

CITY OF FREEPORT, ILLINOIS

MANAGEMENT LETTER

FOR THE FISCAL YEAR ENDED
APRIL 30, 2014



November 7, 2014

The Honorable Mayor
Members of the City Council
City of Freeport, Illinois

In planning and performing our audit of the financial statements of the City of Freeport, Illinois, for the year ended April 30, 2014, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control structure.

We do not intend to imply that our audit failed to disclose commendable aspects of your system and structure. For your consideration we herein submit our comments and suggestions which are designed to assist in effecting improvements in internal controls and procedures. Those less significant matters, if any, which arose during the course of the audit, were reviewed with management as the audit field work progressed.

The accompanying comments and recommendations are intended solely for the information and use of the Finance Committee, City Council, management, and others within the City of Freeport, Illinois.

We will review the status of these comments during our next audit engagement. We have already discussed many of these comments and suggestions with various City personnel. We would be pleased to discuss our comments and suggestions in further detail with you at your convenience, to perform any additional study of these matters, or to review the procedures necessary to bring about desirable changes.

We commend the finance department for the well prepared audit package and we appreciate the courtesy and assistance given to us by the entire City staff.

Lauterbach + Amen LLP

LAUTERBACH & AMEN, LLP

CURRENT RECOMMENDATIONS

1. **GASB STATEMENT NO. 67 FINANCIAL REPORTING FOR PENSION PLANS AND GASB STATEMENT NO. 68 ACCOUNTING AND FINANCIAL REPORTING FOR PENSIONS**

Comment

In June 2012, the Governmental Accounting Standards Board (GASB) issued Statement No. 67, *Financial Reporting for Pension Plans*, which applies to individual pension plans issuing their own audited financial statements, and Statement No. 68, *Accounting and Financial Reporting for Pensions*, which applies to the state and local government employers that sponsor pension plans. The Statements apply to the reporting of the Illinois Municipal Retirement Fund (IMRF), Police Pension Fund and Firefighters' Pension Fund for the City. The Statements establish standards for measuring and recognizing liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures related to the pension plans. The Statements specifically identify the methods and assumptions that are to be used in calculating and disclosing these pension-related accounts in the financial statements and also provide for additional note disclosures and required supplementary information. The Statements are intended to improve information provided by state and local government employers regarding financial support to their pension plans, and ultimately requires that the total net pension liabilities of the pension plans be recorded on the face of the financial statements of the sponsoring government. GASB Statement No. 67 is applicable to the separately issued financial statements of the pension plans for the year ended April 30, 2015. GASB Statement No. 68 is applicable to the City's financial statements for the year ended April 30, 2016.

Recommendation

We recommend that the City reach out to the private pension actuary engaged to provide the pension fund actuarial calculations (IMRF will automatically be providing the necessary information to all member agencies) in order to confirm the timeline for implementation and to review requested materials that will be required in order to implement the provisions and requirements of the new Statements. Lauterbach & Amen, LLP will also work directly with the City to assist in the implementation process, including assistance in determining the implementation timeline with the City and private actuary, providing all framework for the financial statements in order to complete the implementation, and assist in answering any questions or concerns the City or pension fund(s) might have related to the implementation process or requirements.

Management Response

The City recognizes the new GASB Statements and will work with the auditors for the proper reporting of the net pension liability be recorded on the face of the financial statements.

CURRENT RECOMMENDATIONS – Continued

2. FUND BALANCE POLICY

Comment

During our current year-end audit procedures, we noted the City has a fund balance policy. However, this fund balance has not been updated in many years and should be updated due to GASB Statement No. 54.

A fund balance policy establishes a minimum level at which the projected end-of-year fund balance/net position should be maintained, taking into account the constraints imposed upon the resources reported by the governmental and proprietary funds.

Recommendation

We recommend the City update its fund balance policy to be consistent with the requirements of GASB Statement No. 54, including addressing the fund balance reporting categories (nonspendable, restricted, committed, assigned, and unassigned).

Management Response

City administrations have consistently targeted a three-month cash balance as a reasonable goal for municipal stability and liquidity. That policy emanated from past City Councils that specifically discussed this issue, taking into account recommended best practices. In recent years, the City has been challenged by the state of the local economy, a desire to limit the tax burden imposed upon local taxpayers, and uncertain State receipts from shared revenue sources. Nevertheless, the City has sought to increase its cash reserves while balancing the foregoing factors. We agree that updating and formalizing our Fund Balance Policy is a worthwhile goal as part of the current budget process that is already underway.

The City will seek to split fund balance categories as follows:

- Nonspendable
- Restricted
- Committed
- Assigned
- Unassigned

3. EMPLOYEE PERSONNEL POLICY

Comment

During our year-end audit procedures, we noted the City does not currently have a limitation on vacation and sick time carryover from year to year.

Recommendation

We recommend that the City revise the current personnel policy on file. The revised policy should reflect limitations on carryover for the compensated absences.

CURRENT RECOMMENDATIONS – Continued

3. EMPLOYEE PERSONNEL POLICY – Continued

Management Response

The City's Employee Handbook was last updated January 29, 2007. Nothing has changed to prompt updating the manual. More importantly, many of the city's personnel are subject to collective bargaining agreements which define the amount of vacation and sick time that an employee may carry over from year to year. Changes in these contracts must therefore be made through the collective bargaining process.

4. POLICY AND PROCEDURE MANUAL

Comment

During our current year-end audit procedures, the City's finance department does not have a policy and procedure manual. Written procedures, instructions and assignments of duties will prevent or reduce misunderstanding, error; inefficient or wasted effort duplicated or omitted procedures and other situations that can result in inaccurate or untimely accounting records. A policy and procedure manual should aid in the training of new employees and possibly allow for delegation to other employees of some accounting functions that management currently performs.

A policy and procedure manual will require a substantial investment of time and effort for management to develop. However, we believe this time will be more than offset by time saved later in training and supervising accounting personnel. Also, in the process of the comprehensive review of existing accounting procedures, for the purpose of developing the manual, management may discover procedures that can be eliminated or improved to make the system more efficient and effective.

Recommendation

A sample of areas that should be covered as the accounting portion of the procedure manual is as follows:

- Flow charts and descriptions of the accounting cycles, such as:
 - Cash receipts process – collections, deposits, bank reconciliations, etc.
 - Accounts receivable process – billing, recording, write-offs, etc.
 - Cash disbursements and accounts payable process – approvals, coding, purchasing, check preparation, invoice cancellation, general ledger posting, etc.
 - Payroll process – hiring, employee files, time cards, distribution, etc.
- Description of standard entries and allocations
- Description of other specific accounting areas of unusual nature

Management Response

The City is in agreement with this recommendation. As noted in the recommendation, this manual will require a substantial investment of time and effort to develop. Most individuals within departments have formal procedures which the City intends to review to ensure they are current and in compliance with State and Federal laws.

CURRENT RECOMMENDATIONS – Continued

5. GRANT ADMINISTRATION

Comment

During our current year-end audit procedures, we noted that the City did not have adequate procedures in place for tracking and monitoring grant activities. Each grant has unique reporting and compliance requirements. It is the City's responsibility to track and properly account for all grant monies received and to monitor the City's compliance with grant requirements. The City has not established a central tracking mechanism with the finance department to monitor all grant activity for Single Audit and financial reporting purposes.

Recommendation

We recommend the City develop specific policies and procedures for a central tracking and monitoring of grant activities by the finance department.

Management Response

The City presently tracks grants through individual departments in conjunction with the Finance Department. Consistent with this recommendation, the City has already established a central tracking and monitoring procedure within the Finance Department that operates as a cross check on grant activities within respective departments.

6. SEGREGATION OF DUTIES

Comment

During our current year-end audit procedures, we noted a limited segregation of duties. Segregation of duties is one of the most integral components of an internal control system. Segregation of duties insures that no one individual has access to resources (e.g., cash and investments) if the individual also is responsible for processing, summarizing and reporting information or authorizing transactions. Certain functions, such as segregating cash receipts and cash disbursements from anyone with the ability and/or responsibility to record these transactions in the general ledger and/or reconcile accounts in the general ledger provides a mechanism for preventing or detecting on a timely basis any errors or irregularities. Currently, the City needs improvement in the segregation of duties due to the limited staffing of the finance department.

Recommendation

We recommend that the organization of the finance department and the functions assigned to the individual staff be reviewed and possibly modified to improve internal controls and the segregation of duties.

Management Response

Segregation of duties has been mentioned in virtually all audit reports for the City over the past 20 years. It is not uncommon for a municipality our size to have limited staff. However, the City will continue to assess and strengthen internal controls to the extent possible. Many changes have already been made.

CURRENT RECOMMENDATIONS – Continued

7. CREDIT CARD PURCHASES

Comment

During our current year-end audit procedures, we noted purchases paid for with City credit cards; did not always have credit card receipts or an “authorized buyer” signature, and some were missing explanations as to the City’s business purpose of the purchase. Because credit cards are easy to use and widely accepted, strong internal controls are necessary to ensure the cards are not misused.

Recommendation

We recommend that the City adopt formal written procedures for credit card expenditures. These procedures should require that all credit card receipts be signed by the purchaser, and that a description of the purpose of the purchase be described on the receipt or be attached to the receipt. Original receipts must be submitted and credit card purchases over a determined dollar threshold should require appropriate approval.

Management Response

The City will adopt a formal policy signed by the Mayor for credit card expenditures. The policy will require that all credit card receipts be signed by the purchaser and include a description of the purchase on the receipt. Additionally, a spending threshold has already been established.

8. BANK RECONCILIATIONS

Comment

During our current year-end audit procedures, we noted that the Water and Sewer bank account for the City’s trial balances did not tie to the ending reconciled balance in the bank reconciliations. This has been an ongoing issue for many years. Therefore, we needed to reconcile the general ledger balances in order to balance to the bank reconciliations.

Recommendation

Bank reconciliations should be updated subsequent to adjusting journal entries in order to ensure that bank reconciliations tie to general ledger cash balances. We recommend as a means of better control, that bank reconciliation’s be performed each month and any variances be investigated and adjusted immediately.

Management Response

Water and Sewer reconciliations have been a challenge for years. The City has merged Water and Sewer accounts management with the Finance Department to strengthen the resources for bank reconciliation and general ledger management. In addition, the City continues to improve its utilization of its software for accounts management.

CURRENT RECOMMENDATIONS – Continued

9. **FUNDS OVER BUDGET**

Comment

During our current year-end audit procedures, we noted that the following funds had an excess of actual expenditures over budget for the fiscal year:

<u>Fund</u>	<u>Excess</u>
Drug Forfeiture	\$ 11,633
Landfill Closure	57,193

Recommendation

We recommend the City investigate the causes of the funds over budget and adopt appropriate future funding measures.

Management Response

The two funds mentioned would ordinarily be subject to a year-end budget adjustment as part of the City's Supplemental Appropriation approved for Fiscal Year 2014. Last year, the City was in the middle of a Finance Director search which resulted in the City not having sufficient personnel to oversee this process. This oversight in adjusting the Supplemental Appropriation is a budget anomaly. The City has since appointed a full-time Finance Director and added a highly skilled City Accountant to ensure compliance with all state and federal financial requirements.

10. **FUNDS WITH DEFICIT FUND EQUITY**

Comment

During our current year-end audit procedures, we noted the following fund with a deficit fund equity:

<u>Fund</u>	<u>Deficit</u>
Landfill Closure	\$ 3,036,867

Recommendation

We recommend the City investigate the causes of the various deficits and adopt appropriate future funding measures.

CURRENT RECOMMENDATIONS – Continued

10. **FUNDS WITH DEFICIT FUND EQUITY – Continued**

Management Response

The Landfill Closure deficit is the result of IEPA required future reporting and laboratory work for the remainder of the 15 and 30-year landfill closure periods. Laboratory tests on individual cells have resulted in IEPA imposing additional testing and maintenance beyond the original expected landfill closure requirements. These requirements have increased the original cost of closing the landfill. This deficit is currently being covered by revenues received from the City negotiated transfer station lease for municipal waste. Design and maintenance expenditures are also supported by funds generated by the two municipal TIF districts where the landfills are located.