

# Audit and Finance Committee Status Report

## August 19, 2005

### Introduction

Since June 2, 2005, the Audit and Finance Committee has met several times, initially with the charge of providing input to the City's budget for 2005-06. That role has expanded considerably based on meetings with the Mayor, City Auditors, Finance Director and City Manager. The City's auditors, Kern, Shores and Company, provided the Committee valuable information regarding their 2003-2004 audit findings. The City Finance Director has provided valuable background information. Most recently the City Manager has been a major resource.

Considering that this is an important subject that has been receiving a lot of attention both in and outside of City Hall, the Committee deemed it appropriate to provide the council and community with a brief Status Report of findings and progress to date. In addition this committee will continue its work to assist the city in these remedial efforts.

### A. Fiscal Year (FY) 2004 AUDIT (July 1, 2003-June 30, 2004)

In the July 20<sup>th</sup> meeting of the Audit and Finance Committee, the final independent auditor's report for FY 2004 and the City's response to the audit findings were reviewed. The purpose of the Audit and Finance Committee Status Report is to provide an overview of the City's commitment to resolve the audit findings agreed to during this meeting.

The FY 2004 audit report included an adverse opinion due to the omission of the Thunder Creek Golf Course Authority and the McAlester Regional Health Center Authority. The audit report included a qualified opinion due to the City's failure to maintain complete capital asset records. In addition, the audit report contained Reportable Conditions – which, for the purpose of the Audit and Finance Committee Status report are classified as Procedural and Systemic. The systemic findings involve the upgrade of the current financial system and the implementation of capital assets identification and tracking system.

The following summarizes what these findings mean and the City's response to address each of these areas:

**Adverse Opinion** – The City has committed to include the financial activities of the Thunder Creek Golf Course Authority and the McAlester Regional Health Center Authority in the City's Annual Report. The McAlester Regional Health Center Authority has had an annual audit routinely, but the audit was not included in the City's audit for several years. However, it will be included in the FY 2005 Annual Audit Report and has been published on the City's website. Inclusion of the Thunder Creek Golf Course Authority is pending determination of legal status and review of available records. In about 1999, the Authority dissolved and the last audit was performed. No records are

available at this time and the status of ownership of the golf course is unclear. Therefore, no audit is available or can be completed at this time.

### *Committee Analysis*

**The McAlester Regional Health Center Authority data has been included. When the status of Thunder Creek is determined and the golf course financial data is either included or excluded because the City clearly owns, or no longer owns Thunder Creek, then the City's auditors should be able to eliminate the Adverse Opinion related to the Thunder Creek Golf Course audit.**

**Qualified Opinion** – The City has committed to identifying and tracking capital assets going forward. The City of McAlester has always maintained an asset inventory of capital assets. Some capital assets though included in inventory have not been depreciated over time and contribute to the findings of the audit. Buildings and high cost items have been depreciated and all significant assets (i.e. vehicles, computer equipment, etc.) have been tracked through inventory. Any items that are no longer used are surplus and auctioned annually. Recommended depreciation of fixed assets excluding infrastructure will be initiated once Accounting Policies and Procedures, which are currently under development, are adopted and the process defined. The draft Accounting Policies and Procedures will be presented to the Audit and Finance Committee to review and amend as needed prior to adoption.

The other contributing factor to the finding is that, current government accounting standards also require governmental entities to retroactively record all major infrastructure assets (roads, bridges, water and sewer lines, etc). The minimum requirement is to report major infrastructure assets acquired after June 30, 1980. Smaller cities and towns across the state and nation are experiencing great difficulty in implementing this requirement and McAlester is no exception. An implementation time frame has not yet been determined.

### *Committee Analysis*

**The Committee will work with the City to determine how best to meet this requirement. The City will likely continue to receive a qualified opinion in this area until the requirement is met.**

**Procedural Findings** – The procedural issues pertain to day-to-day operations and the corrections to these findings involve changes to or implementing new operating procedures. These procedural changes have been or are in the process of being implemented. The following example is provided to illustrate a procedural issue:

*The City and Authorities have no formal policies or procedures established for the maintenance of annual and sick leave records in total or reconciling the departmental totals to the total leave calculated for the City as a whole.*

This example was taken from the annual auditor's report for fiscal year 2004. At one time, all leave records were centralized. However, as the City grew and the paperwork burden increased the process was changed and maintained by individual departments. With the implementation of the accounting software and resolving the connectivity issues anticipated to be complete by the end of 2005, this issue will be addressed with all leave records consistent and centralized. Further, each department will be able to input this information from their work stations into the system which will facilitate reconciliation of total leave calculated for the City as a whole. Changes in procedures are being made to address the audit findings.

### *Committee Analysis*

**Once made, these changes will result in increased accountability by departments and the city government as a whole. The Committee recommends that the City implement a time clock/card system. This should be included with other systemic improvements discussed below. Employees should be clocking in and out for payroll rather than filling out time sheets. With computerization this can be done with scanned ID Cards and /or PC's for office workers at individual work stations. Current manual tracking allows more error and a time card system will more accurately record actual time worked.**

**Systemic Findings** – The City Manager has committed to upgrading the City's financial system software and contracting with the software company to provide the necessary training to City employees to implement the upgrade. As of the date of this report, the server hardware to provide connectivity City-wide has been purchased and training scheduled. The Microsoft Exchange Server should be up and running by September 15, barring unforeseen complications. The accounting software that is already being used by the City has some functions that have not been fully utilized in the past and software modules that can be added to address some of the issues raised by the audit findings. These changes to software usage and subsequent training required are also anticipated to be completed by September 15.

Changes to fund tracking and integration of department records into the system will also be accomplished as part of the system upgrade. In addition the City committed to identifying and tracking capital assets. The time frame for initial implementation of these changes is estimated to be six months and the City Manager will report progress on a periodic basis to the city council.

### *Committee Analysis*

**These upgrades and enhancements are deemed to be critical to the long-term improvement of city government. They will involve considerable effort and significant costs which should be considered as investments to eliminate future problems.**

## **B. FY 2005 Audit (July 1, 2004-June 30, 2005)**

As appropriate the Committee will work with the independent auditors engaged to perform the FY 2005 Audit. Reports of our actions will be forthcoming with their report, findings and recommendations. It should be noted that since the FY 2004 Audit was completed at the end of FY 2005, the FY 2005 Audit will contain most if not all of the findings from the FY 2004 Audit as there has not been time for correction. The impact of the changes implemented cannot be fairly assessed until the FY 2006 Audit is performed.

## **C. FY 2006 Budget**

Committee members are working closely with the City Manager and Finance Director to closely monitor revenue receipts compared to revenue projections. It is likely that a budget revision to some level will be required to adjust budgeted revenue and debt service requirements. The City Manager is aware of the need to closely monitor all expenses and is committed to restrict any expenses that can be deferred until a later time. This restriction on expenses is not anticipated to impact public health or safety.

### ***Committee Recommendation pending Budget Revision***

**Since a budget reduction is imminent, it is recommended that City Departments and the City Council not obligate itself to any major “non-essential” expenditures until budget issues are resolved.**

## **D. Investigative Audit**

The FY 2004 Audit Report is an annual audit of the City’s finances as required by law. As such, its objective is to render an opinion as to the “fairness” of the financial statements when taken as a whole. This opinion provides “reasonable assurance” (not absolute) that the numbers fairly represent the City’s financial position and operating results for the fiscal year being audited.

If the auditors, in the course of their audit, find significant problems or issues, they are required to report them. These findings are documented in their audit report. In meetings with the auditors, the Committee has confirmed that no other significant issues were identified that have not been included in the audit report. It is important to note, however, that an overall financial audit is not designed to find all instances of non-compliance and that it only covers the fiscal period being audited.

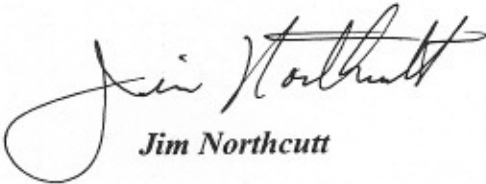
Audits of an investigative nature whether conducted by the State Auditor and Inspector or other independent auditors are more highly focused (in a particular area) than a general financial audit and therefore, require a more specific scope be defined. To this point, and in response to questions, the auditors have informed the Committee that results of their testing procedures did not disclose sufficient evidence of non-compliance with any laws

or regulations to justify an investigative audit by the State Auditor and Inspector. The Committee is reviewing whether there are areas where this more specific type of audit might be beneficial from a cost/benefit standpoint. We intend to discuss and review our findings at our meeting scheduled for September 7.

*Respectfully submitted by the members of the Audit and Finance Committee*

*Citizen Committee Members*

  
*Jane Auld*

  
*Jim Northcutt*

  
*Steve Harrison*

  
*Mel Stubbings*

  
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