

**WATER AND SEWERAGE SYSTEM OF
DUPAGE COUNTY, ILLINOIS**

An Enterprise Fund of the
DuPage County, Illinois

COMMUNICATION TO THOSE CHARGED
WITH GOVERNANCE AND MANAGEMENT

As of and for the Year Ended November 30, 2013

WATER AND SEWERAGE SYSTEM OF DUPAGE COUNTY, ILLINOIS

TABLE OF CONTENTS

	<u>Page No.</u>
Introductory Letter	1
Required Communication of Internal Control Related Matters Identified in the Audit to Those Charged with Governance	
Financial Reporting	2 – 3
Controls Over Utility Billing and Receipting	3
Other Communications to Those Charged with Governance	
Two Way Communication Regarding Your Audit	4 – 5
Communication of Recommendations and Informational Points to Management that are not Material Weaknesses or Significant Deficiencies	
Recommendations / Professional Standards Update	
Revenue Bond Proceeds	6
Capital Assets Capitalization Policy	6
GASB Statement No. 68: Accounting and Financial Reporting for Pensions	6 – 7
Required Communications by the Auditor to Those Charged with Governance	8 – 11
Management Representations	



Baker Tilly Virchow Krause, LLP
1301 W 22nd St, Ste 400
Oak Brook, IL 60523-3389
tel 630 990 3131
fax 630 990 0039
bakertilly.com

May 9, 2014

To the Honorable Chairman and Members
of the County Board
DuPage County, Illinois

Dear Honorable Chairman and Members of the County Board:

This report includes our management letter and SAS No. 114 communication related to the November 30, 2013 financial audit of the Water and Sewerage System of DuPage County, Illinois (System).

PURPOSE OF REPORT

The purpose of this report is to provide information to the County Board and system management in a concise and easy to follow manner. It is intended to focus on what we believe matters most to you.

The report contains our required communications related to internal controls, our SAS No. 114 communications, as well as our management letter comments and recommendations.

If you feel that additions or revisions of this report would help you in your oversight duties, we would be happy to work with you to accomplish these changes.

This report is intended solely for the DuPage County Board and management of the System and is not intended to be, and should not be, used by anyone other than these specified parties.

We would like to again commend the System for their active role in discussing our prior years' recommendations and implementing additional controls to strengthen the internal control system in a cost effective manner. As you will see in the pages to follow the reportable control findings reflect those the System has determined would be cost prohibitive to change and no additional findings have been reported compared to the prior year.

The Baker Tilly Virchow Krause, LLP team members that performed the System's audit this year were Vicki Hellenbrand (Engagement Partner), Wendi Unger, (Independent Pre-Issuance Reviewer), Joe Lightcap (Senior Manager), and Amanda O'Connor (Senior Accountant). If you have any questions on our comments, or if we can offer our services in any other way during the year, please don't hesitate to contact us. Thank you for allowing us to serve you.

Sincerely,

BAKER TILLY VIRCHOW KRAUSE, LLP

Baker Tilly Virchow Krause, LLP

Enclosures

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

To the Honorable Chairman and Members
of the County Board
DuPage County, Illinois

In planning and performing our audit of the financial statements of the Water and Sewerage System of DuPage County, Illinois (System) as of and for the year ended November 30, 2013, 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 an 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 material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified a deficiency in internal control that we consider to be a material weakness and another deficiency that we consider to be a significant deficiency.

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 deficiency in the System's internal control to be a material weakness:

> Financial Reporting

In theory, a properly designed system of internal control staffed with enough people with sufficient training would provide your organization with the ability to not only process and record monthly transactions, but also to prepare a complete set of annual financial statements including the implementation of new standards and all related disclosures. In practice, very few local governments have the skill or time required to prepare annual financial statements.

To avoid the auditor reporting a material weakness in internal control, your system of controls would need to be able to accomplish the following:

1. Present the books and records to the auditor in such a condition that the auditor is not able to identify any material journal entries as a result of our audit procedures. Accomplishing this is very rare for most of our clients.

Honorable Chairman and Members
of the County Board
DuPage County, Illinois

> Financial Reporting (cont.)

2. Prepare a complete set of year-end financial statements with a very high level of accuracy. Auditing standards require 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. If the auditor discovers any 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 rely on us to prepare certain year-end audit entries and handle the year-end financial reporting. Under the current auditing standards, we must, therefore, inform you that the item above is a material weakness in your internal control.

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 deficiency in the System's internal control to be a significant deficiency:

> Controls Over Utility Billing and Receipting

An ideal accounting system includes many procedures and controls designed to limit the access of any one individual to assets. However, the size of your entity precludes large administrative staffs or complex controls. This is not unusual for entities of your size but we are required to inform you that this condition exists. Because some of these accounting system controls do not exist, you must rely more heavily on your direct knowledge of the systems' operations and day to day contact with employees to control and safeguard assets.

There should be segregation between receipting and receivables function when possible in order to achieve a higher level of reliability that errors or irregularities in your processes would be discovered by your staff. Our procedures identified that this control does not currently exist and that the System is in the process of further segregating duties with the hiring of two additional staff in the finance department. Although complete mitigation of this control weakness may not be practical due to your staff size or other reasons we are required to communicate this to you. In addition, as you make changes within your organization, and we continue to rotate audit procedures, more controls of this kind will likely be communicated to you.

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

Baker Tilly Vinchow Krause LLP

Oak Brook, Illinois
May 9, 2014

OTHER COMMUNICATIONS TO 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 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 and 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.

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 System and System 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?

TWO WAY COMMUNICATION REGARDING YOUR AUDIT (cont.)

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

- a. The System'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. We will perform preliminary financial audit work during the months of October-December, and sometimes early January. Our final financial audit fieldwork is scheduled during March to best coincide with your readiness and report deadlines. After fieldwork, we wrap up our financial audit procedures at our office and issue drafts of our reports for your review. Final copies of our reports 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 or wish to provide other feedback. We welcome the opportunity to talk with you.

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

RECOMMENDATIONS / PROFESSIONAL STANDARDS UPDATE

REVENUE BOND PROCEEDS

As of November 30, 2013, the System had approximately \$1,500,000 in bond proceeds remaining from the series 2008A and 2008B revenue bond issuances. While the System had an arbitrage rebate calculation report performed for the period July 23, 2008 to July 23, 2013 that stated there was no arbitrage liability due on the bonds, it is our recommendation that the System consider a supplemental appropriation in fiscal year 2014 to fund projects from the bond proceeds that were originally scheduled to be paid for by the depreciation account.

CAPITAL ASSETS CAPITALIZATION POLICY

In conjunction with the County wide ERP conversion, we recommended the System review its policies related to capital assets. In particular, we recommended the System consider higher capitalization thresholds for infrastructure assets, review depreciation useful lives, and policies relating to when assets will be tagged or inventoried and how transfers of assets in and out of the System are handled. As of the date of this letter, management has made significant progress in this recommendation.

GASB STATEMENT NO. 68: ACCOUNTING AND FINANCIAL REPORTING FOR PENSIONS

The Governmental Accounting Standards Board (GASB) has issued Statement No. 68, which will change the accounting and financial reporting requirements for state and local governments that provide their employees with pensions. This Statement replaces the requirements of GASB Statement Nos. 27 and 50 as they relate to pensions that are provided through pension plans administered as trusts, or equivalent arrangements that meet certain criteria. These changes will affect your financial statements for the year ended November 30, 2016.

This Statement applies specifically to governments that provide their employees with pensions through pension plans in which a government's contributions to the trust used to administer a pension plan are (1) irrevocable, (2) restricted to paying pension benefits, and (3) beyond the reach of creditors.

Government employers that provide their employees with a defined benefit pension are classified in one of the following categories for this Statement:

- > Single employer – is an employer whose employees are provided with a defined benefit pension through a single employer pension plan
- > Agent employer – is an employer whose employees are provided with a defined benefit pension through an agent multiple employer pension plan
- > Cost-sharing employer – is an employer whose employees are provided with a defined benefit pension through a cost-sharing multiple employer pension plan

Under the new standards, in financial statements prepared using the economic resources measurement focus (accrual basis of accounting), the single or agent employer is required to recognize a liability equal to the net pension liability. The net pension liability is defined as the present value of projected benefit payments to be provided through the pension plan, to current and inactive employees, that is attributed to those employees' past periods of service (total pension liability), less the amount of the pension plan's net position.

RECOMMENDATIONS / PROFESSIONAL STANDARDS UPDATE (cont.)

GASB STATEMENT No. 68: ACCOUNTING AND FINANCIAL REPORTING FOR PENSIONS (cont.)

The new Statement contains requirements related to the actuarial cost method and certain other assumptions used in the preparation of an actuarial valuation. The Statement also requires that an actuarial valuation of the total pension liability be performed at least every two years, with more frequent valuations encouraged. In addition, this Statement also requires disclosing certain information in the notes to the financial statements, as well as presenting certain required supplementary information (RSI) for the ten most recent fiscal years.

For government employers that provide their employees with a defined contribution pension, the new standards generally carry forward the existing financial reporting requirements.

We are available to further discuss these changes and the impact on your financial statements.

REQUIRED COMMUNICATIONS BY THE AUDITOR TO THOSE CHARGED WITH GOVERNANCE

To the Honorable Chairman and Members
of the County Board
DuPage County, Illinois

Thank you for using Baker Tilly Virchow Krause, LLP as your auditor.

We have completed our audit of the financial statements of the Water and Sewerage System of DuPage County, Illinois (System) for the year ended November 30, 2013 and have issued our report thereon dated May 9, 2014. 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 those charged with governance 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 prior year Report on Internal Control dated April 15, 2013.

Honorable Chairman and Members
of the County Board
DuPage County, Illinois

QUALITATIVE ASPECTS OF THE ENTITY'S SIGNIFICANT ACCOUNTING PRACTICES

Accounting Policies

Management is responsible for the 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. As described in Note I to the financial statements, the System changed accounting policies related to deferred outflows of resources, deferred inflows of resources, and net position by adopting Statement of Governmental Accounting Standards (GASB) Statement No. 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position and GASB Statement No. 65, Items Previously Reported as Assets and Liabilities in 2013. Accordingly, the effect of the accounting change as of the beginning of the year is reported in the Statement of Net Position. We noted no transactions entered into by the 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.

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 was:

Depreciation expense

We evaluated the key factors and assumptions used to develop the expense in determining that it is reasonable in relation to the financial statements taken as a whole.

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.

CORRECTED AND UNCORRECTED MISSTATEMENTS

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. During our audit we proposed a material audit adjustment to reclassify the System's allocation adjustment to the proper objects for financial reporting and to reclassify contributed assets to a revenue account. Management has corrected all such misstatements.

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.

Honorable Chairman and Members
of the County Board
DuPage County, Illinois

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.

MANAGEMENT REPRESENTATIONS

We have requested certain representations from management that are included in the management representation letter. This letter follows this required communication.

INDEPENDENCE

We are not aware of any relationships between Baker Tilly Virchow Krause, LLP and the System 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 November 30, 2013, Baker Tilly Virchow Krause, LLP hereby confirms that we are, in our professional judgment, independent with respect to the System in accordance with the Code of Professional Conduct issued by the American Institute of Certified Public Accountants. We provided no services to the System other than audit services provided in connection with the audit of the current year's financial statements and nonaudit services which in our judgment do not impair our independence.

- > Financial statement preparation
- > Adjusting journal entries
- > Trial balance formatting from general ledger data

None of these nonaudit services constitute an audit under generally accepted auditing standards, including *Government Auditing Standards*.

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 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.

OTHER MATTERS

With respect to the supplementary information accompanying the financial statements, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

Honorable Chairman and Members
of the County Board
DuPage County, Illinois

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

The Baker Tilly Virchow Krause, LLP team members that performed the System's audit this year were Vicki Hellenbrand (Engagement Partner), Wendi Unger, (Independent Pre-Issuance Reviewer), Joe Lightcap (Senior Manager), and Amanda O'Connor (Senior Accountant). We welcome the opportunity to discuss the information included in this letter and any other matters. Thank you for allowing us to serve you.

Baker Tilly Virchow Krause, LLP

Oak Brook, Illinois
May 9, 2014