ended December 31, 2009 which we reported upon on March 8, 2010.

This letter, by its nature, focuses on improvements and does not comment on the many strong areas of the utilities' systems and procedures. The comments and suggestions in this letter are not intended to reflect in any way on the integrity or ability of the personnel responsible for the utilities' operations. They are made solely in the interest of establishing sound internal control practices and improving the utilities' operations.

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

#### **ELECTRIC UTILITY OPERATING RESULTS**

The electric utility's operating income decreased in 2009 to \$828,000 compared to \$886,000 in 2008. Operating revenues and expenses decreased \$117,000 and \$59,000 respectively in 2009 due to lower electric sales and lower purchased power cost. The total kWh sold decreased 6%.

The electric utility's rate of return was 5.21% in 2009 compared to a rate of return of 6.12% in 2008. Electric rates were last changed in January 2007. Management needs to continue to monitor earnings, reserves, and capital plans to evaluate the proper timing for a rate application.

#### **WATER UTILITY OPERATING RESULTS**

The water utility's operating income increased in 2009 to \$272,000 compared to \$230,000 in 2008. The water utility sold 2% fewer gallons in 2009 compared to 2008. Operating expense decreased \$11,000 in 2009 due to decreases in employee benefits.

The water utility's rate of return was 2.34% in 2009 compared to an authorized rate of return of 6.50%. The utility was authorized a 14% increase in water rates effective October 1, 2009.

#### **WASTEWATER UTILITY OPERATING RESULTS**

The wastewater utility's operating income increased in 2009 to \$701,000 compared to \$753,000 in 2008. Operating revenues increased \$15,000 due to increases in sewer surcharge revenue. While there was an overall increase in wastewater revenues, there was a decrease in retail revenues based on water consumption. We recommend the utility considered reviewing wastewater service rates which were last revised in 2007.

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## CURRENT YEAR COMMENTS

### *INFORMATION TECHNOLOGY GENERAL CONTROLS*

As part of our audit, we evaluated the information technology controls as they relate to financially significant applications. Our procedures primarily focused on documenting and evaluating general computer controls, including:

- > Logical access to data and applications
- > Systems development and deployment
- > Change and incident management
- > Data backup and recovery

We note that the utility is in a unique situation where many of these functions are performed by WPPI Energy. WPPI Energy is not a typical third party service provider, rather the utility is a member of this organization. This results in WPPI Energy having a vested interest in the integrity of the utility's systems and financial data. As such the typical service level agreement and service provider standards may not be deemed necessary by utility management.

Although WPPI Energy provides IT services for the utility the utility is still responsible for the function and accuracy of IT information maintained by WPPI Energy. During 2009 WPPI Energy created the *Informational Services General Controls* document which was provided to utility management. This document provides the utility with an understanding of the controls in place at WPPI Energy as well as the responsibilities of the utility to ensure the integrity of financial data. For example, the document outlines the authorization and access policies for WPPI Energy IT staff to the member databases and servers. The document also outlines the utility's responsibility to ensure access is limited to authorized personnel on the local level. We encourage management to review the document to ensure the utility is meeting its responsibilities and to address any questions with your WPPI Energy representative.

### *GASB NO. 51 ACCOUNTING AND FINANCIAL REPORTING FOR INTANGIBLE ASSETS*

In June 2007, the Governmental Accounting Standards Board issued Statement No. 51 *Accounting and Financial Reporting for Intangible Assets*. The purpose of this standard was to establish accounting and reporting standards for intangible assets and reduce the inconsistencies, particularly in the areas of recognition, measurement, and amortization, which have resulted since the inclusion of intangible assets in the description of capital assets in Statement No. 34.

Statement No. 51 provides guidance to define and identify intangible assets. The following items are some examples of intangible assets (not all inclusive) that are commonly found in utilities:

- > Easements
- > Computer software
- > Air rights or pollution permits
- > Plant capacity (in facilities which are not owned by the entity)
- > Water rights
- > Natural resource rights

The standard outlines that assets meeting the above definition must be recorded at historical cost or the estimated fair value at the time of acquisition, classified as capital assets in the statement of net assets and included in the capital assets footnote, segregated as a separate class of asset if significant and amortized over the contractual period or useful life.

The provisions of this standard are required to be implemented prospectively only for governments of your size.

This standard is effective for periods beginning after June 15, 2009. We are available to discuss with management the specific steps needed to ensure you are ready for implementation.

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## **PRIOR YEAR COMMENTS**

### ***DEPOSITORY SECURITY***

We noted during the audit that the utilities have deposits at financial institutions above the current FDIC insurance limits. We understand that the utilities along with the city have obtained a collateral pledge from the bank to secure such deposits. We recommend management work with the city to ensure that the collateral pledge remains adequate throughout the year.

#### ***Status 12/31/2009***

In 2009 the insurance or depository agreements were reduced to \$5,292,470 compared to \$12,608,000 in 2008.

### ***INVESTMENT POLICY***

Currently, the utilities have an investment policy that states you can only invest in securities that have a rating by one of the national rating agencies in either of the top two categories. This policy mirrors state statutes on allowable investments. We noted that the utilities held several securities at December 31, 2008 which had dropped below that rating level. When these securities were purchased they met the requirements of the investment policy. We recommend that the utilities develop and implement a policy for ongoing review of the securities in its investment portfolio to ensure investments remain in compliance with your investment policy and state statutes. This would consider the proper balance between protecting the principal of investments, potential future earnings and the acceptable level of risk determined by the governing body.

#### ***Status 12/31/2009***

Management noted one investment which had an A2 rating for much of 2009, however as of year end it was rated Aa2.

### ***AGING ACCOUNTS RECEIVABLE***

During the 2008 audit we noted that accounts receivable over 90 days past due has increased by 50% over the prior year. Further discussions with management noted that the current economy has slowed customer payments and that the current process of sending three late notices and then sending the accounts to collections for at least six months prior to the use of the tax roll option delays the time until these accounts are placed on the tax roll. Management may want to review this process to ensure that collections are not being delayed unnecessarily or that delinquent customers are not able to file for bankruptcy in the time that the account is in collections.

#### ***Status 12/31/2009***

Stoughton Utilities added a collections specialist position in 2009. As a result, the accounts receivable over 90 days past due decreased by 28% compared to prior year. Additionally, overall accounts receivables balance decreased by 8% compared to last year.

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## **PRIOR YEAR COMMENTS (cont.)**

### ***TREATMENT OF EXCESS SEWER VOLUMES***

An analysis of volumes billed for sewer treatment and the total volume treated at the plant revealed that for 2008 the infiltration/inflow (I/I) level was at 38%. Although this was an improvement over the 39% I/I for 2007 this is still a significant level. We realize that 2008 was a very unusual year with the record snowfalls and heavy rains, but we recommend management begin to monitor this on a regular basis to identify when the differences occur and work to eliminate any significant leaks in the system.

#### ***Status 12/31/2009***

In 2009 the infiltration/inflow (I/I) level decreased to 31% compared to 38% in 2008. We understand management is working with a consultant on this issue, which has been determined to relate to the age of the system, and intends the complete slip lining projects in the future to address this.

### ***COMMITMENT TO COMMUNITY PROGRAM***

The electric utility retains the commitment to community program funds at the local level for both the conservation and low income programs. We noted that the program spending during 2008 was slightly higher than collections, which indicates that customers are utilizing these programs. However we also noted that the accumulated balance of \$72,000 is still a significant amount of unspent program funds, primarily in energy conservation funds. We encourage management to investigate additional programs for using these funds or promote current programs in the community for increased participation.

#### ***Status 12/31/2009***

During 2009 disbursements were \$5,000 lower than collections. As a result the accumulated balance grew slightly to \$106,000 compared to \$101,000 in 2008. Management is investigating additional programs for using these funds or promote current programs in the community for increased participation.

## **INTERNAL CONTROLS**

Planning and performing our audit of the financial statements of the Stoughton Utilities as of and for the year ended December 31, 2009, in accordance with auditing standards generally accepted in the United States of America, includes considering 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 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, there can be no assurance that all such deficiencies have been identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies.

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 identified the following deficiency in internal control that we consider to be a material weakness:

- > Financial Reporting

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**INTERNAL CONTROLS (cont.)**

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the following deficiencies in the Stoughton's internal control to be significant deficiencies:

- > Segregation of Duties

***FINANCIAL REPORTING***

Accounting standards require that the utilities have in place systems and controls to prepare and review a complete set of year-end financial statements, including the statement of cash flows and all required footnotes, such that there is only a remote likelihood that the auditor will discover a material change to the statements or footnotes. In prior years management has relied upon the auditor for the preparation of such statements. This year management prepared the initial draft of the statements including the statements of cash flows and the footnotes. This is no small undertaking and as such we commend management for this. During our audit we did note a few items that needed to be reclassified, added or updated in the financial statement presentation, some of which were material. As such we must report a material weakness in financial reporting for this year. Very few governments are able to prepare statements requiring no alterations by the auditors, however we will re-evaluate this area again next year.

***SEGREGATION OF DUTIES***

Our review of internal control disclosed a significant deficiency in that segregation of duties is not feasible due to the limited number of staff in the office. For example, the same person is involved in handling cash and bookkeeping.

This situation necessitates an increased amount of management involvement in the day-to-day operation of the system. This is not unusual in utilities of your size, but management should continue to be aware of this condition and realize that the concentration of duties and responsibilities in a limited number of individuals is not desirable from a control point of view.

Procedures, designed to improve controls, have been established by management including:

- > Authorization of official depository.
- > Review and acceptance of the audit report and management letter.
- > Authorization of capital expenditures.
- > Approval of annual budgets.
- > Cross training of personnel and rotation of duties entailing custody of certain liquid assets.

These procedures are helpful in assuring that management is knowledgeable of and involved with the day-to-day system operations.

Although the above items are beneficial, you should be aware that the following additional controls have not been implemented:

- > Review of the year end accrued payroll
- > Reviews of the monthly receivable reconciliations
- > Review of the reconciliation of open work orders to the construction balance in the ledger

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## **COMMUNICATIONS TO UTILITIES COMMITTEE**

We have completed our audit of the financial statements of Stoughton Utilities for the year ended year ended December 31, 2009 and have issued our report thereon dated March 8, 2010. This letter presents communications required by our professional standards.

### ***OUR RESPONSIBILITY UNDER AUDITING STANDARDS GENERALLY ACCEPTED IN THE UNITED STATES OF AMERICA***

The objective of a financial statement audit is the expression of an opinion on the financial statements. We conducted the audit in accordance with auditing standards generally accepted in the United States of America. These standards require that we plan and perform our audit to obtain reasonable, rather than absolute, assurance about whether the financial statements prepared by management with your oversight are free of material misstatement, whether caused by error or fraud. Our audit included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit does not relieve management or the Utilities Committee of their responsibilities.

As part of the audit we obtained an understanding of the entity and its environment, including internal control, sufficient to assess the risks of material misstatement of the financial statements and to design the nature, timing and extent of further audit procedures. The audit was not designed to provide assurance on internal control or to identify deficiencies in internal control.

### ***OTHER INFORMATION IN DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS***

Our responsibility does not extend beyond the audited financial statements identified in this report. We do not have any obligation to and have not performed any procedures to corroborate other information contained in client prepared documents, such as official statements related to debt issues.

### ***PLANNED SCOPE AND TIMING OF THE AUDIT***

We performed the audit according to the planned scope and timing previously communicated to you in our city-wide letter about planning matters.

### ***QUALITATIVE ASPECTS OF THE ENTITY'S SIGNIFICANT ACCOUNTING PRACTICES***

#### ***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 utilities are described in Note 1 to the financial statements. We noted no transactions entered into by the utilities 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.

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**COMMUNICATIONS TO UTILITIES COMMITTEE (cont.)**

***QUALITATIVE ASPECTS OF THE ENTITY'S SIGNIFICANT ACCOUNTING PRACTICES (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. The most sensitive estimate affecting the financial statements were the accrual of compensated absences and fair value of the ATC investment. We have reviewed managements' assumptions and methodologies for this.

***Financial Statement Disclosures***

The disclosures in the financial statements are neutral, consistent, and clear.

***DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT***

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

***AUDIT ADJUSTMENTS***

Professional standards require us to accumulate all known and likely misstatement identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management.

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 utilities' financial reporting process. Matters underlying adjustments proposed by the auditor could potentially cause future financial statements to be materially misstated. We did not have audit adjustments to the financial statements.

***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. If a consultation involves application of an accounting principle to the governmental unit's 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.

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**COMMUNICATIONS TO UTILITIES COMMITTEE (cont.)**

***MANAGEMENT REPRESENTATIONS***

We have requested certain representations from management that are included in the management representation letter. This letter is attached.

***INDEPENDENCE***

We are not aware of any relationships between Baker Tilly Virchow Krause, LLP that, in our professional judgment, may reasonably be thought to bear on our independence.

Relating to our audit of the financial statements of for the year ended December 31, 2009, Baker Tilly Virchow Krause, LLP hereby confirms in accordance with the Code of Professional Conduct issued by the American Institute of Certified Public Accountants, that we are, in our professional judgment, independent with respect to the Stoughton Utilities and provided no services to the utilities other than audit services provided in connection with the audit of the current year's financial statements.

***OTHER AUDIT FINDINGS OR ISSUES***

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 Utilities' auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

We welcome the opportunity to discuss the information included in this letter and any other matters. Thank you for allowing us to serve you.

Sincerely,

BAKER TILLY VIRCHOW KRAUSE, LLP

*Baker Tilly Virchow Krause LLP*





**Stoughton Utilities**

600 South Fourth Street  
P.O. Box 383  
Stoughton, WI 53589-0383

*Serving Electric, Water & Wastewater Needs Since 1886*

February 11, 2010

Baker Tilly Virchow Krause, LLP  
Ten Terrace Court  
P.O. Box 7398  
Madison, WI 53707

Dear Auditors:

We are providing this letter in connection with your audit of the financial statements of the Stoughton Municipal Utilities as of December 31, 2009 and 2008 and for the years then ended for the purpose of expressing an opinion as to whether the financial statements present fairly, in all material respects, the respective financial position, results of operations, and cash flows of the Stoughton Municipal Utilities in conformity with accounting principles generally accepted in the United States of America. We confirm that we are responsible for the fair presentation in the financial statements of financial position, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material regardless of size, if they involve an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

We confirm, to the best of our knowledge and belief, the following representations made to you during your audit.

1. The financial statements referred to above are fairly presented in conformity with accounting principles generally accepted in the United States of America.
2. We have made available to you all –
  - a. Financial records and related data.
  - b. Minutes of the meetings of our governing body and summaries of actions of recent meetings for which minutes have not yet been prepared.
3. There have been no communications from regulatory agencies concerning noncompliance with, or deficiencies in, financial reporting practices.



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4. There are no material transactions that have not been properly recorded in the accounting records underlying the financial statements.
5. There are no uncorrected financial statement misstatements to be included on a schedule of uncorrected financial statement misstatements.
6. We acknowledge our responsibility for the design and implementation of programs and controls to prevent and detect fraud.
7. We have no knowledge of any fraud or suspected fraud affecting the entity involving:
  - a. Management,
  - b. Employees who have significant roles in internal control, or
  - c. Others where the fraud could have a material effect on the financial statements.
8. We have no plans or intentions that may materially affect the carrying value or classification of assets, liabilities or fund equity.
9. The following, if any, have been properly recorded or disclosed in the financial statements:
  - a. Joint ventures
  - b. Related party transactions, including revenues, expenses, loans, transfers, leasing arrangements, and guarantees, and amounts receivable from or payable to related parties.
  - c. Collateralization agreements with financial institutions.
  - d. Guarantees, whether written or oral, under which the utility is contingently liable.
  - e. All accounting estimates that could be material to the financial statements, including the key factors and significant assumptions underlying those estimates, and we believe the estimates are reasonable in the circumstances.
10. We are responsible for compliance with the laws, regulations, and provisions of contracts and grant agreements applicable to us, including debt contracts and debt covenants; and we have identified and disclosed to you all laws, regulations and provisions of contracts and grant agreements that we believe have a direct and material effect on the determination of financial statement amounts, including legal and contractual provisions for reporting specific activities in separate funds.
11. There are no –
  - a. Violations or possible violations of budget ordinances, provisions of contracts and grant agreements, laws or regulations and any related debt covenants whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency.
  - b. Rates being charged to customers other than the rates as authorized by the applicable authoritative body.
  - c. Violations of restrictions placed on revenues as a result of a bond resolution covenants – such as revenue distribution, or debt service funding.

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- d. Unasserted claims, assessments or pending lawsuits that our lawyer has advised us are probable of assertion and must be disclosed in accordance with Financial Accounting Standards Board (FASB) Statement No. 5, Accounting for Contingencies.
- e. Other material liabilities or gain or loss contingencies that are required to be accrued or disclosed by Statement of Financial Accounting Standards No. 5.
- 12. Provision, when material, has been made to reduce excess or obsolete inventories to their estimated net realizable value.
- 13. We have satisfactory title to all owned assets, and there are no liens or encumbrances on such assets nor has any asset been pledged as collateral other than liens created by our revenue debt.
- 14. We have complied with all aspects of contractual agreements that would have a material effect on the financial statement in the event of noncompliance.
- 15. Net asset components (invested in capital assets, net of related debt; restricted; and unrestricted) are properly classified.
- 16. Provisions for uncollectible receivables have been properly identified and recorded.
- 17. Interfund activity and balances have been appropriately classified and reported.
- 18. Special and extraordinary items are appropriately classified and reported.
- 19. Deposits and investment securities are properly classified in category of custodial credit risk.
- 20. Capital assets are properly capitalized and depreciated.
- 21. Required supplementary information (RSI) is measured and presented within prescribed guidelines.
- 22. With regards to the Commitment to Community report, we are responsible for the preparation of the report including its accuracy, completeness and timely filing with the PSCW. We believe this report to be complete and accurate as prepared by WPPi.
- 23. We understand that, as part of your audit, you prepared and acknowledge that we have reviewed and approved those entries and understand the impact on the financial statements.

To the best of our knowledge and belief, no events, including instances of noncompliance, have occurred subsequent to December 31, 2009 and through the date of this letter that would require adjustment to, or disclosure in, the aforementioned financial statements.

Signed: Robert P. Kunkley

Title/Date: UTILITIES DIRECTOR 2/11/10

Signed: Kim M. J.

Title/Date: Finance & Admin. Manger 2/11/10