



Denver City Council

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## Finance Committee Summary

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Wednesday, August 16, 2006 1:30 p.m. Council Conference Room

**Committee Members Present:** Faatz, Chair; Brown, Vice-Chair;  
Boigon, Lehmann

**Committee Members Absent:** Rodriguez

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### 1) Management Report from the 2005 City Audit (KPMG):

#### Committee Discussion

Beth Machann, Budget & Management, explained that the City is required to provide a yearly financial statement – Comprehensive Annual Financial Report (CAFR) – that shows the financial position of the various funds of the City and their related statements of financial transactions. An external auditor – KPMG, LLP – conducts an audit of the internal controls of the financial reporting procedures and standards then issues an analysis on the effectiveness of the City's financial reporting operations. Ms. Machann indicated that recommendations from the audit results in the City taking action(s) to remediate any problems that are outlined.

Bob Kuehler, KPMG, LLP, outlined the standards used for financial reporting:

- Reportable conditions: Conditions that reflect significant deficiencies in the design or operation of internal controls and could adversely affect the organization's ability to record, process, summarize, and report financial data consistent with assertions of management in financial statements.
- Material weakness: A reportable condition in which the design or operation of one or more internal control components does not reduce to a relatively low level of risk errors or fraud amounts that would be material in relation to the financial statements being audited and may not be detected within a timely period by employees while in the performance of their assigned functions. These are critical areas that must be resolved.

Mr. Kuehler and Ms. Machann highlighted the material weaknesses and reportable conditions from this years' report as follows (see attachment):

#### Material Weakness:

- 1) The City, including DIA and Public Works – Wastewater Management, did not have adequate internal controls to ensure that capitalization of assets was appropriately stated – an estimated \$15 million was adjusted to correct the errors.

- 2) Ten million dollars in Capital Improvement Projects (CIP) were not reclassified to buildings as projects were completed and placed into service – an adjustment was made to correct this error.
- 3) As of December 31, 2005 the airport did not reconcile its capital asset subsystem balances to the balances reported in the general ledger system – an audit adjustment was recorded in the amount of \$26 million and related depreciations were adjusted by \$3.1million to correct the balances. Similar circumstances were noted at Wastewater Management.

Ms. Machann explained that once an asset is in use it must be identified for depreciation purposes. This reflects appropriate Governmental Accounting Standards Board (GASB) procedures. The City has committed to and begun to develop and implement fiscal accountability procedures for capital assets to be completed by October 31, 2006. She noted various actions have been taken to address the causes that resulted in the material weaknesses such as assigning one lead person from Public Works to coordinate the reporting functions, working more directly with the Auditor's Office, beginning a mid-year close process, and upgrading the fiscal systems at DIA and Wastewater. The audit and changes are important to bond holders and citizens because they create trust, stated Ms. Machann. When done properly the reporting is a great management tool in assessing and conducting remediation for the City's assets (buildings and roads), commented Mr. Kuehler. The Convention Center and Art Museum construction expansions caused some of the systems problems, noted staff.

Councilmember Faatz asked if the Fiscal Rules Committee would stay in existence. Ms. Machann said she did not know. David Broadwell, City Attorney's Office, stated that Charter language could include rules promulgated by the Manager of Finance to clarify the standards in the system and agencies could carry out the functions generated by the rules.

Reportable Conditions:

- 1) Most of the reportable conditions are attributable to financial reporting – the CAFR was not prepared in a timely manner, since the City's books and records tend to close-out in the first quarter of the following year it's reporting, this resulted in the City making 25 adjustments to the ledger representing \$100,000 to \$100 million.
- 2) Timely reconciliations of payroll and accounts payable warrant accounts and the payroll agency fund were not complete.
- 3) The City does not have a regular process in place to adequately explain variances in financial statements - line items- from year to year.
- 4) The City requires 90 days to close its books and records and the independent audit is not completed until 165 days after year-end.

Mr. Kuehler noted that reports are useful if they are generated timely. Ms. Machann indicated the City is working on gathering data and developing reports by the end of October. The problem is that the budgeting process impacts the reporting cycle. Remediation for these conditions includes a year-end reporting package, continuance of system enhancements (Information Technology) regarding applications, systems,

and data centers, and implementing a mid-year close. Agencies impacted by the lack of policies and procedures for inadequate controls have agreed to develop and implement policies and procedures for financial reviews, sign-offs, and proper preparation. Staffing is an issue and agencies are beginning to identify adequate resources/technical expertise to prepare the financial statements in a timely manner. Mr. Kuehler indicated that Denver compared to other major cities does not fair well regarding its reporting timelines and that accounting functions are not given the attention they should. Ms. Machann indicated that training for finance and accounting functions is not the same. The City is organizing a training program to address both functions and to assure appropriate staff coverage for the work that must be performed. Councilmember Lehmann stated she hopes to see requests in the 2007 budget for additional staff. David Hartman, Department of Revenue, stated he was working with Budget & Management to increase the budget for additional staffing. They are considering upgrading vacancy positions to require expertise/credentials to begin to build a program. Ms. Machann noted that approximately 70% of the Information Technology controls have been mitigated. She explained that the agency consolidation project over the past year and half caused the compliance problems, but is confident that the systems issues have been resolved.

Other Comments:

Mr. Kuehler said the report identifies a lack of understanding of the roles and responsibilities for accounting, financial reporting, and internal controls throughout the City. The report noted that it was practice in today's business environment for the chief executive officer (CEO) and the chief financial officer (CFO) to certify financial statements. KPMG recommended that at a minimum the City should designate an individual responsible for the CFO function. It was noted that the Mayor initiated a Financial Management Task Force to address the City's financial structure and is recommending structural changes that would require Charter revisions. Currently, City Council is evaluating the recommendations for a ballot proposal this November. Councilmember Faatz asked if the reportable conditions would require Charter changes. None of them would require Charter changes, stated Mr. Broadwell. Mr. Hartman said the proposals now before Council would help with the structural changes needed to address the reportable conditions. Ms. Machann indicated that Committees have been established to identify and coordinate changes until a CFO model is approved.

2) **Finance Committee goals for 2007:**

Councilmember Faatz asked for feedback from Councilmembers and Finance staff regarding issues that should be brought to Committee for discussion. The following was recommended for future meeting discussions:

- 1) Accounting/Financial Management 101 – periodic review of how these functions are performed. (Councilmember Lehmann)
- 2) Quarterly report on spending plans – supplemental preparation. (Councilmember Boigon)
- 3) Periodic review of financial reporting. (David Hartman)

- 4) Auditor assessment – tax audit of sales taxes. (Councilmember Faatz)
- 5) Denver Retirement Board update. (Councilmember Faatz)
- 6) Status on improvements (audit report). (Beth Machann)
- 7) Conduct Elected Officer Financial training (book instruction). (Beth Machann)
- 8) Accounts receivable tracking (ticket collections). (David Hart)

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