

050032

VILLAGE OF LOMBARD
REQUEST FOR BOARD OF TRUSTEES ACTION
For Inclusion on Board Agenda

Resolution or Ordinance (Blue)
X Recommendations of Boards, Commissions & Committees (Green)
Other Business (Pink)

TO: PRESIDENT AND BOARD OF TRUSTEES

FROM: William T. Lichter, Village Manager

DATE: January 27, 2005 (COW)(B of T) Date February 3, 2005

TITLE: A Motion to Accept and File with the Village Clerk the 2004 Comprehensive Annual Financial Report, Management Letter and Recommendations regarding the Management Letter Comments.

SUBMITTED BY: Timothy Sexton, Assistant Director of Finance

BACKGROUND/POLICY IMPLICATIONS:

The Finance Committee at their January 18, 2005 meeting unanimously voted to recommend that the Village Board accept and place on file with the Village Clerk the 2004 Comprehensive Annual Financial Report and Management Letter. In addition, the Finance Committee has unanimously concurred with staff recommendations prepared in response to the Management Letter comments. Village Board approval of these recommendations is requested. The Management Letter and the staff responses are attached. The 2004 Comprehensive Annual Financial Report has previously been distributed to the Village Board.

Fiscal Impact/Funding Source: N/A

Review (as necessary):

Village Attorney X _____ Date _____
Finance Director X Leonard J Flood Date 1/27/05
Village Manager X William T. Lichter Date 1/27/05

NOTE: All materials must be submitted to and approved by the Village Manager's Office by 12:00 noon, Wednesday, prior to the Agenda Distribution.

VILLAGE OF LOMBARD, ILLINOIS

MANAGEMENT LETTER

**FOR THE YEAR ENDED
MAY 31, 2004**

November 1, 2004

The Honorable Village President
Members of the Board of Trustees
Village of Lombard, Illinois

In planning and performing our audit of the financial statements of the Village of Lombard, Illinois, for the year ended May 31, 2004, 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, Board of Trustees, management, and others within the Village of Lombard, 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 Village 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 Village staff.

Lauterbach & Amen LLP
LAUTERBACH & AMEN, LLP

CURRENT RECOMMENDATIONS

1. GASB STATEMENT NO. 40 – DEPOSIT AND INVESTMENT AND INVESTMENT RISK DISCLOSURES

The deposits and investments of the Village are exposed to risks that have the potential to result in losses. This Statement addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. As an element of interest rate risk, the Statement requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates. Deposit and investment policies related to risks identified in this statement are also required to be disclosed. The provisions of this Statement are effective for the Village's fiscal year beginning June 1, 2005

Level of Detail of Disclosures. As a general rule, disclosures should be organized by investment type (i.e. U.S. Treasury securities, U.S. Agency securities, certificates of deposit, etc.). Disclosures are required to be made by the Village as a whole, but may also be required at the governmental and business-type activities, individual major funds, nonmajor funds in the aggregate, or fiduciary (pension trust) fund type levels. The Village should also disclose their deposit and investment policies related to various risks required to be disclosed by this Statement. If no policy is adopted related to these risks, then that fact must also be disclosed.

Credit Risk. The Statement defines credit risk as “the risk that an issuer or other counterparty to an investment will not fulfill its obligations.”

Credit Risk - Custodial. GASB Statement No. 3 required disclosure of custodial risk in three categories. Statement No. 40 essentially eliminated the distinction between categories 1 and 2, as a result exception based reporting is now required and only deposits and investments in category 3 are disclosed. Category 3 includes deposits and investments which are essentially uninsured and uncollateralized, or are collateralized but the collateral is not held by the Village or is not in the Village's name.

Credit Risk – Credit Quality Ratings. Statement No. 40 requires the Village to disclose the credit quality ratings of debt securities as described by a nationally recognized rating agency (i.e. Standard and Poor's, Moody's Investor Service or Fitch Ratings) as of the date of the financial statements. Obligations of the U.S. Government and obligations explicitly guaranteed by the U.S. Government are excluded from this disclosure requirement.

Credit Risk – Concentration of Credit Risk. The Village is now required to disclose, by amount and issuer, investment in any one issuer that represents five percent or more of total investments. As with credit quality rating obligations of the U.S. Government and obligations explicitly guaranteed by the U.S. Government are excluded from this disclosure requirement. Also exempt are mutual funds, external investment pools (i.e. Illinois Funds) and other pooled investments, which are, by nature, diversified.

CURRENT RECOMMENDATIONS (Continued)

1. GASB STATEMENT NO. 40 – DEPOSIT AND INVESTMENT AND INVESTMENT RISK DISCLOSURES (Continued)

Interest Rate Risk. Changes in interest rates can have a significant impact on the fair value of interest-bearing investments. The longer the period, for which an interest rate is fixed, the greater the potential variability in fair value resulting from changes in interest rates. Statement No. 40 now requires the Village to disclose the interest rate risk of debt securities by using one of the following methods.

Interest Rate Risk – Segmented Time Distribution. Under this method, investments are disclosed by type and fair value. For each type of investment, fair value is categorized by maturity date by category (less than 1 year, 1 –5 years, 6 –10 years, etc.) It is anticipated that this method will be the most widely used method.

Interest Rate Risk - Weighed Average Maturity. Is similar to segmented time distribution except that the weighted average maturity is disclosed for each investment type. The portfolio's overall weighted average maturity is also disclosed.

Interest Rate Risk – Specific Identification. Specific identification discloses each individual investment, its maturity date and fair value.

Interest Rate Risk – Duration. Duration is the measure of a debt security's cash flows using present values, weighted for cash flows as a percentage of the investment's full price.

Interest Rate Risk – Simulation Model. Simulation models analyze the changes in an investment's fair value based upon hypothetical fluctuations in interest rates.

Statement No. 40 recommends the Village use whichever of the five methods above they use in practice.

Foreign Currency Risk. Statement No. 40 requires the disclosure of U.S. dollar balances of deposits and investments, if any, that are exposed to foreign currency risk .

Recommendation:

We recommend the Village review its existing investment policy to ensure that all the potential risks are included and review the Village's procedures to manage, track and report deposit and investment so the disclosures required by Statement No. 40 will be readily available. In addition, the Police and Firefighters' pension plans hold a majority of the Village's deposits and investments; accordingly, the disclosure requirements should be communicated to the Pension Boards as soon as possible to ensure that the requirements may be met on a timely basis.

CURRENT RECOMMENDATIONS (Continued)

2. GASB EXPOSURE DRAFT – FINANCIAL REPORTING FOR POSTEMPLOYMENT BENEFITS

In addition to pension benefits, many local governments provide other postemployment benefits (OPEB) as part of the total compensation offered to attract and retain qualified employees. Other postemployment benefits include postemployment healthcare (medical, dental, vision, etc.) and other forms of postemployment benefits, when provided separately from a pension plan (i.e. life insurance, long-term care, etc.) Other postemployment benefits do not include termination offers and benefits (i.e. early retirement incentive programs) or sick leave conversions. The exposure draft proposes that employers accrue the cost of other postemployment benefits as those benefits are earned by employees.

Post employment benefits are part of compensation for services rendered by employees. Benefits are earned and obligations accumulate during employment; however, payment is deferred until employment terminates. For example, health care costs typically increase significantly with age. Thus, the health care premium for a younger, active employee typically would be less than for a retiree. When the premium for active employees is different than retirees, it is called an age-adjusted premium. When a single amount is used for both groups, the blended amount is called a common premium. The premium charged for retirees will be less if a common premium is used. The GASB describes this difference as the implicit rate subsidy.

Employer-paid healthcare premiums, of course, are a form of employee compensation, thus, it would be expected that healthcare premiums paid for active employees would be treated as a cost of the current period. However, if a common premium is used, a significant portion of the premium charged for active employees (the implicit rate subsidy) may actually relate to services provided by retirees in prior periods. Under the matching principle of accrual accounting, such amounts should have been accrued as expense when the benefiting retirees were still active employees.

GASB proposes to recognize other post employment benefit costs (expenses) systematically over the employees' years of service. In addition, the government would be required to provide relevant information about the accrued OPEB obligation, the cost of employee services, including OPEB and the progress, if any, made in funding these costs.

GASB is proposing three implementation phases for small, medium and large employers. Implementation is effective for periods beginning after December 15, 2006, 2007 and 2008.

Recommendation:

We recommend the Village become familiar with the future financial reporting requirements for postemployment benefits.

PRIOR RECOMMENDATIONS

1. BANK RECONCILIATION

Comment

Previously, we noted that throughout the year bank account reconciliations for certain significant accounts were not being performed on a timely basis.

Recommendation

We recommended that the bank accounts be reconciled shortly after the end of each month and that any discrepancies be investigated in a timely manner. Being able to timely detect discrepancies will facilitate improved internal controls.

Status

The Village has implemented this comment and it will not be repeated in the future.

2. CONSTRUCTION DEPOSITS

Comment

Previously, we noted that a number of material construction project deposits from the Village's detailed listing which are five years and older have not been reimbursed. Currently, if construction project deposits are held for seven years, they are remitted to the State of Illinois as unclaimed property.

Recommendation

We recommended that the Village establish policies and procedures (with a thorough review of all related accounts) that provides for construction deposits to be refunded on a timely basis avoiding the need to remit these deposits as unclaimed property to the State of Illinois.

Status

The Village is working toward implementing this comment and we will check the status during the fiscal year May 31, 2005 audit.

PRIOR RECOMMENDATIONS (Continued)

3. INTEREST EXPENSE

Comment

Previously, we noted that interest income is being distributed to funds with only a positive cash balance, and the funds with a negative cash balance are neither receiving interest income nor being charged interest expense.

Recommendation

We recommended the Village distribute the interest income proportionately based on each fund's percentage ownership and charge interest expense to the appropriate funds. The distribution of interest income and income expense should be done on a monthly basis.

Status

The Village has implemented this comment and it will not be repeated in the future.



TO: Finance Committee Members
William T. Lichter, Village Manager
Leonard J. Flood, Director of Finance

FROM: Tim Sexton, Assistant Director of Finance
Anne M. Fairbairn, Accounting Manager

DATE: January 12, 2005

SUBJECT: Responses to the FYE 2004 Management Letter

The FYE 2004 Management Letter comments from the Village auditors Lauterbach & Amen are enclosed for your review. The staff response to the Management Letter comments is as follows:

1. GASB STATEMENT 40 – DEPOSIT AND INVESTMENT AND INVESTMENT RISK DISCLOSURES

Management Letter Recommendation: The Village should review its existing investment policy to ensure that all potential risks are included and review the Village's procedures to manage track and report deposit and investment so disclosures required by the statement are available. Additionally, the Village needs to communicate with the Pension Boards the requirements of the statement.

Staff Response: GASB Statement 40 replaces GASB Statement 3 for audit disclosure in the CAFR. The auditors plan to educate the Village on the specific requirements. The Village will be implementing during the Fiscal Year 2006 audit. The information will be provided by the institutions providing the collateral for the investments. The Village will work with the Pension Boards to ensure compliance.

2. GASB EXPOSURE DRAFT – FINANCIAL REPORTING FOR POSTEMPLOYMENT BENEFITS

Management Letter Recommendation: The Village should become familiar with the future financial reporting requirements for postemployment benefits.

Staff Response: This is another complicated technical comment, which the auditors are planning on educating their clients. They did indicate that the insurance providers will have an actuarial analysis done and will provide information to the Village about our exposure.

PRIOR RECOMMENDATIONS

1. BANK RECONCILIATION

Management Letter Recommendation: The auditors recommended the bank accounts be reconciled shortly after the end of each month and that any discrepancies be investigated in a timely manner.

Status: The Village has implemented this comment and it will not be repeated in the future.

2. CONSTRUCTION DEPOSITS

Management Letter Recommendation: The Village establish policies and procedures (with a thorough review of all related accounts) that provides for construction deposits to be refunded on a timely basis avoiding the need to remit these deposits as unclaimed property to the State of Illinois.

Staff Response:

Year	Construction Dep.	Miscellaneous Dep.
≤FY2002	\$103,570.00	\$54,588.83
FY2003	\$51,000.00	\$5,364.25
FY2004	\$229,450.00	\$12,276.00
Total	\$384,020.00	\$72,229.08

The table above displays the Construction and Miscellaneous Deposit balances in an aging schedule format. The numbers appear to be improving for the very old deposits. However, we still have a significant dollar amount of deposits which are at least 2 years old. The Finance Department continues to work with the Building Inspectional Division to turn around the deposits as the permits are completed.

3. INTEREST EXPENSE

Management Letter Recommendation: The Village distribute the interest income proportionately based on each fund's percentage ownership and charge interest expense to the appropriate funds. The distribution of interest income and interest expense should be done on a monthly basis.

Status: The Village has implemented this comment and it will not be repeated in the future.

The auditors will be in attendance at the January 18th meeting to answer any questions regarding these issues.

cc: Village President & Board of Trustees
All Department Heads