



CITY OF ROCHELLE, ILLINOIS

MANAGEMENT LETTER

For the Year Ended December 31, 2017



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

Ladies and Gentlemen:

In planning and performing our audit of the financial statements of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the City of Rochelle, Illinois (the City) as of and for the year ended December 31, 2017, 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 and therefore material weaknesses may exist that were not identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be material weaknesses. In addition, we reviewed the status of the comments from the December 31, 2016 audit. The status of these comments is included in Appendix A.

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 a combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the City's financial statements will not be prevented, or detected and corrected, on a timely basis.

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

Sikich LLP

Naperville, Illinois
July 10, 2018

MATERIAL WEAKNESSES

We consider the following to be a material weakness over internal controls

1. Material Audit Adjustments and Technology Fund

During our audit, we identified certain material financial statement adjustments which affected the current year financial statements. An adjustment was recorded to account for the over-billing of fiber revenue for several years.

The City's general ledger should support all information in the annual financial statements. If audit adjustments are proposed and recorded (since external auditors cannot be considered a part of internal controls) by definition, a material weakness has occurred. It is the responsibility of management to record all transactions necessary to generate financial statements and disclosures in accordance with generally accepted accounting principles.

We recommend the City continue to identify and record transactions in the proper period and to the proper fund to ensure all transactions are accounted for in accordance with generally accepted accounting principles, and all necessary financial presentations and note disclosures are included as required by generally accepted accounting principles.

In addition to the over-billing by the City, we also noted that the City is not retaining proper signed agreements in place, or on file, for monthly lease revenue for fiber revenues. Without a signed agreement in place, the lessee is not obligated to continue in their monthly lease, which could result in an abrupt reduction in revenue from fiber leases to the City, or a failure to pay for past fiber usage. Further, the most recent lease in place with a particular customer shows that the City was supposed to begin receiving an additional 3% increase in payments beginning in November 2014, however, the lessee continues to pay the original amount, resulting in revenue that the City was due by agreement but did not collect during the year ended December 31, 2017. We recommend that they City require signed agreements for all leases and that those agreements clearly define the rate structure and term of the contract.

Management Response

An error in billing occurred which resulted in an overcharge to the customer in a prior year. The contracts are being reviewed and appropriate documentation will be retained on the customer file. A tickler file will need to be created for all future billing changes.

2. Inventory

During our testing of inventory, we noted certain opportunities for the City to improve its internal controls over inventory.

During our review of inventory costs, we noted multiple items for which the inventory cost was not calculated correctly based upon the most recent invoices. We recommend the City regularly monitor the inventory cost values and undertake a full analysis of all inventory items to ensure the average cost is properly calculated within the inventory management system.

MATERIAL WEAKNESSES (Continued)

2. Inventory (Continued)

Additionally, many items we selected for test counts during our inventory count have not been purchased in the last 7 years, therefore, there was no invoice available to review the cost of these inventory items. Based on discussion with City officials, there is not a formal policy for disposal of obsolete inventory. We recommend that the City create a formal policy over its inventory in order to ensure that there are adequate processes in place to record, track, and maintain adequate inventory records and establish a reserve for obsolete inventory by fund.

Management Response

The software automatically calculates average cost. A review of these costs will be done periodically to look for unreasonable values. An inventory policy to record, track, maintain adequate records, and procedure for disposal of obsolete inventory will be created.

**APPENDIX A
STATUS OF PRIOR YEAR RECOMMENDATIONS**

MATERIAL WEAKNESS

Inventory

During our testing of inventory, we noted certain opportunities for the City to improve its internal controls over inventory.

First, during our inventory observation, we noted multiple differences in the inventory listing maintained in the general ledger and what was counted as part of the year end physical inventory. Based on discussion with City officials, it was determined that one of the primary causes for these differences is that contractors often use materials but do not report usage to the City in an accurate or timely manner. We recommend the City consider the use of a perpetual inventory system to mitigate this weakness and require prompt and accurate reporting of all inventory usage.

Next, we noted during our physical inventory observation that there are items in inventory that appeared to be obsolete, potentially overstating the inventory balance and that no allowance for obsolescence has been established by the City. Based on discussion with City officials, there is not a formal policy for disposal of obsolete inventory. We recommend that the City create a formal policy over its inventory in order to ensure that there are adequate processes in place to record, track, and maintain adequate inventory records and establish a reserve for obsolete inventory by fund.

Next, we noted transformers are capitalized when purchased, not when put in service. This practice is in compliance with Federal Energy Regulatory Commission guidelines; however it is not compliant with generally accepted accounting principles. This will potentially overstate capital assets and depreciation while understating inventory. We recommend the City only capitalize assets that are placed in service.

Status - Comment has been partially implemented as of December 31, 2017. See current year material weakness #2.