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MANAGEMENT LETTER

The Honorable Mayor and City Council
City of Butler, Missouri

In planning and performing our audit of the financial statements of City of Butler, Missouri as of and for the year ended March 31, 2011 in accordance with auditing standards generally accepted in the United States of America, we considered its internal control over financial reporting (internal control) as a basis for determining 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 internal controls. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

However, during our audit we became aware of several matters that are opportunities for strengthening internal controls and operating efficiency. The comments below summarize our suggestions regarding those matters. A separate letter dated July 18, 2011 contains our communication regarding significant deficiencies in the City's internal control and compliance issues. This letter does not affect our report dated July 18, 2011 on the financial statements of City of Butler, Missouri.

We will review the status of these comments during our next audit engagement. We have already discussed the following comments with your management personnel, and will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations. Our comments are summarized as follows:

A. INVENTORY

Based on our observation of year end inventory procedures and other work on the account balances, we noted the following issues:

1. The City does not count all physical inventory on March 31, resulting in a risk of misstatement of inventory counts underlying the value of inventory in the City's Statement of Net Assets, and misstatement of repair and maintenance expense in the City's Statement of Activities and proprietary funds' Statement of Revenues, Expenses, and Changes in Net Assets.
2. Although we requested to be present during the counting, because it takes place on different dates prior to year end, we were not able to observe the actual procedures. When attempting to reperform the counts, we noted a high number of discrepancies in item counts, some of which are the result of changes between their count date and our observation, and some of which are counting errors.

These discrepancies have included both overstatements and understatements of inventory.

3. In addition to parts and supplies which are properly classified as inventory, the City includes small equipment and tools in their inventory listings. For the Light Plant inventory, these items were assigned a value and included in the inventory value. Small equipment and tools should be listed and tracked for control purposes, but should not be included in the inventory value.
4. The City's policy for inventory valuation is to use average cost based on the first in, first out method. However, the City does not have a method of calculating average cost. Prices entered on the inventory listings are not taken from the actual purchase invoices. For larger, more expensive items, the department head calls the vendor and uses the current price; for smaller items, the price might be left the same as the prior year or estimated.
5. The City's general ledger inventory balances are not adjusted at year end to actual inventory values as determined by year end inventory procedures. As discussed above, year end inventory procedures are not adequate to determine actual inventory values to support such an adjustment.

We make the following recommendations regarding inventory:

1. Inventory procedures should be changed to require a physical count of all inventory on the last business day of the fiscal year.
2. The City's should change its inventory valuation method to actual cost rather than average cost. Actual cost is more easily calculated and generally does not materially differ from average cost, given the nature of the City's inventory items and usage.
3. The City should consider implementation of a perpetual inventory system to enable accuracy in the application of first in, first out inventory valuation.
4. Small equipment and tools should be tracked in a separate system and not included in parts and supplies inventory.
5. The City's accounting personnel should evaluate the inventory values determined by the year end physical count, and adjust the general ledger as necessary.

B. DAILY DEPOSITS

As noted in prior year audits, daily deposits are not being made by the City. Since cash is so readily subject to error and mishandling, effective control of checks, currency, and other cash items should begin at the time of receipt and continue through deposit, custody, and disbursement. To ensure that cash receipts are being deposited intact in the proper bank accounts, we continue to recommend that all cash receipts be deposited intact daily.

C. DOCUMENTATION OF ADJUSTING JOURNAL ENTRIES

During testing it was noted that the City does not maintain supporting documentation for the adjusting journal entries made. We recommend that documentation be kept for all adjusting journal entries and that the entries be approved by the administrator to ensure that the adjusting entries being made are valid and appropriate.

D. BANK RECONCILIATIONS

During fieldwork we noted two significant journal entries that were entered as a reconciliation tool and should have been cleared prior to year-end, but were still outstanding at year end. We also noted the court cash account was not properly reconciled at year end. The preparation and review of monthly bank reconciliations are primary internal control components. Failure to prepare and properly review bank reconciliations for all bank accounts held by the City may result in misclassification of cash transactions, misappropriation of cash, and other errors or irregularities that may not be detected in a timely manner. We continue to recommend the City reconcile all bank and CD accounts as each statement is received and maintain documentation of such actions taken.

E. AUTHORIZATION OF BANK ACCOUNTS

While confirming the City's bank accounts, we again found, as noted in prior year audits, two unauthorized accounts that had been established using the City's tax identification number. The deposits in these accounts do not belong to the City, and no City authorization to establish these accounts could be found. Even though this is not a failure of the City's internal control, it should concern the City when individuals can establish and control bank accounts without the City's knowledge or authorization. In addition, in the event of bank failure, the City's claim to FDIC insurance funds could be compromised, or at least complicated. We recommend that the City correspond with all banks in the community and remind them that each bank account opened must have authorization by a vote of the City Council to be established.

F. ASSESSMENT AND MONITORING OF INTERNAL CONTROL RISK

A sound system of internal control includes written internal control policies and procedures that are developed based on management's assessment of the risk of material misstatement of financial information, misappropriation of the organization's assets, and other financial risks. A sound system of internal controls also includes internal evaluation to determine whether internal control policies and procedures are being followed and are adequate to reduce these risks to an acceptable level.

While City management does establish internal control procedures based on its assessment of risk and does evaluate the adequacy and operation of these controls in the normal course of supervising employees and carrying out the business of the City, it is preferable to establish these activities as a formal, documented part of the internal control system. We recommend that a written policy and procedures be established that require periodic assessment of internal control risk and evaluation of the internal controls in those areas that are determined to be high risk. Board member involvement in this process will help ensure that internal controls at all levels of the organization can be objectively assessed

G. CAPITAL ASSETS

The City does not maintain a current listing of all capital assets owned by the City. The City's software system has the capability to assist in keeping a capital asset listings. We recommend that the City train the employees responsible for the tracking of assets on the Incode software used by the City to ensure proper tracking of property.

H. DIRECT DEPOSIT REVIEW

Although it appears management is reviewing paystubs for each employee who receives a direct deposited check, there is no documentation of review of the totals of the direct deposited payroll checks. This could result in fraudulent direct deposited payroll checks being issued without being caught in a timely manner by the City. We recommend management review each employee's paystub along with the totals of the amounts to be direct deposited to ensure no additional funds are being issued without proper approval.

I. FINAL BUDGET AMENDMENTS

Although it appears the City does properly amend the budget as necessary, the amendments are not posted in Incode, the City's accounting system. Therefore, the City cannot take advantage of Incode's reporting features to provide current budget variance information for management and the City Council. In addition, the accounting system does not have complete budgetary financial information for future reference. We recommend that the City take full advantage of Incode's budget management features.

J. UNCLAIMED PROPERTY

According to RSMo 447.532, all governmental entities in the State of Missouri are required to report and remit property that has been unclaimed by the owner for more than three years to the state. Abandoned property includes but is not limited to outstanding checks, customer deposits, and overpayments or credit balances on accounts receivable. At March 31, 2011 we noted a number of checks that remain recorded as outstanding for more than three years that have not been remitted to the State. Some of these may have been replaced by other checks and do not represent unclaimed property. We recommend that a policy and procedures be implemented to ensure regular periodic reviews of checks outstanding for more than six months to determine if they should remain recorded as outstanding items. We further recommend that the City review the state procedures for unclaimed property and implement procedures for forwarding such property to the State of Missouri on a regular basis.

We wish to thank the City Administrator, City Clerk, and their staff for their support and assistance during our audit.

This report is intended solely for the use of the City Council and management of the City of Butler, Missouri and others within the City and is not intended to be and should not be used by anyone other than these specified parties.

DSWA Certified Public Accountants, PC.

Raymore, Missouri
July 18, 2011