

CITY OF FREEPORT, ILLINOIS

MANAGEMENT LETTER

**FOR THE FISCAL YEAR ENDED
APRIL 30, 2016**



October 4, 2016

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 (City), Illinois, for the year ended April 30, 2016, 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

PRIOR RECOMMENDATIONS

1. CAPITAL ASSET RECORD KEEPING AND APPRAISAL

Comment

Previously and during our current year-end audit procedures, we noted the City's current practice is to enter, balance and adjust capital asset records at year-end. In addition, the City was not able to provide a listing of Enterprise additions and deletions. Waiting until the end of the year to record an entire year of activity increases the risk of errors and omissions. The City also has not had an appraisal done by an outside appraisal firm in multiple years. This appraisal will be used to track capital assets. The benefits of an appraisal by an outside appraisal firm include but are not limited to 1) records for insurance purposes and 2) provide records of capital assets, including real property that the City owns for financial reporting purposes.

Recommendation

We recommended the City capitalize capital assets and balance and review subsidiary ledgers and schedules on a monthly basis. This will help ensure the accuracy and timeliness of capital asset reporting and expedite the year-end closing process. In addition, we recommended that the City have an outside appraisal firm perform a physical inventory and valuation of all the City's capital assets. A periodic inspection of the assets should also be compared to this detail listing to ensure that all assets are accounted for on a regular basis. We further recommended that all capitalizable items be budgeted and charged to capital outlay accounts and that these accounts are reconciled each year to the total additions to capital assets.

Management Response

Management concurs with these recommendations. The original audit recommendation suggested capitalizing capital assets, balancing and reviewing subsidiary ledgers and schedules on a monthly basis. We agree that this is a preferable way to inventory and update assets. We also agree that an outside appraisal of assets is a good business practice. Candidly, the Finance Department of the City is constrained by its manpower to perform all of these operations at once.

We are making a start on this issue by creating internal procedures and controls to record newly procured capital assets. Procurements posted to capital outlay in the government funds will be eliminated utilizing a capital assets governmental activities fund, where these assets are capitalized. That fund will be merged with all the governmental funds in order to create the statements of Net Position and the Statement of Activities. In 2016, the staff has commenced this process but have been unable to complete it because of the impact of the 2015 audit preparation and account reconciliation on 2016 - 2017 financial operations and audit preparation. Completing the 2016 audit on time will put us in a better position to complete our objective of updated capital assets record keeping. Once this is complete, we can have an appraisal done to verify accuracy.

Status

This comment has not been implemented and will be repeated in the future.

PRIOR RECOMMENDATIONS – Continued

2. ACCOUNT RECONCILIATIONS

Comment

Previously and during our current year-end audit procedures, we noted that throughout the year account reconciliations for certain significant accounts were not being performed on a timely basis. The reconciliations not completed timely were for inventory accounts, other general ledger accounts such as accounts receivable, accounts payable, and miscellaneous receivables.

Recommendation

Due to the materiality of inventory, we recommended inventory counts be taken annually and reconciled to the perpetual inventory records. We also recommended that the accounts receivable, accounts payable and miscellaneous receivables general ledger accounts be reconciled with the detail listings.

Management Response

Management concurs with this recommendation. Many accounts have been reconciled during the Fiscal year 2017. These reconciliations were previously not completed on a monthly basis, affecting primarily Water and Sewer accounts. The City's main accounting system is Locis. Water & Sewer accounting is done through Caselle Clarity. An implementation of a Locis Account Receivables module will help resolve this issue and the Staff is pricing the software for its acquisition. Other City accounts have been reconciled on an orderly basis subsequent to the 2015 audit. The City is currently exploring the possibility of designing a new module in Locis to promote efficiency and uniformity among all receivables.

Status

This comment has not been implemented and will be repeated in the future.

3. COLLATERALIZATION OF DEPOSITS

Comment

Previously, at April 30, 2015 the bank balance was \$2,443,443, of which \$1,140,181 is insured or collateralized. The remaining \$1,053,262 is not insured or collateralized.

Recommendation

Consideration should be given to having all bank deposits insured or collateralized.

Status

This comment has been implemented and will not be repeated in the future.

PRIOR RECOMMENDATIONS – Continued

4. ACCOUNTING SOFTWARE

Comment

Previously, we noted the General Fund trial balance provided for the audit was out of balance by \$4,105 (debits did not equal credits). Upon investigation, it was determined that the general ledger was also not in balance. An inherent system of internal controls is in place when double-entry accounting is utilized. Although the dollar amounts were immaterial at year-end, if the City's system allows for transactions to be out-of-balance then material errors could occur and go undetected.

Recommendation

We recommended the City investigate the nature of the out-of-balance transactions and implement system or procedural changes as necessary to prohibit out-of-balance transactions. We also recommended that management review the financial statements on a monthly basis evaluating key ratios and comparing the current year's amount to budget. This would allow management to assess issues and correct them in a timely manner.

Status

This comment has been implemented and will not be repeated in the future.

5. FUND BALANCE POLICY

Comment

Previously, we noted the City has a fund balance policy. However, this fund balance policy 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 recommended 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).

Status

This comment has been implemented and will not be repeated in the future.

PRIOR RECOMMENDATIONS – Continued

6. **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 recommended 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.

Status

This comment has been implemented and will not be repeated in the future.

PRIOR RECOMMENDATIONS – Continued

7. POLICY AND PROCEDURE MANUAL

Comment

Previously and 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:

- Job descriptions
- 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

This recommendation is underway. A Finance Director was hired on June 2016. Segregation of duties has been taking place among the Finance Director, Deputy City Accountant, and Human Resource Manager. A Finance Department policy and procedure manual is currently being written by the Finance Department. Accounts Payable (including a flow chart), Payroll, and credit card policies and procedures have been completed. We anticipate obtaining Council appropriation of these policies and procedures by the end of FY17.

Status

Although the City is working towards implementing this his comment it has not been fully implemented and will be repeated in the future.

PRIOR RECOMMENDATIONS – Continued

9. SEGREGATION OF DUTIES

Comment

Previously and 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 recommended 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

Management concurs with this recommendation. The policy and procedure manual currently under development by the Finance Director will address these issues. Accounts Payable, Payroll, and Credit are complete. The following parties are involved in assuring internal controls are in place:

- Mayor
- Department Managers
- Finance Department Clerk
- Deputy City Accountant
- Human Resource (payroll)
- Finance Director
- The City Treasurer

Status

Although the City is working towards implementing this his comment it has not been fully implemented and will be repeated in the future.

PRIOR RECOMMENDATIONS – Continued

10. **CREDIT CARD PURCHASES**

Comment

Previously and 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 recommended 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.

Status

This comment has been implemented and will not be repeated in the future.

11. **BANK RECONCILIATIONS**

Comment

Previously, we noted that the General Commingled bank account and 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 recommended as a means of better control, that bank reconciliation’s be performed each month and any variances be investigated and adjusted immediately.

Status

This comment has been implemented and will not be repeated in the future.

PRIOR RECOMMENDATIONS – Continued

12. FUNDS OVER BUDGET

Comment

Previously and 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>4/30/16</u>	<u>4/30/15</u>
Motor Fuel Tax	\$ 8,801	-
Drug Forfeiture	-	15,783
Landfill Closure	-	3,024,209

Recommendation

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

Management Response

The audit identified a fund with an excess of expenditures over budget. By State Statute, the Motor Fuel Tax is handled by the City Treasurer. Every effort is made to track the expenditures and to prepare supplemental appropriations or line item adjustments within department budgets as needed. The newly hired Finance Director will work more closely with the City Treasurer, City Engineer, and City Public Works to ensure protocols are followed and promote timely and accurate accounting.

Status

This comment has not been implemented and will be repeated in the future.

PRIOR RECOMMENDATIONS – Continued

13. FUNDS WITH DEFICIT NET POSITION

Comment

Previously and during our current year-end audit procedures, we noted the following funds with a deficit fund balance/net position:

<u>Fund</u>	<u>4/30/16</u>	<u>4/30/15</u>
Illinois Municipal Retirement	\$ (38,460)	-
Landfill Closure	(5,950,600)	(6,255,435)

Recommendation

We recommended the City investigate the cause of the deficit and adopt appropriate future funding measures.

Management Response

Illinois Municipal Retirement deficit of \$ 38,460 will be collapsed into the General Fund by December 2016 to address the issue.

In regard to Landfill Closure, the City's financial consultant suggested capitalizing our revenue stream for the landfill by purchasing an insurance bond utilizing current revenue flow to provide financial assurance that necessary resources will be available to make future payments. The cost of insurance outweighs its benefits at this time and may need to be reevaluated.

Status

This comment has not been implemented and will be repeated in the future.

PRIOR RECOMMENDATIONS – Continued

14. FUND STRUCTURE – COLLAPSING FUNDS

Comment

Previously and during our current year-end audit procedures, we noted several funds that we would recommend that the City collapse for external reporting in the Annual Financial Report.

Recommendation

We recommended that the City review its fund structure. Collapsing funds would meet the minimum number of funds philosophy and present the Annual Financial Report in a more concise and easier understood format.

Management Response

Management generally concurs with the recommendation but with certain caveats. The Finance Department has been steadily reducing the number of accounts. Our objectives are to collapse as many special funds as possible into the General Fund while maintaining an account identity for the programs themselves. However, all additions and modifications of special funds must be approved by the Council, itself. Some of the City's special funds are created as a result of legal requirement. This applies to some grant funds. It also applies to the City's cemetery fund, as an example. Collapsing funds also has implication for the City's budget process. Once the appropriation Ordinance is approved, the staff cannot unilaterally established new line items and eliminate special funds by administrative action. Therefore, we will first have to identify what funds can be collapsed into the General Fund and then incorporate these changes into the draft Appropriation Ordinance for the FY2017-FY2018 year for adoption.

Status

This comment has not been implemented and will be repeated in the future.