



Inter-Departmental Communication

Date: December 19, 2005
To: Jim Rowland, Chair, Budget and Audit Committee
From: Mark Funkhouser, City Auditor
Subject: Summary of issues reported by KPMG and JMA Chartered for fiscal year 2004

The city's commercial auditors identified problems when they completed the city's annual audit for fiscal year 2004. KPMG LLP prepared the management letter and JMA Chartered prepared the A-133 report.¹ Both documents, which provided detailed information about the problems, are attached. The problems generally relate to two major issues:

- The city hadn't made financial reporting a priority.
- The city hadn't adequately monitored activities funded by federal grants.

Keep in mind that the reports cover the year that ended April 30, 2004. Since that time, the city hired a new finance director and continued implementing a new accounting system.

Financial Reporting Was Not a Priority in Fiscal Year 2004

Because the city hadn't made financial reporting a priority, significant errors and irregularities could occur in the city's financial records without being quickly identified by employees. The technical term for this type of problem is a "material weakness". KMPG highlighted a number of problems related to financial reporting, including:

City systems weren't designed for the necessary accounting. The city's daily processes prepared financial information on a "cash basis". At the end of each year, the city then converted the records from cash basis. Keeping information on a cash basis is easier, but doesn't give a complete picture of the city's financial information. The city should design systems to ensure that staff prepare the needed information as part of their normal assigned duties.

Supervisory review was limited. In some cases, supervisors didn't review supporting documentation and errors were only caught by the auditors.

¹ City of Kansas City, Missouri, *Management Letter*, prepared by KPMG LLP, April 27, 2005; and City of Kansas City, Missouri, *OMB Circular A-133 Reports*, prepared by JMA Chartered, April 30, 2005.

Staff needed to better understand information from the Governmental Accounting Standards Board. City staff need to be able to understand governmental accounting information so that they can develop solutions to technical problems rather than ask KPMG auditors for guidance. The city needed to provide training for staff.

City applied certain checks only once a year. The city applied a number of accounting controls only once a year, usually at the request of KPMG auditors. If the city applied the controls more frequently, the year-end financial reporting could be completed quicker.

Staff didn't routinely analyze certain accounting records. KPMG identified a number of errors in accounting records that staff quickly corrected. City staff should routinely analyze records to identify and correct errors.

City misallocated some funds and then made mistakes in correcting the allocations. City staff reviewed historical records for some construction projects and found some costs not properly allocated. In correcting those records, staff didn't follow generally accepted accounting principles.

City didn't effectively account for property taxes. To effectively account for property taxes, the accounting system needs to provide information on the amount of property taxes that remain to be collected and the likelihood of collecting that money. The city didn't have that information. The city was not checking to ensure that the counties – which are involved in collecting city property taxes – were recording and remitting tax collections properly.

City didn't reconcile grant expenditures. The federal and state governments provide the city grants, but the city didn't always match reported grant expenditures to the accounting records. As a result, the city had difficulty meeting certain accounting rules and preparing a required federal report (the Schedule of Expenditures of Federal Awards).

City made mistakes in summarizing capital assets. Several departments maintain records of capital assets that are then summarized by the Finance Department. KPMG found many errors in the city's records and it took the city about ten months to compile the information after the auditors asked for it.

City didn't routinely review encumbrances. An encumbrance is a way to account for future commitments. In some cases, the encumbrance is no longer needed and should be released, but the city didn't routinely review encumbrances to find those that could be released. KPMG recommended the city review encumbrances every three months.

Reconciling cash. The city had difficulty reconciling bank records.

City couldn't reconcile information related to leased computers. The city leases computers from IBM, but couldn't match city records to IBM's records. Poor records kept staff from accounting for all of the leased computers.

Inadequate Monitoring of Grant Spending

Problems with how the city monitors certain activities adversely affect the city's ability to administer federal grants as required by laws, regulations, contracts and grants. The technical term for this type of problem is a "reportable condition". JMA Chartered highlighted a number of problems related to monitoring, including:

- Made payments inconsistent with grants and contracts.
- Didn't maintain adequate supporting documentation.
- Failed to document review and authorization of payments.
- Didn't reconcile records to the general ledger.

The auditors reported many problems with City Development Block Grants. In addition, the auditors noted problems with Local Law Enforcement Block Grants, Environmental Protection Agency grants, and the city's reporting to the U.S. Department of Housing and Urban Development.

City Has Had Significant Problems for Years

Many of the problems described above were identified in prior years, but had not been addressed. In three of the last five years, commercial auditors found what they call "material weaknesses" in the city's audits. In 15 of the last 17 years, the auditors found "reportable conditions".

cc: Kay Barnes, Mayor
Members of the City Council
Wayne A. Cauthen, City Manager
Debra Hinsvark, Director of Finance