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Missouri State Auditor

City of North Kansas City

October 2011
Report No. 2011-83



<http://auditor.mo.gov>



Thomas A. Schweich
Missouri State Auditor

CITIZENS SUMMARY

Findings in the audit of the City of North Kansas City

Financial Condition	The financial condition of the General Fund has declined significantly, with the fund balance falling from almost \$7 million to \$2.8 million from fiscal year 2008 to fiscal year 2010 and is expected to decrease further during 2011. The city is taking steps to balance expenditures and revenues and is transferring monies from the Gaming Fund to supplement the General Fund.
LiNKCity	Operational costs of the city's fiber optic data network (LiNKCity) have significantly exceeded operational revenues, and the city's investment of \$13.5 million for the LiNKCity network may not be an effective use of city resources. A business performance plan said the original plan outlined, "expectations and assumptions that are neither realistic nor attainable." The city should evaluate whether it makes sense to continue investing public funds in the system.
Disbursements	The city pays more overtime than required by law because it counts nonworking (leave) hours when determining overtime. Overtime paid in fiscal year 2010 totaled \$432,500. In fiscal year 2010, the city paid over \$56,000 in vehicle allowances for 24 city officials and employees. The City Council voted in July 2011 to stop paying vehicle allowances for elected officials, but it is still making such payments for 11 city employees.

In the areas audited, the overall performance of this entity was **Good**.*

American Recovery and Reinvestment Act 2009 (Federal Stimulus)	The City of North Kansas City was awarded \$138,517 and received \$125,752 through the Edward Byrne Memorial Justice Assistance Grant Program. It spent \$18,619 for law enforcement equipment, and passed through \$107,133 to Clay County and the cities of Gladstone, Excelsior Springs, and Liberty.
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*The rating(s) cover only audited areas and do not reflect an opinion on the overall operation of the entity. Within that context, the rating scale indicates the following:

- Excellent:** The audit results indicate this entity is very well managed. The report contains no findings. In addition, if applicable, prior recommendations have been implemented.
- Good:** The audit results indicate this entity is well managed. The report contains few findings, and the entity has indicated most or all recommendations have already been, or will be, implemented. In addition, if applicable, many of the prior recommendations have been implemented.
- Fair:** The audit results indicate this entity needs to improve operations in several areas. The report contains several findings, or one or more findings that require management's immediate attention, and/or the entity has indicated several recommendations will not be implemented. In addition, if applicable, several prior recommendations have not been implemented.
- Poor:** The audit results indicate this entity needs to significantly improve operations. The report contains numerous findings that require management's immediate attention, and/or the entity has indicated most recommendations will not be implemented. In addition, if applicable, most prior recommendations have not been implemented.

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City of North Kansas City

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THOMAS A. SCHWEICH

Missouri State Auditor

To the Honorable Mayor
and
Members of the City Council
City of North Kansas City, Missouri

The State Auditor was petitioned under Section 29.230, RSMo, to audit the City of North Kansas City. We have audited certain operations of the city in fulfillment of our duties. The city engaged McGladrey & Pullen LLP, Certified Public Accountants (CPAs), to audit the city's financial statements for the year ended September 30, 2010. To minimize duplication of effort, we reviewed the CPA firm's audit report. The scope of our audit included, but was not necessarily limited to, the year ended September 30, 2010. The objectives of our audit were to:

1. Evaluate the city's internal controls over significant management and financial functions.
2. Evaluate the city's compliance with certain legal provisions.
3. Evaluate the economy and efficiency of certain management practices and operations, including certain financial transactions.

Our methodology included reviewing minutes of meetings, written policies and procedures, financial records, and other pertinent documents; interviewing various personnel of the city, as well as certain external parties; and testing selected transactions. We obtained an understanding of internal controls that are significant within the context of the audit objectives and assessed whether such controls have been properly designed and placed in operation. We also obtained an understanding of legal provisions that are significant within the context of the audit objectives, and we assessed the risk that illegal acts, including fraud, and violations of contract, or other legal provisions could occur. Based on that risk assessment, we designed and performed procedures to provide reasonable assurance of detecting instances of noncompliance significant to those provisions.

We conducted our audit in accordance with the standards applicable to performance audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform our audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides such a basis.

The accompanying Organization and Statistical Information is presented for informational purposes. This information was obtained from the city's management and was not subjected to the procedures applied in our audit of the city.

For the areas audited, we identified (1) no significant deficiencies in internal controls, (2) no significant noncompliance with legal provisions, and (3) the need for improvement in management practices and procedures. The accompanying Management Advisory Report presents our findings arising from our audit of the City of North Kansas City.

An additional report, No. 2011-33, *Seventh Judicial Circuit, City of North Kansas City, Municipal Division*, was issued in July 2011.



Thomas A. Schweich
State Auditor

The following auditors participated in the preparation of this report:

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Audit Manager:	Robert Showers, CPA
In-Charge Auditor:	Robert L. McArthur II Lori Bryant
Audit Staff:	Robert Graham

City of North Kansas City

Management Advisory Report

State Auditor's Findings

1. Financial Condition The financial condition of the General Fund has declined significantly during the last 4 years. The following table presents General Fund activity and balances for the years ended September 30:

General Fund	Budgeted ⁽¹⁾		Actual ⁽²⁾	
	2011	2010	2009	2008
Beginning fund balance	\$ 2,802,843	4,891,167	6,959,808	7,472,841
Revenues	12,039,300	12,640,781	12,838,649	14,236,525
Expenditures	(14,283,152)	(14,729,105)	(14,907,290)	(14,749,558)
Ending fund balance	\$ 558,991	2,802,843	4,891,167	6,959,808

(1) Source: City budget documents. Budgeted receipts for 2011 do not include the \$2.3 million transfer budgeted from the Gaming Fund.

(2) Source: Audited financial statements

General Fund expenditures have significantly exceeded revenues for four consecutive fiscal years (from 2007 through 2010) and are budgeted to do so in fiscal year 2011. The City Council has tasked the new City Administrator to balance the General Fund budget by the year ended September 30, 2013. The City Administrator and the Finance Manager met with the City Council in June 2011 to formally present options to address the General Fund budget. Since approximately 88 percent of General Fund expenditures are wage-related, the Council approved one of the City Administrator's recommendations to implement a voluntary retirement and resignation incentive program and to reduce the portion of premiums paid by the city for group medical insurance for retirees. The Council also recently voted to eliminate vehicle allowances for elected officials (see MAR finding number 3).

Another change made to improve the financial condition of the General Fund was to transfer monies from the Gaming Fund to the General Fund to make up for lost property tax revenues. When the local casino was built in 1995, the City Council voted to voluntarily stop assessing the General Fund tax levy on personal property. This resulted in approximately \$300,000 less in property taxes for the General Fund annually from 1995 to 2010, or a total of approximately \$5 million. In July 2011, the Council voted to reinstitute the property tax levy. In addition, to make up for a portion of the revenues lost and to balance the General Fund budget, the City Council recently approved the transfer of \$5.9 million from the Gaming Fund to the General Fund over a 3 year period, starting with a \$2.3 million transfer during the year ended September 30, 2011. Although Gaming Fund revenues are unrestricted and may be used for any purpose, the City Council has indicated it does not wish to depend on Gaming Fund revenues to balance the General Fund budget.

In addition, the city has historically paid for residential trash pickup from the General Fund without billing residents for the service. This service costs



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Management Advisory Report - State Auditor's Findings

the city approximately \$500,000 per year. For the year ended September 30, 2011, the City Council approved continuing the payment of trash expenses, but voted to move the costs to the Gaming Fund.

Also, some disbursements do not appear to be necessary uses of city funds. For example, the city spent \$15,060 on an employee appreciation day at Worlds of Fun, and \$3,200 on holiday turkeys for employees. Public funds should be spent only on items which are necessary and beneficial to the city. City residents have placed a fiduciary trust in their public officials to spend city funds in a prudent and necessary manner.

It is essential that the City Council continue to address the General Fund financial condition, both in the immediate and long-term future. By evaluating fund revenues and disbursements, and maximizing revenues to the extent possible the council can ensure the fund is on a more secure footing going forward.

Recommendation

The City Council continue to closely monitor the city's financial condition and take the necessary steps to improve the financial condition of the General Fund.

Auditee's Response

The City Council provided the following written response:

As stated in the audit findings, the Council and staff are very much aware of the declining financial condition of the General Fund. Also stated in the report, transfers from the Gaming Fund have been used to maintain a balanced budget starting in fiscal 2010-11. These transfers are set to stop in 2013. Missouri State Statutes place very few restrictions on gaming revenues and this is an allowable use for those funds.

The Council does not wish to depend on the gaming revenues to balance the General Fund budget in the future and has taken many recent actions to reduce and eventually eliminate the General Funds reliance on gaming revenues. The fiscal year 2011-12 budget, passed on September 13, 2011, reduced the General Fund structural operating imbalance to \$374,112 down from \$2,243,852 in the prior year's approved budget. The fiscal 2011-12 short-fall does not include the planned \$2 million transfer from the Gaming Fund. The second and third transfers of gaming money will continue as approved by the City Council in 2010 in order to improve the unappropriated General Fund balance in case of an emergency.

Besides the budget balancing steps mentioned in the findings, the Council recently approved increasing a variety of service fees, increasing the administrative fees charged by the General Fund to special revenue and enterprise funds and added fees to those same funds for services provided by Public Works' divisions.



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The voluntary retirement and resignation incentive program mentioned in the findings, not only reduced staffing, but also allowed for a reorganization of the Public Works Department to more efficiently meet the needs of the community.

The finding states that \$18,260, or 0.07 percent, of the City's total operating budget was spent to recognize the efforts of City employees in fiscal 2009-10. It also goes on to state that such an expenditure "does not appear to be necessary". The City believes such a small investment in our employees during a time when raises are not an option, cost of living increases have been eliminated and benefits have been reduced in some cases is "a prudent and necessary" expenditure to maintain morale and no matter how small of a gesture show appreciation for the work that they do for this community.

The City Council of North Kansas City values its employees and deems it necessary to recognize their contributions when no other means of recognition is available.

2. LiNKCity

Operational costs of the city's fiber optic data network (LiNKCity) have significantly exceeded operational revenues, and the city's investment of \$13.5 million¹ for the LiNKCity network may not be an effective use of city resources.

While initial plans were for LiNKCity's revenues to cover its operational costs, the system had a combined operating loss of \$971,783 in fiscal years 2009 and 2010, and is expecting an additional operating loss of approximately \$450,000 in fiscal year 2011. The initial investment and operational shortfall have been paid from the Gaming Fund. Total Gaming Fund transfers of approximately \$1.5 million were made to cover LiNKCity activity during the 2 fiscal years ended September 30, 2010, with an additional transfer of \$542,300 in fiscal year 2011. According to a business performance evaluation paid for by the city, the reason for the operating deficit of the LiNKCity system is "a result of the original plan outlining expectations and assumptions that are neither realistic nor attainable". The evaluation also states that technology upgrades are also necessary, requiring additional investment by the city.

The LiNKCity network is the first municipally owned and operated fiber optic system in the state of Missouri, and competes with existing broadband and cable data service providers. According to city documents, the purpose of the network is to provide economic development, educational and employment opportunities, and advanced health care. However, with city

¹ The city's initial investment was approximately \$10.5 million, with an additional \$3 million investment going towards operations.



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residents already having alternative service provider options, the necessity of the system is questionable.

It is the City Council's duty to ensure city investments such as LiNKCity are an effective use of city resources. More evaluation is needed to determine if additional investment into the system is warranted.

Recommendation

The City Council continue to evaluate whether continued involvement in LiNKCity is in the best interest of the city.

Auditee's Response

The City Council provided the following written response:

The City Council has concerns about the feasibility of an on-going subsidy of LiNKCity and directed staff in late 2010 to identify ways to reduce the current operating deficit to whatever extent possible.

The actual operating shortfall for fiscal 2010-11 is expected to be \$451,149. The subsidy to LiNKCity is in the form of a transfer from the Gaming Fund. The Gaming Fund transfer subsidy is budgeted at \$430,000 in fiscal 2011-12. This amount includes a \$265,000 operational subsidy and \$165,000 for capital expenditures.

It is true that the residents had an alternative service provider prior to LiNKCity but many of the City's businesses did not have a high speed internet option. The existing provider would not offer service south of Armour Road, thus placing businesses that located or wanted to locate within the City at a distinct disadvantage when attempting to operate a 21st century business and compete in a global economy where dial up is no longer acceptable technology.

To begin the process of generating additional revenue, the City Council approved a Dark Fiber Lease program in the summer of 2011. This new program has generated a lot of interest in our system and has yielded a number of new leases and additional income for LiNKCity. LiNKCity has also taken a more focused approach in targeting multi-dwelling units as large scale customers that will yield greater revenue and profit for each dollar invested.

3. Disbursements

Our review identified issues with overtime calculations and vehicle allowances.

3.1 Overtime calculations

The city overtime policy results in potentially unnecessary overtime costs. Current city policy considers nonworking time, such as vacation, sick leave, and compensatory time taken, as hours worked when calculating employee overtime. This practice is not required by the Fair Labor Standards Act of 1938 (FLSA) and as a result, the city is paying more overtime to employees



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than required. For example, we noted an instance in which an employee worked 8.33 hours for the week and claimed 35.03 nonworking hours (personal and vacation) for a weekly total of 43.36 hours. The city calculated overtime based on the total hours recorded on the timesheet rather than actual hours worked; and as a result, paid the employee time and one half for 3.36 hours. During the year ended September 30, 2010, the city paid approximately \$432,500 in overtime. Of the total paid, 48 percent was to the Fire Department and 31 percent to the Police Department, both of which are paid from the General Fund.

3.2 Vehicle allowances

Vehicle allowance payments by the city appear excessive. Vehicle allowance payments totaling approximately \$27,300 were paid to 13 elected officials and an additional \$29,200 was paid to 11 city employees during the year ended September 30, 2010. Vehicle allowance payments ranged from \$650 annually to the City Treasurer to \$4,200 to the Parks and Recreation Director. The city began paying a \$2,400 annual vehicle allowance to the Economic Development Manager in October 2010, despite the fact that he was paid only \$538 in actual mileage reimbursement in the previous year. In July 2011, the City Council voted to stop paying vehicle allowances to elected officials effective August 2011. However, the payments are still paid from the General Fund to the 11 city employees.

While vehicle allowances are reported as taxable income, reimbursing officials and employees for actual vehicle use ensures the city is neither overpaying for vehicle use or underpaying the employee for unreimbursed use.

Recommendation

The City Council:

3.1 Consider revising the current overtime policy to ensure employee overtime and compensatory time calculations do not include nonworking time such as leave and compensatory time used.

3.2 Reimburse city employees for actual vehicle use.

Auditee's Response

The City Council provided the following written response:

3.1 *Due to the current environment, such action would take time if a focus were placed upon its implementation. Implementation of this recommendation may or may not be pursued depending upon a variety of factors.*

3.2 *As reported in the findings, City Council voted to stop receiving car allowances as of August 1, 2011.*



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Many city employees receiving a car allowance use personal vehicles daily for travel among the City's 11 locations, to obtain goods or attend meetings not available within the city limits. Tracking, recording and reimbursing on a trip by trip basis would administratively cost more than the allowances.

Most of the employees receiving car allowances receive them as a part of their compensation package set out by contract with the City. The compensation is treated the same as salary compensation as it is taxed, etc. The execution of such a recommendation would take time if a focus were placed upon its implementation and potentially cost the City both in productivity as well as financially.

City of North Kansas City

Organization and Statistical Information

The City of North Kansas City is located in Clay County. The city was incorporated in 1912 and is currently a third-class city. The city employed 196 full-time employees and 119 part-time or seasonal employees on September 30, 2010.

City operations include fire services, law enforcement services, utilities (water/sewer and communications), and recreational facilities (parks, community center, etc.).

Mayor and City Council

The city government consists of a mayor and eight-member city council. The members are elected for 2-year terms. The mayor is elected for a 4-year term, presides over the city council, and votes only in the case of a tie. The Mayor and City Council members, at September 30, 2010, are identified below. The Mayor is paid \$600 per month, plus \$3,249 in annual travel allowances. City Council members are paid \$200 per month, plus annual travel allowances of \$2,599. The compensation of these officials is established by ordinance.

William Biggerstaff, Mayor
 James Martino, First Ward Councilmember
 Jerry Barham, First Ward Councilmember
 David A. Silvers, Second Ward Councilmember
 Bill Sanders, Second Ward Councilmember
 Chris Hertling, Third Ward Councilmember
 Amy Rutledge, Third Ward Councilmember
 Bettie Miller, Fourth Ward Councilmember
 Fred Steffen, Fourth Ward Councilmember

Other Elected Officials

Name and Title	Compensation Paid for the Year Ended September 30, 2010
J.W. Brewer, City Collector	\$9,204
Ron Ball, City Treasurer	3,650

This compensation included a \$2,599 annual travel allowance for the City Collector and a \$650 annual travel allowance for the City Treasurer.

American Recover and Reinvestment Act of 2009 (Federal Stimulus)

The City was awarded \$138,517 and received \$125,752 in American Recovery and Reinvestment Act funding as part of the Edward Byrne Memorial Justice Assistance Grant Program through the United States Department of Justice during the year ended September 30, 2010. According to city documentation, the city spent \$18,619 for law enforcement equipment. In addition, the City of North Kansas City, serving as the fiscal agent for this award, passed through \$107,133 to Clay County, and the Cities of Gladstone, Excelsior Springs, and Liberty.