Performance Audit
Review of the Submitted Budget for Fiscal Year 2008

March 2007

This document contains active links. For more information on how to navigate a PDF document please refer to PDF Navigation Instructions available through any of our Audit Reports pages.

City Auditor's Office

City of Kansas City, Missouri

11-2007

March 7, 2007

Honorable Mayor and Members of the City Council:

This year's budget review focuses on financial pressures the city can expect to face in the medium term – the next 5 to 15 years. Looking at these medium-term financial issues helps put the current budget in context and provides decision-makers with advance notice of difficult issues city government will face.

Over the next 5-15 years, financial pressures the city will have to deal with include:

- **Addressing growth in employee salary and benefits costs.** Growth in employee salary and benefit costs is putting pressure on the city's budget. Personal services costs are projected to increase $27.3 million in fiscal year 2008. The city's four pension systems are underfunded and the city might face additional pressures to fund the liability on health care for retirees.

- **Adequately maintaining city infrastructure.** The city continues to spend less than needed on capital maintenance pushing costs into the future. While the city issued bonds to address the maintenance backlog, the funding is still far below the needed $80 million a year to fix the city infrastructure. General fund support for maintenance has decreased over the last several years. Citizen satisfaction with the maintenance of the city infrastructure continues to be low.

- **Identifying funding to meet growing public safety needs.** Growing public safety needs will put pressure on future budgets. As the Police Department implements recommendations from their recent efficiency study, they are likely to require millions of additional funding. The city also needs to plan for the expiration of the police and fire sales taxes in 2011 and 2017 respectively, as the city needs permanent revenue to fund expanded fire and police operations.

- **Dealing with unfunded commitments.** The city committed to capital projects estimated at $92 million without identifying funding sources. The city committed to these projects outside of the normal capital improvement budget process. Finding resources to finance these projects puts pressure on the city's budget as the new Council will need to consider these projects against other priorities.

- **Facing other obligations with potential long-term impact.** Besides big future financial obligations like the sewer system upgrade, the Budget Office identified other issues that the city will have to face in the next few years. These include increasing solid waste disposal costs and funding future public transportation needs.

The city's financial flexibility is limited posing additional challenges to addressing the medium-term issues. The city's general fund balance remains below the recommended level of eight percent and deferred maintenance is severely underfunded. The city also has a high percentage of restricted operating revenues. In addition, fixed expenditures, like debt service, are high as the city more than doubled its debt in recent years.

The city manager improved the timeliness of the annual and monthly financial reporting, which should improve the city's ability to monitor financial conditions. However, the city manager failed to present the five-year financial forecast as part of the budget process, limiting the city's ability to budget and plan for the coming years.

We provided the city manager and the budget officer a draft of this report on March 1, 2007, but did not ask for written responses. We would like to thank city staff for their cooperation. The audit team for this project was Sue Polys, Julia Talauliker, Joan Pu, and Michael Eglinski.

Gary White
Acting City Auditor

Review of the Submitted Budget for Fiscal Year 2008

Table of Contents

Review of the Submitted Budget for Fiscal Year 2008

List of Exhibits

Introduction

Objectives

This performance audit, a review of the city manager's submitted budget, provides the City Council with information about the city's financial condition and the coming year's budget. Resolution 911385 directs the city auditor to review and comment on the city manager's budget. This is our 17th budget review. We conducted this audit under the authority of Article II, Section 216 of the Charter of Kansas City, Missouri, which establishes the Office of the City Auditor and outlines the city auditor's primary duties.

A performance audit systematically examines evidence to independently assess the performance and management of a program against objective criteria. Performance audits provide information to improve program operations and facilitate decision-making.[1]

This report is designed to identify and describe financial issues the city will face in the next 5 to 15 years.

Scope and Methodology

Our review focuses on the city manager's submitted budget for fiscal year 2008 and follows up on issues raised in last year's budget review. Our methods included:

- Updating financial analyses from prior budget reviews.
- Reviewing prior audit work.
- Reviewing actuarial valuations of the city's pension systems.
- Reviewing the submitted budget and five-year financial forecast.
- Interviewing city staff.

[1] Comptroller General of the United States, *Government Auditing Standards* (Washington, DC: U.S. Government Printing Office 2003), p. 21.

- Reviewing reports and analyses provided by staff and other organizations.

We conducted this audit in accordance with generally accepted government auditing standards. We omitted no information from this report because it was deemed privileged or confidential. We discussed the report with the budget officer and city manager and provided them with drafts of the report, but we did not ask them to write responses to the report and recommendations.

Back to Table of Contents

Findings and Recommendations

Summary

Over the next 5-15 years, the city will face significant financial pressures from future challenges, such as growing employee salary, pension and other healthcare benefit costs; deteriorating capital infrastructure; growing public safety needs; and unfunded project commitments. The city will also need to find solutions to issues like upgrading the sewer system, or dealing with rising cost of solid waste collection and funding for public transportation needs.

The city's limited financial flexibility increases the challenge of addressing the medium-term financial obligations. The city's general fund balance remains below the recommended level of eight percent and deferred maintenance is severely underfunded. The city also has a high percentage of restricted operating revenues. Fixed expenditures, like debt service, are high as the city more than doubled its debt in recent years.

While the city manager acknowledges these challenges, the city has not considered the effect of these mid-term financial obligations on the city's future financial condition. The city manager has not provided the city council with a five-year financial forecast consistently and he did not present it as part of this year's budget process. In addition, the five-year forecast excludes future obligations from analysis of the city's long-term financial condition. Incorporating tools like mid-term forecasting and reporting into the budget process that reflect the impact of the long-term commitments on the city's budget will help the Council focus on long-term sustainability.

The city manager and staff took some steps to improve the city's financial condition. The general fund balance has improved. City staff are making an effort to reduce the city's exposure in growing limited obligation debt for economic development. Staff are drafting debt and economic incentive policies in response to new charter requirements. In addition, the timelines of the CAFR and monthly financial reports have improved.

City Faces Significant Medium-Term Obligations

Over the next 5-15 years the city will face significant financial pressures including funding salary, pension and health care benefit costs; making debt service payments; increasing capital maintenance spending; addressing public safety needs; and identifying funding for unfunded commitments. The city also will need to find solutions to upgrading the sewer system and dealing with increasing costs of solid waste disposal and funding public transit.

Employee-Related Obligations Increase Pressure on Budget

Personal services costs are projected to increase $27.3 million in fiscal year 2008. The increases in health insurance premiums, projected to rise more than 15 percent next year, are unsustainable. In addition, the city pension systems continue to be underfunded and the city might face additional pressures from funding the liability on health care for retirees.

The city faces pressures from increased employee-related costs. In his transmittal letter, the city manager states that personal services costs are projected to increase $27.3 million (6.5%) over the current year. The additional costs are for increases in salaries and health insurance premiums and for adding new positions.

In an effort to improve services, the city is adding 139 positions in the upcoming year at an annual cost of $7 million. In addition to merit increases, the city will spend $5.9 million to adjust salaries for city employees in order to attract and retain personnel, including front line employees.

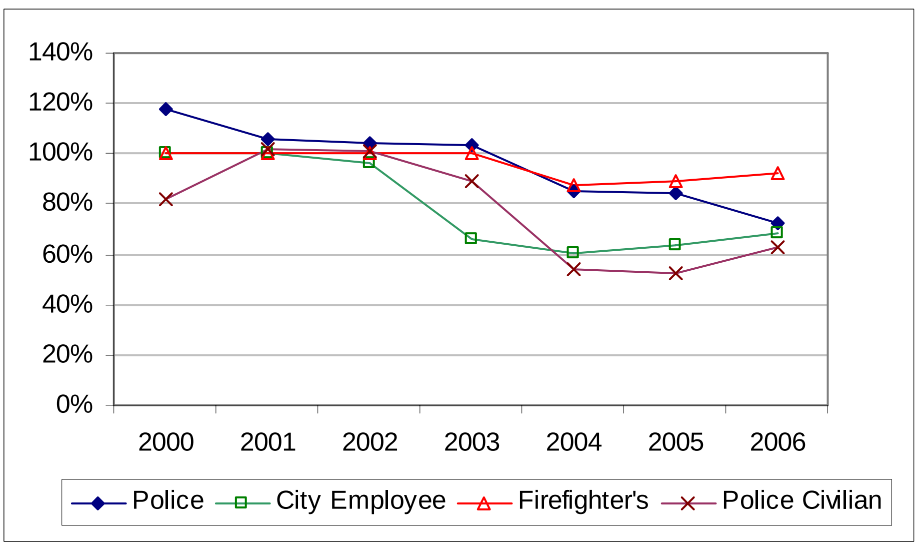
Health insurance costs are expected to increase significantly. The 2008 submitted budget estimates that rate increases for all city plans in the upcoming year would be over 15 percent, comparable to rate increases nationally of at least twelve percent per year. According to the city manager, these annual increases are not sustainable over time. He proposes developing a plan that will allow the city to address its health care needs going forward.

Future health care costs for retirees are still unknown. In addition to increases in employee salary and benefit costs, the city faces unknown future obligations associated with health care for retirees. The city does not yet know the costs associated with providing other post-employment benefits (OPEB) for retired city employees. Accounting standards[2] will soon require the city to recognize the costs of non-pension benefits to retirees, such as health insurance. The city is required to estimate and report the unfunded liability along with the annual contribution required to cover future city obligations. It is important for the city to adequately address the issue because how the city funds its liabilities could affect bond ratings. The rating agencies would be looking for information on how management plans to address the cost of liability arising from providing these benefits and at the issuer's financial flexibility to address these costs.

The Finance Department has hired a consultant to do an actuarial study to determine the city's liability, including liability for Police retirees. The city estimates that the report will be completed by the end of April. The city is required to report this liability in financial reports starting with fiscal year 2008.

The pension systems are underfunded. In the last few years the city did not contribute the actuarially required amount to its pension systems. The percentages contributed have declined since 2001. (See Exhibit 1.)

Exhibit 1. Pension Contribution as a Percentage of Required Amount



Sources: Actuarial Reports for Employees' Retirement System, Firefighters' Pension System, Police Retirement System, and Civilian Employees' Retirement System.

[2] Governmental Accounting Standards Board Statements 43 and 45 on financial reporting and accounting of other post-employment benefits issued in June 2004.

Although, funded ratios[3] for the city employees, police, and firefighters pension systems improved slightly in fiscal year 2006, the systems are not fully funded. (See Exhibit 2.) If the city's contributions continue falling short of the system's required rate, the funded ratio may continue to drop, indicating a weakening of the system's financial condition.

Exhibit 2. Funded Ratios for City and Police Pension Systems

Funded Ratio	May-01	May-02	May-03	May-04	May-05	May-06
Police	97.5%	95.7%	89.5%	84.7%	81.6%	82.0%
Police Civilian	99.7%	97.9%	82.1%	78.4%	74.5%	74.4%
City Employee	108.7%	100.5%	88.3%	84.7%	82.6%	93.1%
City Firefighters	93.9%	87.4%	82.3%	83.0%	84.6%	87.9%

Sources: Actuarial Reports for Employees' Retirement System, Firefighters' Pension System, Police Retirement System, and Civilian Employees' Retirement System.

The city should identify ways to deal with growing future pension and other benefit obligations. The city budget officer is concerned that the city will not be able to sustain its pension systems as city obligations increase. He identified ways to reduce future obligations by consolidating the city pension system with the police system, changing from a defined benefit to a defined contribution system, and changing amortization schedule assumptions for the police and police civilian systems. The city manager is recommending that the city develop a uniform approach to funding pension and other benefits. Addressing these future costs is important as they might affect the city's credit ratings.

Growing Tax-Supported Debt Obligates Future City Revenues

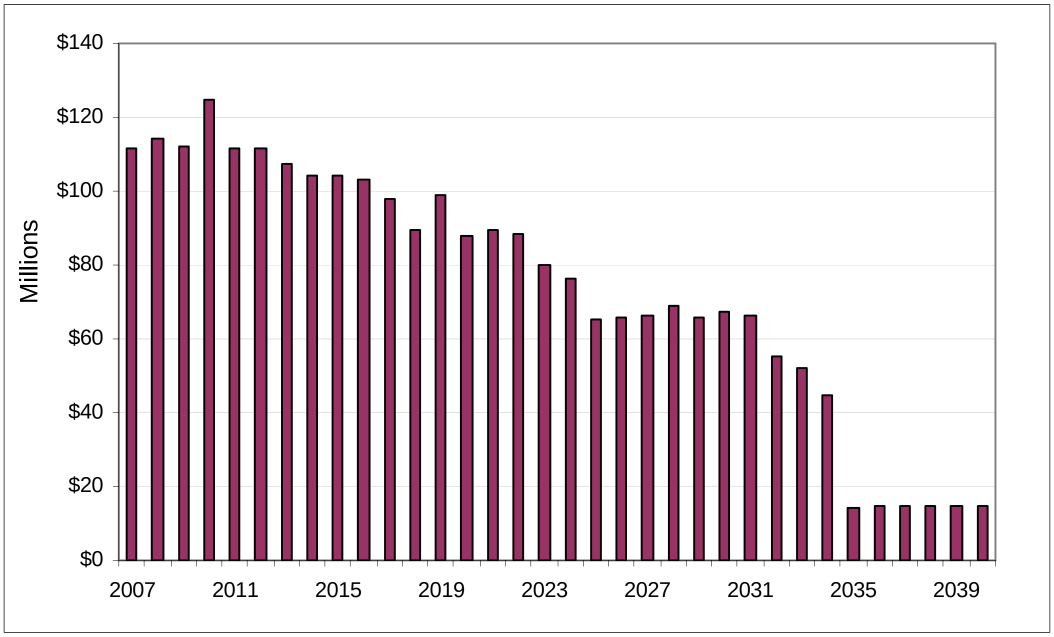
The city faces big annual debt service payments in the near future. The city's debt obligations have more than doubled in the last few years, with current total principal and interest due of $2.5 billion. Debt service on various economic development initiatives, that are dependent on how well the projects perform, constitutes 53 percent of total debt service outstanding. While city staff are making an effort to reduce the city's exposure in limited obligated bonds and has drafted debt and economic incentive policies, high tax-supported debt payments might limit the city's future flexibility.

The city's debt obligations have increased. The city doubled its tax-supported debt in 2005. Consequently, the city faces big annual payments for debt service. At the end of 2006, projected principal and interest payments on outstanding tax supported debt were about $2.52

[3] Funded ratio – an actuarial value of assets divided by actuarial accrued liability.

billion. (See Exhibit 3.) The city intends to issue an additional $40 million for capital needs in fiscal year 2008.

Exhibit 3. Scheduled Debt Service Payments on Current Tax-Supported Debt



Source: Debt Manual payment schedules.

The performance of economic development projects affects the city's debt obligations. Almost 53 percent of the city's debt is for limited obligation bonds issued to support various economic development projects. Such debt depends on performance of the projects. If revenue from projects does not meet projections, the city is obligated to cover the debt service on these bonds. Currently five out of ten tax increment financing (TIF) plans backed by city bonds are not generating enough revenue to cover debt service. Being unable to meet debt service payments from TIF revenues could affect basic services, as money from the general fund is diverted from other city priorities.

The city issued more debt in 2006 for KC Live!, a seven block entertainment district downtown. The total debt issued for this project is $295 million. The city is hoping the project is successful but there is no firm estimate on the future revenue stream. Finance staff are still refining their projections as businesses in the area and their opening dates become known. The projected revenue to debt service ratio is 103.5 percent,[4] which means expected revenue will barely be enough to cover debt service payments. Such a low coverage ratio leaves little

[4] Finance Department's presentation on KC Live! revenue growth at the June 22, 2006 business session.

margin for error in the event the project does not perform to expectations.

Staff is taking action to reduce the city's exposure in limited obligation debt. Finance staff told us they plan to reduce interest rate risk and limit the city's exposure on limited obligation debt. Treasury is planning to reduce the amount of debt that obligates the city to cover debt service if KC Live! and Sprint arena project revenues fall short.

The majority of current limited obligation debt is variable rate debt. While variable rate bonds offer flexibility, such bonds also add fees and some uncertainty to the financing costs. Treasury staff told us they plan to convert most of the variable rate debt either by reissuing new fixed rate debt or synthetically fixing the rates through other financial instruments. According to the finance director, limiting variable rate bonds to 25 percent of the total portfolio is the benchmark.

The charter requires policies on debt and economic development. Citizens approved a new city charter in August 2006, which requires debt and economic incentive policies. Finance staff is working on drafting both policies. According to staff, the debt policy draft is being updated to incorporate the use of a wider range of financial tools. Staff plans to use consultants to help draft the economic development policy.

City Needs to Increase Capital Maintenance Spending

Citizen satisfaction with the maintenance of the city is low. The city continues to spend less on maintenance than the needed $80 million. The city's Bond Financial Advisory Committee has recommended that a minimum level of maintenance funding come from non-bond funding. While the Bond Financial Advisory Committee, the city manager, and the Chamber of Commerce all support renewal of the one-cent capital sales tax, they also support using some of that money for maintenance rather than new capital projects. Historically, the Public Improvement Advisory Committee has just used the sales tax money for new projects. The 2008 submitted budget increases funding for maintenance in major infrastructure categories by ten percent, with a large part of that increase from general obligation bonds.

Citizens are dissatisfied with city maintenance. The 2005 Citizen Survey[5] reports that 15 percent of citizens are satisfied with maintenance of city streets, buildings, and facilities. When asked which three services should receive the most attention in the next two years, maintenance of

[5] *City Services Performance Report for Fiscal Year 2005*, Office of the City Auditor, Kansas City, Missouri, November 2005, pp. 5 and 6.

city streets, buildings, and facilities received an overwhelming 73 percent, while the next highest emphasis was traffic flow with 31 percent. Kansas City residents are significantly less satisfied with the maintenance of city streets, buildings, and facilities than residents in other major cities, including Dallas, Denver, Minneapolis, and St. Louis. (See Exhibit 4.)

Exhibit 4. Citizen Satisfaction with Overall Maintenance of City Streets, Buildings, and Facilities, 2002 - 2005[6]

City	2002	2003	2004	2005
Kansas City	**24**	**21**	**14**	**15**
Dallas	37	31	41	41
Denver	37	44	44	45
Minneapolis	64	58	58	58
St. Louis	26	25	22	33

Sources: City Services Performance Reports for Fiscal Years 2003-2005.

The city is contributing less than the $80 million needed for capital maintenance. The city's Five-Year Capital Improvements Plan[7] states that current estimates for annual maintenance needs are approximately $80 million. The city's proposed budget increases the general fund contribution for fiscal year 2008 from $21.9 to $24 million. The city manager's budget also proposes an influx of $30 million in general obligation bond proceeds toward capital maintenance for a total of $54 million. One risk of using debt to fund maintenance is that future funding for maintenance is likely to decline, because tax revenue will be needed to cover the debt. The city manager plans to restructure the city's outstanding general obligation debt and use those savings to pay the debt service on this new issuance.[8]

The Bond Financial Advisory Committee recommends minimum maintenance funding, exclusive of bonds. The Bond Financial Advisory Committee[9] recommended that the Council allocate at least $36.3 million per year to the maintenance program while the infrastructure bonds are outstanding. According to the Bond Financial Advisory Committee Annual Report, the city did not meet this recommendation and allocated only $21.8 of the $36.3 million in revenue to the maintenance program. [10]

[6] By percent of respondents who rated the item as "Satisfied" or "Very Satisfied," excluding "don't know".
[7] Five Year Capital Improvements Plan, 2006-2007 to 2010-2011, City of Kansas City, Missouri.
[8] Submitted Budget 2008, city manager's transmittal letter, p. 4.
[9] The five-member committee, appointed by the mayor, makes recommendations to the Council on the financial aspect of the use of $250 million in general obligation bond money approved by the voters.
[10] Bond Financial Advisory Committee Annual Report, Fiscal Year 2005-06, City of Kansas City, Missouri, Prepared by the City Treasurer's Office, November 2006.

The Bond Financial Advisory Committee supports renewal of the capital sales tax and recommends adequately funding the maintenance program from the sales tax or other general municipal revenues. The Government Finance Officers Association recommends that jurisdictions also use pay-as-you-go financing for capital maintenance. Repair and replacement projects with short useful lives are not appropriate for long-term debt financing.[11] The committee's annual report states that the general obligation financed projects met the committee's recommendation that the city finance projects with a useful life no less than the term of the bond.

The city manager and Chamber of Commerce recommend contributing a large portion of capital sales tax to maintenance. The city manager said in his budget transmittal letter that staff believe the City Council should consider allocating a significant portion of the upcoming one-cent capital improvements sales tax renewal to fund a portion of the city's annual maintenance needs. The Kansas City Chamber of Commerce report[12] on capital maintenance also strongly recommends renewing the one-cent sales tax for capital improvements, which expires in 2008, and committing up to 50 percent of the nearly $68 million tax revenue towards the deferred maintenance backlog. Historically, capital sales tax revenues have been used for new capital projects. The Public Improvement Advisory Committee makes recommendations for how the capital sales tax revenue is spent.

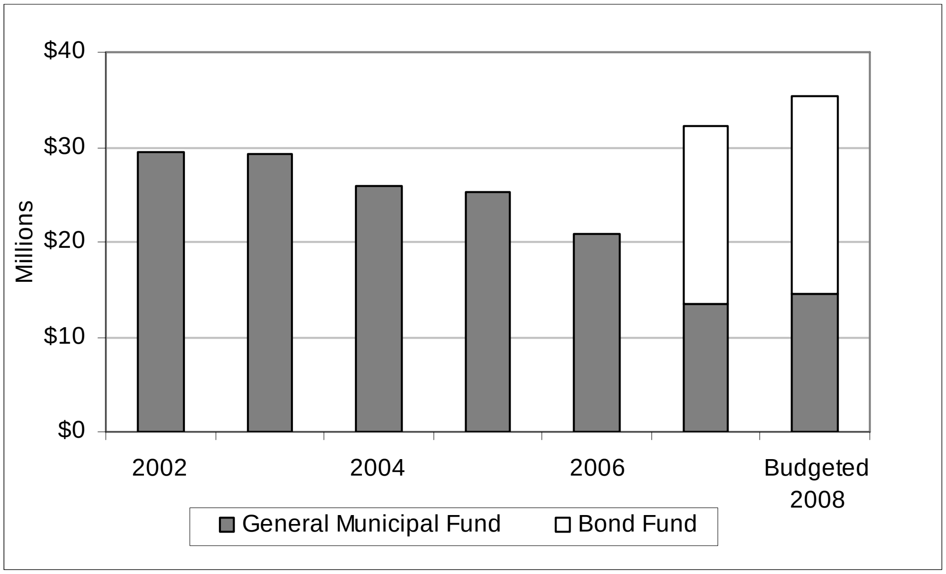
The city manager increased the maintenance budget. In the submitted budget, the amount allocated for major infrastructure maintenance activities has increased. Funds for street preservation and marking; municipal building rehabilitation; bridge rehabilitation; traffic signal improvements; and boulevards, curbs, and sidewalks infrastructure maintenance activities increased by 10 percent, compared to fiscal year 2007. Bond funds account for almost 59 percent of the total budget for these activities. The total funding for maintenance for these items is about $35 million in fiscal year 2008. Only $14.4 million came from general revenues. (See Exhibit 5.)

---

[11] *An Elected Officials Guide to Debt Issuance*, Second Edition, Government Finance Officers Association, JB Kurish and Patricia Tigue, 2005, p. 9.

[12] The Greater Kansas City Chamber of Commerce, An Updated Analysis of Kansas City, Missouri's Deferred Maintenance, January 2007.

Exhibit 5. Funding for Street Preservation & Marking, Bridge Rehabilitation, Municipal Building Rehabilitation, Traffic Signal Safety Improvements, Boulevard Curbs and Sidewalks



Sources: Five-Year Capital Improvements Plan 2000-2005, and Submitted Budget 2008.

Growing Public Safety Needs Will Put Pressure on Future Budgets

City leaders need to address growing public safety needs over the next 5-10 years. Implementing recommendations from the recent efficiency study for the Police Department will require additional funding. The department has already asked for $20 million to replace and update vehicles and technology. The city needs to plan for the expiration of the police and fire sales taxes in 2011 and 2017 respectively. In addition, growth of public safety sales tax revenue is limited by revenue being redirected to TIF.

Implementing the police efficiency study, "Blue Print for the Future,"[13] will require increased funding. The Police Department requested $20 million in increased funding for fiscal year 2008 to implement recommendations made in the efficiency study. (See Exhibit 6.) The study evaluated opportunities for more productive use of the department's workforce. Of the $20 million in requests, the city's submitted budget adds funding for two positions to handle the additional work of maintaining the department radios and in anticipation of the radio system being upgraded. The city also allocated $250,000 to start implementation of the "Blue Print."

[13] Report of a Deployment Audit of the Police Department, A Blue Print for the Future, Kansas City Police Department Efficiency Study, Berkshire Advisors, September 2006.

Exhibit 6. Police 2008 Budget Requests Supported by "Blue Print" Recommendations

Budget Request	Amount Requested
106 additional police cars to ensure that an officer is available to cover every district.	$ 4,091,070
Police mobile and portable radio replacement and upgrades to dispatch consoles, control stations, and radio tower repeaters.	15,308,215
Three crime scene technicians to increase amount of time that may be spent at each crime scene.	139,823
Four crime lab criminalists in anticipation of cessation of two grants.	209,596
Crime lab information management system LIMS to manage cases.	500,000
Total	$20,248,704

Source: Kansas City Police Department Budget Transmittal Letter, Proposed Budget for Fiscal Year 2007-08, September 18, 2006.

The Police Department has formed task forces to consider other recommendations made in the "Blue Print," which will likely require additional funding.

The city is considering options for renewal of the police sales tax. The city and Police Department are discussing renewal of the ¼-cent Police, emergency medical response, and emergency management tax, which is used for capital improvements and is set to expire in 2011. In order to meet the Police Department's growing vehicle and equipment needs, they are considering asking voters to renew the tax and allow it to pay for vehicles and equipment.

The expiration of the ¼-cent fire sales tax will require planning. The city used the fire sales tax to hire 135 new fire fighters, to buy new equipment, and to improve fire stations. Before the tax expires in 2017, the city needs to renew the tax, find another source of income, or reduce fire spending. The city has not yet started planning for renewal of the tax.

Public safety sales tax growth is limited by revenue redirected to TIF. About $4.4 million from the police and fire sales taxes will be redirected to TIF this year. The city's 2008 budget projects the police city sales tax will generate $20.8 million and the fire city sales tax will generate $20.6 million in revenue.

Unfunded Commitments Obligate Future Spending

The city is committed to $92 million in unfunded capital projects. The Council directed the city manager over the last few years to develop financing for five capital projects committed to outside of the normal capital improvement budget process. The city funded two of the five projects in fiscal year 2007. Finding resources to finance these unfunded projects puts pressure on the city's already tight budget. The Council will need to prioritize these projects against other planned capital projects.

The city has not identified a funding source for some capital projects. The city committed to about $126 million for five capital projects in the last few years that were not part of the adopted Capital Improvement Plan. Two of these projects are fully funded and one is partially funded. About $92 million in unfunded commitments remains. (See Exhibit 7 for the status of project funding.)

Exhibit 7. Capital Projects Committed to Outside the Budget Process

Project	Project Description	Funding Amount	Status
	Projects Funded in 2006		
Music Hall Improvements	The project improves the Music Hall's stage to facilitate larger touring productions of Broadway shows as well as improvements to the backstage area and audience seating. Resolution No. 051010, Adopted 8/25/2005	$9 million	Funded by refinancing Bartle Hall.
Police Academy Road Improvements	The project would rebuild Shoal Creek Parkway, Pleasant Valley Road, and a portion of Searcy Creek Parkway to facilitate travel around the new Kansas City Police Academy and Shoal Creek Patrol Station as well as boost development in the area. Resolution 050924, Adopted 8/4/2005	$10 million	Funded through the Public Safety sales tax, Shoal Creek TIF revenues, Public Improvement Advisory Committee Capital Improvement Plan, and the Water Services Department.

Project	Project Description	Funding Amount	Status
Unfunded/Partially Funded Projects			
American Royal Improvements	The city will facilitate the needs of the American Royal Association to continue operating after the loss of a portion of the Liberty Street lot for redevelopment of the Mexican Customs Facility. Ordinance No. 051401, Passed 12/15/2005	$8-10 million	Not funded. Issues at the federal level still need to be resolved before proceeding with the Mexican Customs facility.
American Royal Master Plan	The mayor and Council directed the city manager to work with the American Royal Association to develop financing for their master development plan. Resolution 051400, Adopted 11/17/2005	$35 million	Not funded. The current thinking is that the city first needs to consider the adaptive reuse of Kemper.
Performing Arts Center	The city made a commitment to finance construction of public parking garages for the new performing arts center. Resolution No. 030372, Adopted 4/3/2003	$62 million	$47 million not funded. $15 million funded toward the purchase of land and grading of 16th St. for the new Bartle Hall Ballroom. The city may do the project in phases or determine whether the center can be financed with Bartle Hall debt.

Source: Office of Management and Budget.

Project commitments made outside the budget process put pressure on funding other capital projects. Finding resources to finance these projects puts pressure on the city's budget. The city's budget officer said that when the city commits to projects outside of the budget process, the projects are not evaluated in the context of other issues. Every project has merit in isolation; however, resources are scarce.

As the city manager pointed out last year in a letter to the Council,[14] without prioritization against all other city needs, reductions from the adopted Capital Improvement Plan and the current capital budget will be necessary. The police academy roadway project is an example of this. The city is partially funding the roadway project through money from the

[14] Memorandum from City Manager Wayne Cauthen to the Mayor and City Council, December 2, 2005.

capital improvement plan, but the Public Improvement Advisory Council (PIAC) did not consider it in the context of other capital projects. PIAC considers citywide and neighborhood capital needs annually and recommends a five-year capital program to the city manager, mayor and City Council. In the case of the police academy roads, the Council directed PIAC to include an allocation of $2.7 million in the fiscal year 2008 Capital Improvement Sales Tax Citywide Program.

City Faces Other Obligations with Potential Long-term Impact

Besides big future financial obligations like the sewer system upgrade city management has identified other issues that the city will have to face in the next few years. These include increasing solid waste disposal costs and funding future public transportation needs.

The cost of solid waste disposal will be going up. The city manager identified solid waste disposal as another long-term issue. According to city staff, the Kansas City area will run out of landfill space in the next ten years, which will substantially increase the cost of disposal. City staff also told us that using a contractor for trash pick up is costing the city more than collection performed by city crews. The city manager plans to use a consultant to study the best ways to provide solid waste services to the city and pointed out that the city must begin identifying alternative solutions for disposal of solid waste.

Funding future transportation needs will be a challenge. The Kansas City Area Transportation Authority will need a new funding source when the 3/8-cent sales tax expires in 2009. The tax provides about half of the city funding for public transportation in the city. In 2006 the citizens of Kansas City approved the light rail system initiative. Implementing light rail will require substantial planning and funding.

Back to Table of Contents

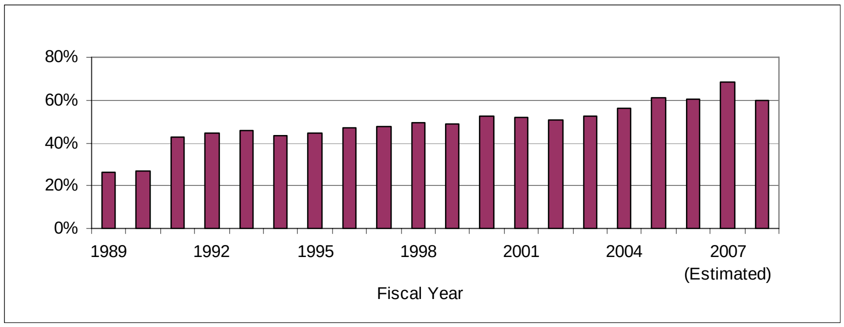
City's Financial Flexibility Limited

Indicators for the city show limited financial flexibility, reducing the city's ability to respond to changing priorities or unforeseen conditions. A high portion of the city's operating revenues are restricted and debt service continues to grow. The fund balance remains too low. The city faces a "structural imbalance" because the fund balance is below the target level of eight percent and the city's capital maintenance remains too low. In addition, although the city's five-year financial forecast shows a projected surplus, it fails to include future city obligations.

More Than Half of Revenues Are Restricted

The city's restricted revenues have been about 60 percent of operating revenues since 2005. (See Exhibit 8.) Restricted revenues are legally earmarked for a specific use by state law, bond covenants, city ordinances, or grant requirements. The higher the percentage of restricted revenues, the less flexibility the City Council has to respond to changing priorities and unforeseen conditions.

Exhibit 8. Restricted Revenues as Percentage of Operating Revenue

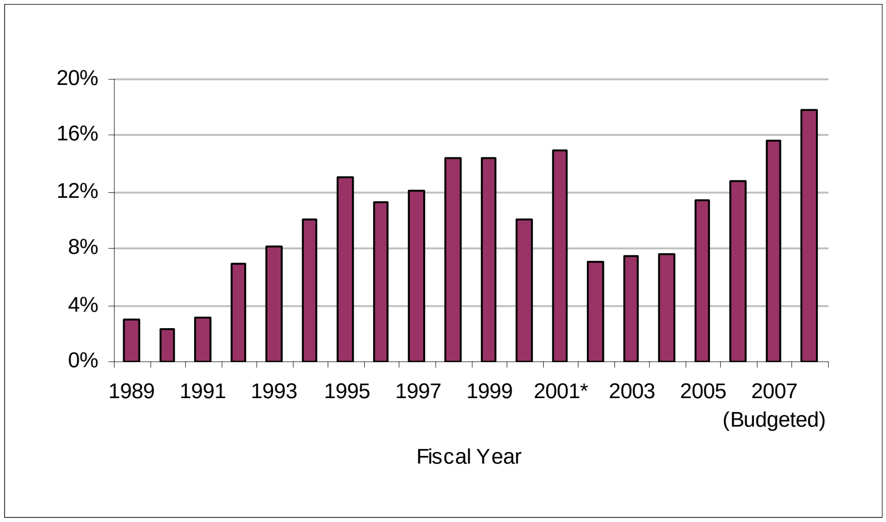


Sources: Adopted Budgets 1989 – 2006 and Submitted Budget 2008.

Debt Service Continues to Grow

Debt service is budgeted at 18 percent ($122 million) of operating and capital expenditures in fiscal year 2008, which is the highest it has ever been. (See Exhibit 9.) Fixed expenditures are those over which officials have little short-term control. Debt service is a fixed expenditure. As it continues to grow, the City Council has fewer options to adjust spending in response to economic changes.

Exhibit 9. Debt Service as Percentage of Operating and Capital Expenses[15]



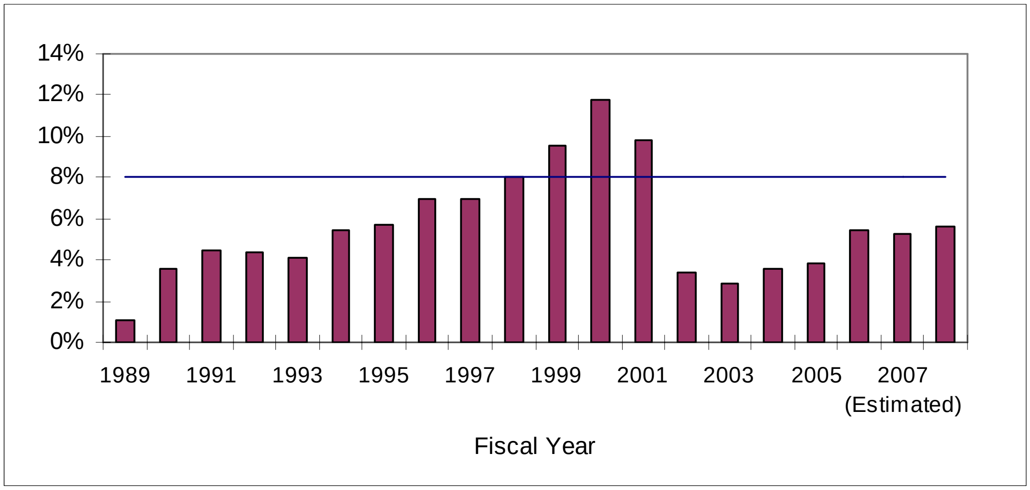
Sources: Adopted Budgets 1989 – 2006 and Submitted Budget 2008.

Fund Balance Too Low

The fund balance is too low. The projected balance for fiscal years 2007 and 2008 is below six percent. (See Exhibit 10.) The city promised to take steps to rebuild its fund balance at a presentation to rating agencies in June 2004. At that time, the city agreed to restore fully the fund balance to eight percent in four to five years. The city manager has steadily been rebuilding the fund balance. He also recommends that the City Council develop a policy of a minimum fund balance of 10 percent of expenditures. However, the fund balance of 5.6 percent still remains below the city's current policy of eight percent of general fund expenditures. A low fund balance diminishes the city's ability to respond to unanticipated emergencies such as natural disasters and uneven cash flow.

[15] Schedule I of the 2008 Submitted Budget reported operating expenses as one category. Starting with fiscal year 2007, this category includes capital expenses. We used this category in our calculation of debt service.

Exhibit 10. General Fund Balance as Percentage of Expenditures



Source: Adopted Budgets 1989 – 2006 and Submitted Budget 2008.

Conditions for "Structural Balance" Unmet

The city does not meet all the criteria for a structurally balanced budget. For the budget to be structurally balanced the city needs to meet several conditions:

- Current expenditures should equal current revenues,
- An adequate fund balance is maintained,
- Revenue growth is equal to or greater than expenditure growth in coming years, and
- Capital maintenance expenditures are not deferred.

The five-year forecast projects current revenues equal to current expenditures and projected revenues exceed projected expenditures. (See Exhibit 11.) The city does not meet all criteria for a structurally balanced budget, however, because the city's capital maintenance is deferred and fund balance is below the target level of eight percent. The city's five-year forecast also excludes future city obligations. So while the forecast shows a surplus, including those future obligations could result in a deficit.

Exhibit 11. Projected Budgetary Surplus

Fiscal Year	Projected Surplus
2008	$1.0 million
2009	2.5 million
2010	1.5 million
2011	0.8 million
2012	0.5 million

Source: Five-year Financial Forecast, FY2008-2012.

Back to Table of Contents

Significant Improvements in Reporting, but Forecast Never Presented

The city manager improved timeliness of the annual and monthly financial reporting, which should improve the city's ability to monitor financial conditions. However, the city manager failed to present a key analysis – the 5-year financial forecast – that addresses medium-term financial conditions. That analysis, which should have been presented to the City Council last fall as part of the process of preparing the budget, has not yet been presented, limiting the city's ability to adequately budget and plan for the coming years.

Timeliness of Annual Financial Report Improves

The Comprehensive Annual Financial Report (CAFR) for fiscal year ending April 30, 2006 was released about six months after the end of the fiscal year, a six month improvement from past years. The fiscal years 2003 and 2004 CAFRs were released almost a year after the end of the fiscal year. The city released the CAFR for fiscal year 2005 about nine months after the end of the fiscal year.

Finance Resumed Monthly Financial Reports

Finance staff resumed submitting monthly financial reports to the Council in 2006. In 2005, city staff did not present any monthly financial statements to the Council. The city charter requires the finance director to submit a monthly financial report to the city manager and council no later than 20 days after the close of each month.[16] These statements are prepared to keep city council members informed of fund activity and status. The report contains the financial summaries of the revenue and expenditure activities of the city for each month.

City Manager Failed to Present 5-Year Forecast

During his tenure, the city manager has not presented the 5-year forecast in October as required by resolution.[17] The city manager has had four opportunities to present the five-year forecast as part of the budget process. The city manager only presented the forecast twice, once in February and once in November of 2005. The city manager did not present the forecast as part of the fiscal year 2008 budget process.

[16] City Charter, Article VIII, Section 837.
[17] Resolution 950481 adopted on April 20, 1995 directed the city manager to present a 5-year financial forecast each October as part of the budget process.

The five-year financial forecast is an important tool for providing the City Council with a long-term perspective on the city's financial condition. Incorporating tools into the budget process that reflect future commitments will help the council to concentrate on long-term sustainability.

Recommendations

1. The city manager should present the five-year forecast in October to the City Council as part of the budget process.

2. The city manager should develop a strategy for meeting medium-term obligations including:

    - Adequately funding the city's four pension systems.
    - Making debt service payments.
    - Addressing deferred capital maintenance.
    - Identifying revenue to meet unfunded commitments.
    - Identifying revenue to meet future public safety needs.
    - Developing strategies that would address future financial obligations.

3. The city manager should take measures to incorporate funding discussions on special projects within the regular budget process.

Back to Table of Contents