



CITY OF ROCK FALLS, ILLINOIS

MANAGEMENT LETTER

April 30, 2018



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SIKICH.COM

The Honorable Mayor
Members of the Council
City of Rock Falls, Illinois

In planning and performing our audit of the financial statements of the governmental activities, business-type activities, each major fund and the aggregate remaining fund information of the City of Rock Falls, Illinois (the City) as of and for the year ended April 30, 2018, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's 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 certain deficiencies in internal control that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A 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. A material weakness is a deficiency, or a 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.

The City's written responses to the deficiencies in our audit have not been subjected to the audit procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

In addition, we reviewed the status of the material weaknesses for the period ended April 30, 2017. The status of these recommendations is included in Appendix A.

This communication is intended solely for the information and use of the Mayor, the City Council and the management of the City and is not intended to be and should not be used by anyone other than these specified parties.

Sikich LLP

Rockford, Illinois

October 11, 2018

MATERIAL WEAKNESSES

We consider the following to be material weaknesses over internal controls

Segregation of Duties

With a limited number of staff in City offices and departments, proper segregation of duties is difficult to accomplish. A fundamental element of internal control is the segregation of certain key duties. The basic idea underlying segregation of duties is that no employee or group should be in a position both to perpetrate and to conceal errors or fraud in the normal course of their duties. In general, the principal incompatible duties to be segregated include:

- Custody of assets, in particular cash
- Authorization or approval of related transactions affecting those assets
- Recording or reporting of related transactions
- Execution of the transaction or transaction activity

An essential feature of segregation of duties/responsibilities within an organization is that no one employee or group of employees has exclusive control over any transaction or group of transactions.

We noted specific lack of segregation of duties listed below. This list should not be considered to be all inclusive as we did not perform a comprehensive review of all control structures throughout the City.

The Deputy City Clerk can enter invoices into the system, process checks, and mail checks. The Deputy City Clerk can both receive and record the same cash receipt. The Deputy City Clerk has administrative access to the accounting software (MSI) and performs accounting functions. The effectiveness of established controls is diminished when personnel involved in the accounting function have the ability to modify their access rights to the various modules of the accounting software.

The Accounts Payable/Payroll Clerk can enter invoices into the system, process checks, and mail checks. In addition, the Accounts Payable/Payroll Clerk can both receive and record the same cash receipt.

The Building Department Secretary can create permits and collect cash for permits.

Custody of assets, including check signing authority, authorization or approval of related transactions affecting those assets, recording or reporting of related transactions, and execution of the transaction or transaction activity should be segregated. With a limited staff, segregation of these duties may not be possible. In this case, it is important department heads remain diligent in their monitoring of financial transactions.

A detailed review of financial statements, budget vs. actual results, bank reconciliations, payroll registers, and invoices and supporting documentation for checks greatly enhances the internal control. This review should be performed by someone other than the preparer of the documents.

MATERIAL WEAKNESSES (Continued)

Segregation of Duties (Continued)

Review of bank reconciliations should include tests of mechanical accuracy and tracing of items on the reconciliation to the relevant source documents. The nature of unreconciled differences should be determined and followed up on in a timely manner and any journal entries deemed necessary, as a result, be recorded.

In all cases, we recommend the City reassign duties in order to more fully segregate conflicting duties.

Management's Response

Deputy City Clerk

The Deputy City Clerk cannot process invoices without approval by a Department Head and the City Administrator who both initial the invoice prior to entering into the system. The Deputy City Clerk can process checks however, the Deputy City Clerk is not a signor on ANY accounts held by the City.

Accounts Payable/Payroll Clerk

The Accounts Payable/Payroll Clerk cannot process invoices without approval by a Department Head and the City Administrator who both initial the invoice prior to entering into the system. The Deputy City Clerk can process checks however, the Accounts Payable/Payroll Clerk is not a signor on ANY accounts held by the City.

Review of Financial Statements

Review of financial statements, budget vs. actual, bank reconciliations, payroll registers, invoices and the supporting documentation for checks is and has been conducted on a regular basis over the past several years by persons other than those that prepared those documents.

Year End Close Process

During our audit we proposed numerous audit adjustments, which management has reviewed and approved. Adjustments that were proposed were the result of recurring year end accruals that were not recorded, transactions that were not recorded in the proper period or classified correctly, and government-wide conversion entries such as capital assets and long-term debt.

Generally accepted auditing standards emphasizes that the external auditor cannot be part of an entity's internal control process over financial reporting. We recommend that procedures or checklists be adopted and followed to include all procedures that management determines are needed to be performed on a monthly or year end basis to ensure general ledger accounts are properly adjusted.

Management's Response

Management will review and determine what procedures or checklists are necessary to ensure that the general ledger accounts are property adjusted. Management also recognizes that the amount of adjustments required are decreasing on a yearly basis.

SIGNIFICANT DEFICIENCY

Inventory

During our testing of inventory, we noted there is no written inventory policy to provide guidance on securing inventory, and recording the activity of inventory purchased and used.

During our testing of inventory, we noted several inventory invoices selected for testing which could not be located for the Electric Department to support the average cost of inventory items held at year end. In addition, several invoices could not be located for the Water Department to support the average cost of the inventory item.

We recommend the City develop an inventory control policy to provide guidelines to accurately track and secure inventory. In addition, we recommend the City retain invoices for all inventory items to support the average cost of the inventory item used and review inventory for obsolescence on a periodic basis.

Management's Response

The City's Electric Department has maintained the current inventory program since 2003. During the conversion to the current program in 2003, all old invoice information was destroyed in the conversion. Considering the age of some of our infrastructure within the electric system, it is acceptable to have inventory on hand which may have been purchased prior to 2003. Unfortunately, until such time that all electric inventory purchased prior to 2003 is used, the City will not have invoices which support the average cost of the inventory currently held which was purchased prior to 2003. The Electric Department does keep copies of all invoices for products in inventory since 2003. Those invoices are kept passed the mandatory 7 year period and are not destroyed until such time that the inventory is used.

The City's Water Department inventory process was reviewed during after the 2017 audit for necessary changes and after review, a process was implemented and they are now required to keep copies of all invoices of inventoried items.

**APPENDIX A
STATUS OF COMMENTS FROM APRIL 30, 2017
CITY OF ROCK FALLS**

MATERIAL WEAKNESSES

We consider the following to be material weaknesses over internal controls

1. Segregation of Duties

With a limited number of staff in City offices and departments, proper segregation of duties is difficult to accomplish. A fundamental element of internal control is the segregation of certain key duties. The basic idea underlying segregation of duties is that no employee or group should be in a position both to perpetrate and to conceal errors or fraud in the normal course of their duties. In general, the principal incompatible duties to be segregated include:

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An essential feature of segregation of duties/responsibilities within an organization is that no one employee or group of employees has exclusive control over any transaction or group of transactions.

We noted specific lack of segregation of duties listed below. This list should not be considered to be all inclusive as we did not perform a comprehensive review of all control structures throughout the City.

The Deputy City Clerk can enter invoices into the system, process checks, and mail checks. The Deputy City Clerk can both receive and record the same cash receipt. The Deputy City Clerk has administrative access to the accounting software (MSI) and performs accounting functions. The effectiveness of established controls is diminished when personnel involved in the accounting function have the ability to modify their access rights to the various modules of the accounting software.

The Accounts Payable/Payroll Clerk can enter invoices into the system, process checks, and mail checks. In addition, the Accounts Payable/Payroll Clerk can both receive and record the same cash receipt.

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Custody of assets, including check signing authority, authorization or approval of related transactions affecting those assets, recording or reporting of related transactions, and execution of the transaction or transaction activity should be segregated. With a limited staff, segregation of these duties may not be possible. In this case, it is important department heads remain diligent in their monitoring of financial transactions.

MATERIAL WEAKNESSES (Continued)

1. Segregation of Duties (Continued)

A detailed review of financial statements, budget vs. actual results, bank reconciliations, payroll registers, and invoices and supporting documentation for checks greatly enhances the internal control. This review should be performed by someone other than the preparer of the documents.

Review of bank reconciliations should include tests of mechanical accuracy and tracing of items on the reconciliation to the relevant source documents. The nature of unreconciled differences should be determined and followed up on in a timely manner and any journal entries deemed necessary, as a result, be recorded.

In all cases, we recommend the City reassign duties in order to more fully segregate conflicting duties.

Status: This comment has been repeated as Material Weakness #1 for the current year.

2. Uninsured and Uncollateralized Deposits

We noted approximately \$4 million of the bank balance of the City's deposits were uninsured and uncollateralized. The City's investment policy requires collateral to be pledged by financial institutions for which deposits exceed FDIC insurance coverage.

We recommend the city monitor their collateral monthly on a monthly basis to ensure all City deposits are insured or collateralized by financial institutions where deposits are held.

Status: This comment has been implemented as of April 30, 2018.

3. Year End Close Process

During our audit we proposed numerous audit adjustments, which management has reviewed and approved. Adjustments that were proposed were the result of recurring year end accruals that were not recorded, transactions that were not recorded in the proper period or classified correctly, and government-wide conversion entries such as capital assets and long-term debt.

Generally accepted auditing standards emphasizes that the external auditor cannot be part of an entity's internal control process over financial reporting. We recommend that procedures or checklists be adopted and followed to include all procedures that management determines are needed to be performed on a monthly or year end basis to ensure general ledger accounts are properly adjusted.

Status: This comment has been repeated as Material Weakness #2 for the current year.

MATERIAL WEAKNESSES (Continued)

4. Segregation of Duties - Pension Accounting

We noted the Firefighters' Pension accountants prepare checks, sign all checks, reconcile the bank statements, and transfers funds from the pension investment accounts to the pension checking account. Investment transfers can only be made between pension accounts. Invoices and check registers are reviewed and approved by the Firefighters' Pension Board. However, supporting checks or cancelled checks are not reviewed by the Board to ensure the payments correspond with approved invoices.

We recommend the Pension Board receive and review the monthly bank statements, and a second review by the Pension Board of investment account transfers be required.

Status: This comment has been implemented as of April 30, 2018.

5. Prior Period Adjustment

During our review of the minutes of the City Council and through discussions with management, it was noted that the City sold property after year-end that was not recorded on the City's general ledger. The City took ownership of the property in 2006 and did not record the capital asset at the time the deed was transferred to the City. We proposed a prior period adjustment, which was reviewed, approved, and posted by the City to record the capital asset on the City's general ledger as of April 30, 2017.

Status: This comment has been implemented as of April 30, 2018.

SIGNIFICANT DEFICIENCY

1. Inventory

During our testing of inventory, we noted there is no written inventory policy to provide guidance on securing inventory, and recording the activity of inventory purchased and used.

During our testing of inventory, we noted several inventory invoices selected for testing which could not be located for the Electric Department to support the average cost of inventory items held at year end. In addition, several invoices could not be located for the Water Department to support the average cost of the inventory item.

We recommend the City develop an inventory control policy to provide guidelines to accurately track and secure inventory. In addition, we recommend the City retain invoices for all inventory items to support the average cost of the inventory item used and review inventory for obsolescence on a periodic basis.

Status: This comment has been repeated as Significant Deficiency #1 for the current year.