

CITY OF FREEPORT, ILLINOIS
MANAGEMENT LETTER

**FOR THE FISCAL YEAR ENDED
APRIL 30, 2015**



February 15, 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, Illinois, for the year ended April 30, 2015, 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. **CAPITAL ASSET RECORD KEEPING AND APPRAISAL**

Comment

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 recommend 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 recommend 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 recommend 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 this recommendation and will begin the process of creating the internal procedures and controls to record newly procured capital assets accordingly. Procurements posted to capital outlay in the governmental 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 creating the government-wide statements of Net Position and the Statement of Activities. Once the mechanics of the above defined procedure have been completely implemented we will take the necessary steps to update and itemize the current infrastructure asset book values.

2. **ACCOUNT RECONCILIATIONS**

Comment

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.

CURRENT RECOMMENDATIONS – Continued

2. ACCOUNT RECONCILIATIONS – Continued

Recommendation

Due to the materiality of inventory, we recommend inventory counts be taken annually and reconciled to the perpetual inventory records. We also recommend 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 and is currently reconciling the accounts receivable, including customer deposits, with current ledger balances on a monthly basis. These reconciliations were previously not being completed on a monthly basis during the fiscal year. The current finance personnel have updated the reconciliations and corrected errors.

Miscellaneous receivables, such as services in the Water & Sewer Department, will be documented through an approved system of invoicing for better tracking.

3. IMRF NPO PAY-OFF

Comment

During our current year-end audit procedures, we noted that the City used the phase-in rate therefore, an IMRF Net Pension Obligation was established and this obligation has been outstanding for a number of years. The election of the phase-in rate delays IMRF's recovery of the unfunded pension costs, and based on IMRF's interest rate assumption at 7.5%, the election of the phase-in rate over the ARC rate is more costly to the participating employers. This election requires participating employers to not only fund over time the difference between the phase-in contribution amounts and ARC contribution amounts, but charges a 7.5% interest rate on the difference as well. The balance at the end of FY 15 is \$272,770.

Recommendation

We recommend the City contact IMRF directly to obtain the NPO balance for pay off. If additional payments are not made for employers electing the phase-in rate, the NPO will be recorded on an annual basis within the financial statements, with interest continuing to increase this balance.

Management Response

Management will consider this recommendation. The City currently has \$160,000 in reserves in the IMRF Fund to help accomplish this.

CURRENT RECOMMENDATIONS – Continued

4. COLLATERALIZATION OF DEPOSITS

Comment

During our current year-end audit procedures, at April 30, 2015 the bank balance is \$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.

Management Response

Each of the City's banks view the account balances on the last day of the month to determine whether additional collateral is needed. Several large deposits were made just before the bank cut off on the last day of the fiscal year. The bank in question did not have time to purchase collateral before the close of business that day. Additional collateral would be purchased upon their next review. Accordingly, this is not a recurring problem.

5. ACCOUNTING SOFTWARE

Comment

During our current year-end audit procedures, 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 recommend 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 recommend 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.

Management Response

Management has investigated the source of the General Fund imbalance, identified and corrected the source of the situation and taken steps to prevent a similar occurrence in the future. Management is currently reviewing the structure of internal reporting. With the departure of the prior Finance Director, the focus has been on remedying current audit related issues and addressing budget reconciliation problems. The resolution of these issues in turn should improve the internal reporting and result in fewer issues in future audits.

PRIOR 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 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.

Management Response

Management is aware of the GASB reporting requirements for pensions. The statements will be adjusted according to GASB principles in the April 30, 2016 Annual Financial Report.

Status

This comment has not yet been implemented but will be implemented in the April 30, 2016 Annual Financial Report.

PRIOR RECOMMENDATIONS – Continued

2. FUND BALANCE POLICY

Comment

Previously and during our current year-end audit procedures, 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).

Management Response

The City targets a three month cash balance as a reasonable goal for stability and liquidity. The City hopes to finalize this recommendation via a formal Council resolution by the end of fiscal year 2016.

Status

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

3. EMPLOYEE PERSONNEL POLICY

Comment

Previously and 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 recommended that the City revise the current personnel policy on file. The revised policy should reflect limitations on carryover for the compensated absences.

Management Response

The City has made changes to its vacation and sick time policy that provide reasonable limitations on vacation and sick time accrual while still meeting the requirements of state and federal law. Accordingly, this recommendation has been addressed.

Status

Management acknowledges this comment and will continue to monitor and review on a yearly basis; therefore, this comment will not be repeated in the future.

PRIOR RECOMMENDATIONS – Continued

4. 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 currently underway. The City is currently conducting a Finance Director search. Nevertheless, current finance personnel have been addressing long standing issues and improving processing procedures. The City is working with the government accounting division of a leading bank to evaluate the City's financial procedures in order to improve the cash receipts and cash disbursement activities as well as the accounts receivable and accounts payable process. A policy and procedures manual in the Finance Department will be a major priority for the new Finance Director.

Status

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

PRIOR RECOMMENDATIONS – Continued

5. GRANT ADMINISTRATION

Comment

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

Management Response

The City has a new Grant Administrator who has centralized grant administration and coordinates directly with the Finance Department. No grant can be opened, processed, or closed out without the involvement of the Grant Administrator. Moreover, all grant disbursements are made through the Finance Department with the approval of the Grant Administrator. The Grant Administrator also has cleaned up reporting issues with state and federal agencies during his short tenure with the City.

Status

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

PRIOR RECOMMENDATIONS – Continued

6. 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

While segregation of duties is a perennial issue in small communities with limited staff, the City has nevertheless been working in ways to segregate duties. In the Finance Department, a separate person currently prepares invoices from the person who prepares checks for payment. We are also working with a leading bank to examine all aspects of our financial procedures, including the possibility of outsourcing certain functions of cash receipt and accounts payable. The City has not completed all of the work on this issue, but have taken the audit recommendation to heart and sought to implement various facets of it.

Status

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

PRIOR RECOMMENDATIONS – Continued

7. 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.

Management Response

The City has implemented a credit card policy for credit card expenditures. No credit card bill can be processed without an accompanying invoice and explanation of the expense, accompanied by a sworn statement of the purchaser. Credit cards are now issued through the Finance Department and the department is also considering the use of procurement cards.

Status

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

8. BANK RECONCILIATIONS

Comment

Previously and during our current year-end audit procedures, 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.

PRIOR RECOMMENDATIONS – Continued

8. BANK RECONCILIATIONS – Continued

Management Response

The City's Water and Sewer reconciliations have been a challenge for years. The situation has not been helped by the use of two different accounting systems. The City's financial consultant has been diligently working on Water & Sewer reconciliations, and has resolved many of the preexisting issues. In addition, we have merged Water & Sewer account management with the Finance Department to strengthen general ledger management. Management sees one of the next steps being the utilization of a single software accounting system for both the general ledger and water & sewer, or the posting of Water & Sewer entries within the general ledger, but as a clearly identified enterprise fund.

Status

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

9. 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>4/30/15</u>	<u>4/30/14</u>
Drug Forfeiture	\$ 15,783	11,633
Landfill Closure	3,024,209	57,193

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. The landfill budget overages were budget anomalies that were the result of additional unanticipated future monitoring required by current regulations to be recognized.

Regarding other line items and funds, the City's Finance Department prepares regular line item reports to departments and to the Mayor and Council. Every effort is made to track the expenditures and to prepare supplemental appropriations or line item adjustments within department budgets as needed.

Status

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

PRIOR RECOMMENDATIONS – Continued

10. FUNDS WITH DEFICIT NET POSITION

Comment

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

Fund	4/30/15	4/30/14
Landfill Closure	\$ (6,255,435)	(3,036,867)

Recommendation

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

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. These requirements have increased the original cost of landfill closure. They were not foreseeable; money was set aside for closure, but not for extended testing and maintenance beyond the original closure period.

The increased closure cost is covered in three ways: (1) the landfill closure fund; (2) through the City's transfer station fees; and (3) through the assistance of the adjacent Tax Increment Financing District. In essence, there is a dedicated revenue stream that offsets current costs as they occur and future costs as known today.

The City's financial consultant has suggested capitalizing our revenue stream for the landfill by purchasing an insurance bond utilizing current revenue flows to provide financial assurance that necessary resources will be available to make future payments. If this is not an acceptable solution, another solution may be to convert the landfill closure fund from a proprietary fund to a governmental fund. In this manner the closure cost would be relegated to current financial resources and would never show a deficit fund balance. Only the entity wide statements would recognize the long term closure cost as a long term liability and recognize the expense. The City remains open to solutions that meet generally accepted accounting principles.

Status

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

PRIOR RECOMMENDATIONS – Continued

11. 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

The City agrees that many of the City's special funds should be collapsed into the General Fund while maintaining an accounting identity for the programs themselves. However, all special funds are approved by Council and can only be modified by Council action. In addition, some special funds are created as a result of legal requirements, either through our grants or state requirements. The City staff is currently investigating which funds could be integrated into the General Fund while maintaining their identity. The final structure of the chart of accounts will likely be built around program lines instead of organizationally. The City hopes to incorporate these changes into the City's fiscal year 2017 budget documents.

It should be noted that the City has already taken some steps to eliminate accounts that were set up by individual departments for special purposes. However, additional consolidation will in most cases require Council action as set forth above.

Status

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