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## Report on Internal Control Structure, Reportable Conditions and Advisory Comments, 2006

City of De Soto

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CITY OF DE SOTO, MISSOURI

**REPORT ON INTERNAL CONTROL STRUCTURE,  
REPORTABLE CONDITIONS AND  
ADVISORY COMMENTS**

**October 31, 2006**



**SCHOWALTER & JABOURI, P.C.**

**CERTIFIED PUBLIC ACCOUNTANTS**

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January 11, 2007

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City Council and City Manager  
City of De Soto, Missouri

Council Members and City Manager:

In planning and performing our audit of the financial statements of the City of De Soto, Missouri (the "City") for the year ended October 31, 2006, we considered the City's internal control structure to determine our auditing procedures for the purpose of expressing an opinion on the financial statements, and not to provide assurance on the internal control structure.

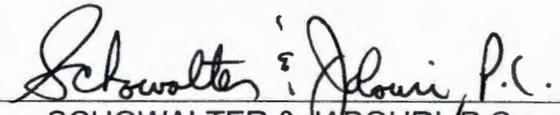
However, we noted matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the City's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. The reportable condition noted on page 5 is considered to be a material weakness.

We will review the status of these comments during our next audit engagement. We have already discussed these comments and suggestions with various City personnel, and we will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations.

We also became aware of several matters that are opportunities for strengthening internal controls and operating efficiency. The memorandum that accompanies this letter summarizes our comments and suggestions regarding those matters. We previously reported on the City's internal control structure in our report dated January 11, 2007. This letter does not affect our report dated January 11, 2007, on the financial statements of the City.

We want to take this opportunity to express our appreciation to David Dews, Amy Rhodes, their staffs, and the rest of the City's personnel for the assistance and cooperation we received and the many courtesies extended to us during the course of the audit.

  
SCHOWALTER & JABOURI, P.C.

## FOLLOW-UP ON PRIOR YEAR COMMENTS AND SUGGESTIONS

### I. CROSS TRAINING OF ACCOUNTING PERSONNEL

Currently, accounting personnel are not fully cross-trained on significant accounting functions. As a result, when an employee is absent, their duties are suspended until they return. This situation leaves the City very vulnerable in the event that an unforeseen absence should occur. Having employees appropriately cross-trained and performing an individual's duties in their absence assures all significant accounting processing will continue in the event an employee is absent from work and provides an additional internal control.

We continue to encourage the City to fully implement this recommendation to ensure all significant accounting functions be processed by more than one City individual.

### II. DISBURSEMENTS

We previously noted that checks require two signatures, one of which is the Mayor's, which is applied through a stamp. The person who stamps the signature is the same person who prepares the check. We believe that the internal controls could be improved if the person who applied the stamp was separate from the check preparation process. (Requiring two signatures by individuals independent of the preparation of the disbursement ensures preventative internal controls are in place.) By including two signature lines on the check it is apparent that the City intends to have two individuals reviewing and approving the disbursement.

Therefore, we continue to recommend that an employee independent of the check preparation be responsible for stamping the checks with the signature stamp, thereby requiring the review of the checks.

### III. CASH

Missouri Statutes require that funds on deposit in financial institutions must be collateralized by the depository institution with appropriate securities to the extent not provided by FDIC insurance. During the prior two audits the Library's deposits were undercollateralized.

We are pleased to announce that the Library's deposits were fully collateralized in the current year; therefore, this comment no longer applies.

FOLLOW-UP ON PRIOR YEAR COMMENTS AND SUGGESTIONS (CONTINUED)

IV. PUBLICATION OF FINANCIAL STATEMENTS

Section 77.110, RSMo states that the Council shall publish a full and detailed statement of the receipts and expenditures and indebtedness of the City at the end of each fiscal year and six months after the end of each fiscal year in a newspaper of general circulation of the City. The financial statements were not published during previous years.

We are pleased to inform you that the City's financial statements were published during the year; therefore, this comment no longer applies.

V. OVER EXPENDITURE OF BUDGET

During the prior year, actual expenditures exceeded budgeted expenditures in the Capital Improvement fund.

We recommended that the City ensure that a monitoring process was in place and that any budget amendments were made when circumstances change from those originally anticipated.

This comment has been implemented and no longer applies.

VI. DE SOTO VOLUNTEER FIRE ASSOCIATION

During the prior year, it came to our attention that the De Soto Volunteer Fireman Association was not separately incorporated and was using the City's employee identification number.

We continue to recommend that the Association separately incorporate and apply for tax exempt status. Also, a Form 990, "Return of Organization Exempt From Income Tax", may need to be filed each year depending on the amount of receipts. The form must be filed by the fifth month after the end of the Association's accounting period.

## CURRENT YEAR'S COMMENTS AND SUGGESTIONS

### REPORTABLE CONDITION

#### I. SEGREGATION OF DUTIES AND INTERNAL CONTROL

Internal controls are designed to safeguard assets and help prevent or detect losses from employee dishonesty or error. A fundamental concept in a good system of internal control is the segregation of duties.

Currently, the City's Finance Director has access to every aspect or process of the core accounting functions (i.e. payroll, receipts and disbursements). In addition, the Finance Director prepares all bank reconciliations. These bank reconciliations are not reviewed.

We recommend that core accounting functions be segregated. At a minimum, a person independent of the core accounting functions should review the completed bank reconciliations in a timely manner and indicate such by initialing and dating the reconciliation.

In addition, the Finance Director has the ability to record journal entries, which are not reviewed by an independent individual.

We recommend that anytime a journal entry is made a person independent of the preparation review the journal entry.

### OTHER COMMENTS AND SUGGESTIONS

#### II. INVESTMENT POLICY

The City currently does not have a formal investment policy.

We recommend the City develop and formalize a cash and investment policy. Such a plan should include both long and short-term objectives, maximize interest income and keep interest costs to a minimum. If investment services are utilized, the City should bid these services. In addition, the investment returns and composition should be analyzed at least quarterly to evaluate performance and adherence to the investment policy.

## OTHER COMMENTS AND SUGGESTIONS (CONTINUED)

### III. UTILITY ADJUSTMENTS

During our testing of utility adjustments, it was noted that while the adjustments require approval prior to being made, the approval is verbal and therefore there is not adequate support and evidence of proper approval.

We recommend that the City maintain adequate documentation for all utility adjustments made as well as evidence of that approval via a signature and date.

### IV. CHANGING STANDARDS FOR AUDITORS, MANAGEMENT, FINANCE COMMITTEE MEMBERS AND BOARD OF DIRECTOR MEMBERS

Fraud, scandals, and problems with financial reporting over the past many years have created heightened public expectations and increased regulatory oversight. These changes first impacted public companies with the passage of the Sarbanes-Oxley Act in 2002. Since that time, we have been deliberate in informing and assisting our clients of the impending "trickle-down" effects to help them be well positioned to comply with any requirements and to be proactive in implementing best business practices.

In the first half of 2006, nine new Statements on Auditing Standards (SASs) auditing standards were issued; all of which will impact Corporation. In essence the impact was not a "trickle-down" from the public company sector, which is regulated by the Public Company Accounting Oversight Board (PCAOB), but a ramping up by the Audit Standards Board (ASB) that regulates all nonpublic companies (including NPOs) so as to have largely comparable audits across the entire profession. The PCAOB and the ASB have collaborated, and will continue to collaborate as future standards are set.

The new SASs referenced above are significant. Some of the most important content relates to:

- Clarification and distinction between the auditor's responsibility and the responsibility of an organization's governing board and management.
- Increased requirements of governing boards and audit committees.
- Increased requirements of management.
- Auditors will be required to plan their audits based on the organization's risk assessment and evaluation of internal controls.
- Increased focus on the organization and its internal control and a lower the threshold as to which auditors must communicate deficiencies.

OTHER COMMENTS AND SUGGESTIONS (CONTINUED)

IV. CHANGING STANDARDS FOR AUDITORS, MANAGEMENT, FINANCE COMMITTEE MEMBERS AND BOARD OF DIRECTOR MEMBERS (continued)

The practical applications of these new SASs are significant. Some of the most notable impact relates to:

- Auditors must test and document more, and be less predictable (clients may have less time to prepare and respond).
- Auditors must perform audits with increased skepticism.
- Client will have to provide more data.
- Audits will take longer.
- External users of the audited financial statements may ask for comment letters as well.
- Unfavorable comment letters may negatively impact public perception, and over time could infer a possible breach of fiduciary responsibility.

SASs 104 through 111, known as the *Risk Assessment Standards*, are effective for fiscal periods beginning after December 15, 2006. SAS 112, *Communication of Internal Control Matters*, is effective for fiscal periods ending after December 15, 2006.

We strongly recommend the Board and management review the new auditing standards and their impact on the Corporation. We believe that some of the requirements and practices outlined in the new requirements will take many months to fully adopt and we encourage those charged with governance to place a high organizational priority on these matters. Although the responsibility belongs to the Board, Schowalter & Jabouri, P.C. understands the constraints of time and other resources that will present an additional layer of challenge, and as such we are willing and able to assist you, through communication, interpretation, suggestions regarding implementation, board training and other educational services.