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Finance, Governance and Ethics Committee
City of Kansas City, Missouri
Kansas City, Missouri

In planning and performing our audit of the financial statements of the City of Kansas City, Missouri (the City) as of and for the year ended April 30, 2013, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, 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 our 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 was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and, therefore, there can be no assurance that all deficiencies, significant deficiencies or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements of the City's financial statements on a timely basis. A deficiency in design exists when a control necessary to meet a control objective is missing or an existing control is not properly designed so that, even if the control operates as designed, a control objective would not be met. A deficiency in operation exists when a properly designed control does not operate as designed or when the person performing the control does not possess the necessary authority or competence to perform the control effectively.

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

A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

We observed the following matters that we consider to be deficiencies or significant deficiencies.

Significant Deficiencies

Grant Receivable Accounting

We proposed several adjustments to the grant receivable accounts. There were several causes for these adjustments. Insufficient reconciliation and review of the grants receivable accounts could result in a material misstatement not being detected in a timely manner. To improve the accounting for grant receivables, we suggest the following:

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- Obtain and review listings of grants closed during the fiscal year. This will prevent any entries recording receivables for grants that have been exhausted.
- When estimating receivables at year end, it is important to verify that cash receipts have been recorded in the correct period. In the current year, a cash receipt was recorded in the incorrect month, which resulted in improper revenue recognition.
- When preparing the year end receivable estimates, it is important to review the calculations to verify that the receivable is being calculated correctly. In the current year, there were multiple formula errors discovered in the receivable calculations that resulted in misstated receivable balances.
- In situations where grant revenues, including both expenditure reimbursements and program income, exceed the related expenditures, it is important to classify these amounts as deferred revenue rather than negative receivables. An entry was recorded to properly classify grants in this situation.
- When estimating the year end receivable, it is recommended that any final reimbursement requests be used to calculate the receivable. In the current year testing, an adjustment was recorded to reduce the year end receivable for one grant to be equal to the final reimbursement request.
- A standardized year end reconciliation should be developed and distributed to all departments. The use of a standardized reconciliation will ease review of the receivable calculation and allow for the communication of any necessary information to the individual responsible for reviewing the year end receivable.

Deficiencies

General Ledger Account Maintenance and Review

During the course of the audit, several adjustments were proposed to management. The proposed adjustments affected a variety of general ledger accounts, including tax revenue, accounts receivable, accounts payable, deferred revenue, accrued liabilities and various expense accounts. Most errors identified were the result of insufficient general ledger account maintenance and review. Additionally, there appears to be an inadequate process for identifying significant transactions that are relevant to the financial statements.

The issues identified above can be largely attributed to inconsistent accounting policies and practices between the various departments. The current organizational structure of the City allows certain accounting functions to be performed at the department level. This includes purchasing, receiving, capital asset accounting and the recording of journal entries. While the decentralized environment allows for greater accountability and flexibility, it can compromise the effectiveness of internal controls and increase the risk of material misstatement if the accounting functions are not monitored and applied consistently. An emphasis should be placed on strong communication and consistency between all departments. Implementing and enforcing a standard City wide operating and accounting procedures manual would help ensure that transactions are being identified, properly recorded and effectively monitored.

Accounts Payable Cutoff

During our search for unrecorded liabilities, we noted several exceptions in which invoices relating to goods received or services performed prior to the year-end date were not recorded as payables in the proper period. Proper cutoffs are critical for the accuracy of the accrual basis of accounting.

We suggest the City implement additional review procedures to verify that all payables are recorded in the correct period.

Segregation of Duties

Segregation of accounting duties is an essential element of effective internal controls, involving the separation of custody of assets from related recording of transactions. We noted in the payroll transaction cycle where personnel had duties not fully segregated from a proper internal control perspective. Certain individuals have the ability to access master payroll files (but not master human resource files), generate payroll payments, change payroll data, authorize payroll and record certain payroll transactions. We recommend the City evaluate the costs versus the benefits of further segregating these duties.

We observed other matters that we consider to be deficiencies that we communicated to management orally.

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

BKD, LLP

Kansas City, Missouri
October 31, 2013

KANSAS CITY, MISSOURI
RESPONSES TO THE FISCAL YEAR 2013 AUDIT MANAGEMENT LETTER

Material Weaknesses (0)

No material weaknesses were reported for FY 2013.

Significant Deficiencies (1)

Grant Receivable Accounting

We proposed several adjustments to the grant receivable accounts. There were several causes for these adjustments. Insufficient reconciliation and review of the grants receivable accounts could result in a material misstatement not being detected in a timely manner. To improve the accounting for grant receivables, we suggest the following:

- Obtain and review listings of grants closed during the fiscal year. This will prevent any entries recording receivables for grants that have been exhausted.

- When estimating receivables at year end, it is important to verify that cash receipts have been recorded in the correct period. In the current year, a cash receipt was recorded in the incorrect month, which resulted in improper revenue recognition.

- When preparing the year end receivables estimates, it is important to review the calculations to verify that the receivable is being calculated correctly. In the current year, there were multiple formula errors discovered in the receivables calculations that resulted in misstated receivable balances.

- In situations where grant revenues, including both expenditure reimbursements and program income, exceed the related expenditures, it is important to classify these amounts as deferred revenue rather than negative receivables. An entry was recorded to properly classify grants in this situation.

- When estimating the year end receivable, it is recommended that any final reimbursement requests be used to calculate the receivable. In the current year testing, an adjustment was recorded to reduce the year end receivable for one grant to be equal to the final reimbursement request.

- A standardized year end reconciliation should be developed and distributed to all departments. The use of a standardized reconciliation will ease review of the receivable calculation and allow for the communication of any necessary information to the individual responsible for reviewing the year end receivable.

Response – Management agrees with the auditors' recommendations. The new grant accountant position will work closely with departments to develop and implement operating procedures to correct these internal control issues.

Deficiencies (3)

General Ledger Account Maintenance and Review

During the course of the audit, several adjustments were proposed to management. The proposed adjustments affected a variety of general ledger accounts, including tax revenues, accounts receivable, accounts payable, deferred revenue, accrued liabilities and various expense accounts. Most errors identified were the result of insufficient general ledger account maintenance and review. Additionally, there appears to be an inadequate process for identifying significant transactions that are relevant to the financial statements.

The issues identified above can be largely attributed to inconsistent accounting policies and practices between the various departments. The current organizational structure of the City allows certain accounting functions to be performed at the department level. This includes purchasing, receiving, capital asset accounting and the recording of journal entries. While the decentralized environment allows for greater accountability and flexibility, it can compromise the effectiveness of internal controls and increase the risk of material misstatement if the accounting functions are not monitored and applied consistently. An emphasis should be placed on strong communication and consistency between all departments. Implementing and enforcing a standard City wide operating and accounting procedures manual would help ensure that transactions are being identified, properly recorded and effectively monitored.

Response – It may be useful to consider that the General Ledger Account Maintenance and Review comment is a general comment in nature and rolls up a variety of issues into one comment. It may also be useful to consider that this comment is at the lowest level of the hierarchy of internal control comments that being a "deficiency". However, management will continue to work on these issues with the goal of one day removing the comment entirely from the management letter, or at least reducing the number of general ledger accounts that have a proposed adjustment. For example, in FY 2012 capital assets were included as one of the general ledger accounts requiring adjustments. In FY 2013 capital assets is not mentioned as an account needing an adjustment.

Accounts Payable Cutoff

During our search for unrecorded liabilities, we noted several exceptions in which invoices relating to goods received or services performed prior to the year-end date were not recorded as payables in the proper period. Proper cutoffs are critical for the accuracy of the accrual basis of accounting. We suggest that the City implement additional review procedures to verify that all payables are recorded in the correct period.

Response – Management agrees with the auditors' recommendation and will implement additional review procedures.

Segregation of Duties

Segregation of accounting duties is an essential element of effective internal controls, involving the separation of custody of assets from related recording of transactions. We noted in the payroll transaction cycle where personnel had duties not fully segregated from a proper internal control perspective. Certain individuals have the ability to access master payroll files (but not master human resource files), generate payroll payments, change payroll data, authorize payroll and record certain payroll transactions. We recommend the City evaluate the costs versus the benefits of further segregating these duties.

Response - The Payroll section of the Finance department currently consists of four (4) employees due to a reduction in force (RIF) that occurred in 2009 and two (2) retirements that occurred in 2011 of which only one (1) position was allowed to be filled. This has created a situation where certain employees have incompatible duties from an optimal internal control perspective. While each of these employees has their own job duties to perform, they also back-up other employees in the section in cases of absences. In order to create a compensating control, reports will be developed to monitor data inputs performed by these employees to ensure the integrity of the payroll processes.