1-1-2008

Report on Internal Control Related Matters and Advisory Comments, 2007

City of Fenton

Susan Montee, CPA
Missouri State Auditor

June 25, 2008

Art DeWitt, Finance Director
City of Fenton
625 New Smizer Mill Road
Fenton, MO 63026-3597

Fiscal Period: One Year Ended December 31, 2007

Dear Mr. DeWitt:

In accordance with Section 105.145, RSMo, we acknowledge receipt of the financial report of your political subdivision for the above-described fiscal period.

Thank you for your cooperation in sending this information.

Sincerely,

SUSAN MONTEE, CPA
STATE AUDITOR

Dana Wansing

Dana Wansing
Staff Auditor II

FENTON
CITY OF PARKS
625 New Smizer Mill Road
Fenton MO 63026-3597
Phone 636-343-2080
Fax 636-343-1183

STATE AUDITOR'S OFFICE
RECEIVED
JUN 06 2008

June 04, 2008

Ms. Susan Montee, CPA
Missouri State Auditor
P O Box 869
Jefferson City MO 65102

Re: 2007 Audited Financial Report

Dear Ms. Montee:

Please find enclosed a copy of the audited financial reports for the City of Fenton for fiscal year 2007. These reports are filed pursuant to Section 105.145 RSMo.

Please feel free to contact me with any questions over this matter.

Sincerely,

Art DeWitt

Art DeWitt, CPFO
Finance Director
City of Fenton, Missouri

CITY OF FENTON, MISSOURI

REPORT ON INTERNAL CONTROL RELATED MATTERS AND ADVISORY COMMENTS

December 31, 2007

SCHOWALTER & JABOURI, P.C.

CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS

SCHOWALTER & JABOURI, P.C.
CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS
11878 GRAVOIS ROAD
ST. LOUIS, MISSOURI 63127
(314) 849-4999
FAX (314) 849-3486

FINANCIAL SERVICES
COMPUTER SOLUTIONS
ADMINISTRATIVE OFFICES

11777 GRAVOIS ROAD
ST. LOUIS, MISSOURI 63127
(314) 842-2929
FAX (314) 842-3483

April 18, 2008

To the Honorable Mayor and
Members of the Board of Alderman
City of Fenton, Missouri

In planning and performing our audit of the financial statements of the City of Fenton, Missouri (the "City") for the year ended December 31, 2007, in accordance with U.S. generally accepted auditing standards, we considered the City's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing an opinion 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 would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. A control deficiency 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 misstatements on a timely basis.

A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above.

Our comments concerning internal control and other significant matters are presented as follows:

I. Changes Impacting Governmental Organizations
II. Deficiency Considered to be Significant
III. Other Current Year Matters
IV. Status of Prior Year Comments

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

We want to take this opportunity to express our appreciation to the City for the assistance and cooperation we received and the many courtesies extended to us during the course of the audit.

Schowalter & Jabouri, P.C.

SCHOWALTER & JABOURI, P.C.

I. CHANGES IMPACTING GOVERNMENTAL ORGANIZATIONS

The bar is being raised for governmental organizations due to changing public expectations resulting in new audit standards that increase focus on effective internal control systems and processes. These changes have been triggered by fraud, scandals, and financial reporting problems in both for-profit and nonprofit organizations.

Regulators and the public have realized that ***the reliability of financial reporting is directly related to the sufficiency and effectiveness of an organization's internal control systems and processes,*** and the quality of a financial statement audit must be based on this evaluation. The public is seeking assurance that an organization has proper financial safeguards and protections.

As a result, the Auditing Standards Board (ASB) of the American Institute of Certified Public Accountants (AICPA) has issued new standards that have a significant impact on audits and organizations audited by requiring greater attention to internal control systems and processes. They emphasize the distinctions between auditors' responsibility and responsibility of an organization's governing board and management.

The new standards require that internal control deficiencies identified during an audit be evaluated and reported using a different measure than has been in place, which may result in increased reporting of internal control deficiencies.

The bottom line–there must be reasonable attention to monitoring and oversight of an organization's internal controls that is commensurate with the attention commonly given to financial reporting.

Admittedly, this will sound more daunting and onerous than it is in fact. It is a focus, a way of thinking, and a process of managing an internal control framework. The increased requirements and costs may not be as dramatic as they may first appear. For example, an audit committee may need to spend additional time considering internal controls, the finance team may need to spend more time in process management, and there may need to be increased internal audit activities. However, these activities should result in increased efficiencies and long term cost savings.

The new auditing standards:

- SAS 104 through 111, ***Risk Assessment Standards,*** are effective for fiscal periods **beginning on or after** December 15, 2006. These standards increase the auditors' responsibility and requirements, including more extensive understanding of the organization and documentation of audit procedures.

- SAS 112, ***Communication of Internal Control Matters,*** is effective for fiscal periods **ending on or after** December 15, 2006, and changes the definition of internal control deficiencies:

I. CHANGES IMPACTING GOVERNMENTAL ORGANIZATIONS (CONTINUED)

The new auditing standards (continued):

- A **control deficiency** exists when the design or operation of an internal control would not prevent or detect financial misstatements.

- A **significant deficiency** occurs when a control deficiency allows more than a remote likelihood of a misstatement that is more than inconsequential.

- A **material weakness** is a significant deficiency that allows more than a remote likelihood of a material misstatement.

- SAS 114, The Auditor's Communication With Those Charged With Governance, is effective for fiscal periods beginning on or after December 15, 2006. This standard increases the auditors' responsibility to communicate information about audit planning, the client's accounting practices, and other significant matters.

The impact of the new auditing standards on audits:

- Auditors must test and document more, and be less predictable (clients may have less time to prepare for certain testing and response).

- Auditors must perform the audit with increased skepticism, requiring auditors to obtain and scrutinize more supporting evidence. Audits will take longer and be more rigorous.

- Clients will be asked to provide documentation of their risk assessment and internal controls, as well as an evaluation of their effectiveness.

- The auditors' letter of recommendations (management letter) must address internal control deficiencies at an increased level.

- Unfavorable management letters may affect public perceptions about an organization's stewardship and affect the ability to continue to receive funding. Savvy users of financial statements; such as banks, foundations, charity watchdog groups, and regulators, may ask about internal control deficiencies.

I. CHANGES IMPACTING GOVERNMENTAL ORGANIZATIONS (CONTINUED)

The impact of the new auditing standards on governmental organizations:

- Governmental organizations seeking to manage risk and avoid negative comments must understand the COSO framework for internal control and its five key components. (See COSO integrated framework below, from the 1992 report of The Committee of Sponsoring Organizations of the Treadway Commission, designed to help businesses and other entities assess and enhance their internal control systems.) Traditionally, organizations have focused primarily on a single element of the framework–control activities.

- Sufficient attention and resources must be allocated to establish, document, and maintain an effective system of internal controls, including an assessment of key risks that could have a significant affect on financial activities and reporting.

- Audit committees need to be empowered to monitor and oversee management's risk assessment, internal control documentation, and evaluation of effectiveness.

- Boards and management need to affirm to auditors, and if appropriate or required to constituencies and regulators, their responsibility for and maintenance of rigorous systems and processes to protect the organization, its assets, its people, and its reputation.

This is an ongoing process and not a one time event. The financial statement audit is an annual "inspection" rather than a component of "monitoring" maintained by management under the oversight of the governing body.

We recommend studying the COSO internal control guidance and related tools as a means to begin the process of implementation. The principle based evaluation matrix included in the materials is a key starting point to highlight areas of vulnerability.

The COSO integrated framework:

The five key components of an effective system of internal controls over financial reporting:

- **Control environment** (establishing organizational values and control structure, policies, management philosophy, and staff capabilities)

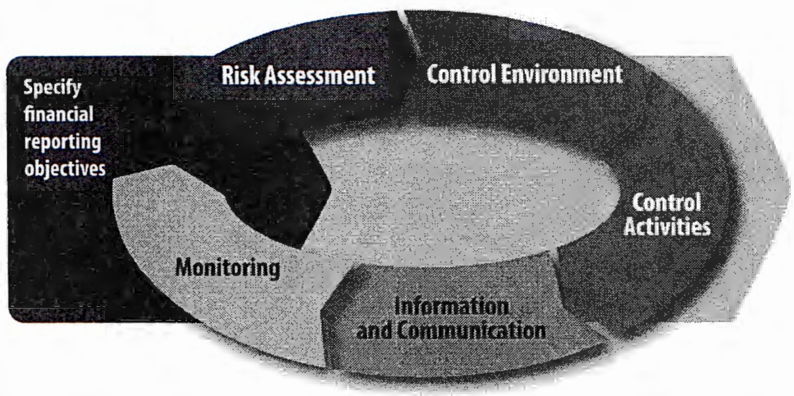
The COSO integrated framework (continued):

- **Risk assessment** (assessing key risks, including those resulting from fraud and errors)

- **Control activities** (implementing policies and procedures, and safeguards that mitigate risks)

- **Information and communication** (providing financial and other information to those inside and outside of the organization to enable the system to properly function)

- **Monitoring** (evaluating whether controls operate effectively)



There are many practical tools and materials to assist in this process that are "scalable" to fit the size and complexity of different organizations in a cost effective manner. See also www.coso.org.

The ultimate benefit and payoff:

Those who have gone through such a process recognize that there are many benefits including:

- Increased ability to anticipate and/or avoid problems and mitigate risks
- Enhanced decision making that avoids unanticipated outcomes
- Realization of increased operational efficiency and effectiveness
- Long-term financial and resource savings

In considering the impact of these changes on the City in future years, we would highlight the following excerpts from SAS 112 for your consideration.

Areas in which control deficiencies ordinarily are at least considered to be significant deficiencies:

- Controls over nonroutine and nonsystematic transactions
- Controls over the period-end financial reporting process, including controls over procedures used to enter transaction totals into the general ledger; initiate, authorize, record, and process journal entries into the general ledger; and record recurring and nonrecurring adjustments to the financial statements

Indicators that a control deficiency should be regarded as at least a significant deficiency and a strong indicator of a material weakness:

- Ineffective oversight of the entity's financial reporting and internal control by those charged with governance
- An ineffective internal audit function or risk assessment function at an entity for which such functions are important to the monitoring or risk assessment component of internal control, such as for very large or highly complex entities

The following are examples of circumstances that may be control deficiencies, significant deficiencies, or material weaknesses:

Deficiencies in the Design of Controls

- Inadequate design of internal control over the preparation of the financial statements being audited
- Inadequate design of internal control over a significant account or process
- Inadequate documentation of the components of internal control
- Insufficient control consciousness within the organization, for example, the tone at the top and the control environment
- Absent or inadequate segregation of duties within a significant account or process
- Absent or inadequate controls over the safeguarding of assets (this applies to controls that the auditor determines would be necessary for effective internal control over financial reporting)
- Inadequate design of information technology (IT) controls (both general and application) that prevent the information system from providing complete and accurate information consistent with financial reporting objectives and current needs

I. CHANGES IMPACTING GOVERNMENTAL ORGANIZATIONS (CONTINUED)

Deficiencies in the Design of Control (continued)

- Employees or management who lack the qualifications and training to fulfill their assigned functions:
    - For example, in an entity that prepares financial statements in accordance with generally accepted accounting principles, the person responsible for the accounting and reporting function lacks the skills and knowledge to apply generally accepted accounting principles in recording the entity's financial transactions or preparing its financial statements.
- Inadequate design of monitoring controls used to assess the design and operating effectiveness of the entity's internal control over time
- The absence of an internal process to report deficiencies in internal control to management on a timely basis

II. DEFICIENCY CONSIDERED TO BE SIGNIFICANT

A. Fraud Policy and Fraud Risk Assessment

During our audit, we noted that a fraud risk assessment has not been performed and there is no formal fraud policy in place. Antifraud programs and controls are the policies and procedures put in place by an organization to help ensure that management directives are carried out. They are part of the overall system of internal control established to achieve reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

We recommend that the City address the risk of fraud occurring by performing a fraud risk assessment to identify, analyze and manage the risk of asset misappropriation. In addition, we recommend the City adopt a fraud policy. The policy would contain a scope as to persons covered, define what actions constitute fraud, who the suspected fraud should be reported to and the procedures to do so, the responsibilities of the person the suspected fraud is reported to and the potential outcome of the investigation into the suspected fraud. A sample fraud policy can be obtained free of charge from the ACFE at their website.

III. OTHER CURRENT YEAR MATTERS

A. Segregation of Duties Related to Cash Disbursements

During our audit, we noted that the accounts payable clerk has the ability to add or change vendor information in the City's accounting system.

We recommend that system controls be implemented to ensure personnel with accounts payable responsibilities do not have access to add or change vendor information. If these duties can not be segregated, monitoring controls, such as periodically reviewing a master file change report, should be implemented.

B. Payroll Monitoring Controls

During our audit, we noted that one individual is responsible for all payroll duties and that there is not an independent review and approval of payroll detail. A final review of payroll for each pay run will help prevent keying or other errors and will also help detect any unusual activity on a timely basis.

We recommend that a detailed review be performed over payroll each period by someone not involved in the preparation of payroll. Ideally, this review would be performed before payroll is run or posted to the general ledger. The review would consist of scanning payroll data for each employee for reasonableness and also verifying that payroll data is consistent with that of prior periods. The individual performing the review should sign or initial the payroll registers to indicate that they have been reviewed and approved for payment.

C. Outgoing Wire Transfers

During our audit, we noted that one individual has the ability to execute ACH or electronic wire transfers without formal review or approval. Although the Finance Director subsequently receives a copy of the transaction, there is no indication that transfers have been reviewed or approved.

We recommend that controls be implemented to ensure that all outgoing wire transfers are formally reviewed and approved and that the approval is documented. In addition, duties over this process could be segregated so that the same employee is not preparing and executing outgoing wire transfers.

D. Journal Entries

Currently, City policy dictates that only non-standard or non-routine journal entries are reviewed and approved by an independent person.

We recommend that all journal entries be reviewed and approved by someone other than the employee who prepared the entry.

IV. STATUS OF PRIOR YEAR COMMENTS

A. Fraud Policy

In the prior year, we recommended that the City adopt a fraud policy.

Current Year Status:

Not implemented. Please refer to item IIA (Fraud Policy and Fraud Risk Assessment) above.

B. Reconciliation of Receipts

In the prior year, we noted that the Planning & Zoning Department's receipts were not being reconciled with the permit issuance information from its computer system.

Current Year Status:

Not implemented. However, this comment will not be repeated in the current year.

C. Journal Entries

In the prior year, we noted a non-standard journal entry that was not reviewed or approved by another employee as dictated by City policy.

Current Year Status:

Although this situation was not noted in the current year, please refer to item IIID (Journal Entries) above.

D. Court Receipts

In the prior year, we recommend that the numerical sequence of court receipts given to offenders be accounted for. In addition, we recommended that voided receipt slips be retained and that the reasoning for the void be documented and approved by a supervisor.

Current Year Status:

Partially implemented. It appears that the numerical sequence of court receipts is being accounted for. In addition, voided receipts are being retained; however, the reason for the void is not being documented and the voids are not being approved by a supervisor.