



FINANCIAL AND COMPLIANCE AUDIT REPORT

**State of Kansas
Fiscal Year 2005**

**A Report to the Legislative Post Audit Committee
Joint Venture By Allen, Gibbs & Houlik and
Berberich Trahan & Co. Under Contract with the
Legislative Division of Post Audit
State of Kansas
February 2006**

Legislative Post Audit Committee

Legislative Division of Post Audit

The Legislative Post Audit Committee and its audit agency, the Legislative Division of Post Audit, are the audit arm of Kansas government. The programs and activities of State government now cost about \$11 billion a year. As legislators and administrators try increasingly to allocate tax dollars effectively and make government work more efficiently, they need information to evaluate the work of government agencies. The audit work performed by Legislative Post Audit helps provide that information.

We conduct our audit work in accordance with applicable government auditing standards set forth by the U. S. Government Accountability Office. These standards pertain to the auditor's professional qualifications, the quality of the audit work, and the characteristics of professional and meaningful reports. These audit standards have been endorsed by the American Institute of Certified Public Accountants and adopted by the Legislative Post Audit Committee.

The Legislative Post Audit Committee is a bipartisan committee comprising five senators and five representatives. Of the Senate members, three are appointed by the President of the Senate and two are appointed by the Senate Minority Leader. Of the representatives, three are appointed by the Speaker of the House and two are appointed by the House Minority Leader.

As part of its audit responsibilities, the Division is charged with meeting the requirements of the Legislative Post Audit Act which address audits of financial matters. Those requirements call for two major types of audit work.

First, the Act requires an annual audit of the State's financial statements. Those statements, prepared by the Department of Administration's Division of Accounts and Reports, are audited by a certified public accounting firm under contract with the Legislative Division of Post Audit. The firm is selected by the Contract Audit Committee, which comprises three members of the Legislative Post Audit Committee (including the Chairman and Vice-Chairman), the Secretary of Administration, and the Legislative Post Auditor. This audit

work also meets the State's audit responsibilities under the federal Single Audit Act.

Second, the Act provides for a regular audit presence in every State agency by requiring that audit work be conducted at each agency at least once every three years. Audit work done in addition to the annual financial statement audit focuses on compliance with legal and procedural requirements and on the adequacy of the audited agency's internal control procedures. These compliance and control audits are conducted by the Division's staff under the direction of the Legislative Post Audit Committee.

LEGISLATIVE POST AUDIT COMMITTEE

Senator Les Donovan, Chair
Senator Anthony Hensley
Senator Nick Jordan
Senator Derek Schmidt
Senator Chris Steineger

Representative John Edmonds, Vice-Chair
Representative Tom Burroughs
Representative Peggy Mast
Representative Bill McCreary
Representative Tom Sawyer

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Barbara J. Hinton, Legislative Post Auditor

The Legislative Division of Post Audit supports full access to the services of State government for all citizens. Upon request, Legislative Post Audit can provide its audit reports in large print, audio, or other appropriate alternative format to accommodate persons with visual impairments. Persons with hearing or speech disabilities may reach us through the Kansas Relay Center at 1-800-766-3777. Our office hours are 8:00 a.m. to 5:00 p.m., Monday through Friday.



LEGISLATURE OF KANSAS
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February 13, 2006

To: Members, Legislative Post Audit Committee

Senator Les Donovan, Chair
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This report contains significant findings, conclusions, and recommendations from the completed Statewide audit covering Fiscal Year 2005. This audit was conducted by the joint venture of Allen Gibbs & Houlik and Berberich Trahan & Co., audit firms under contract with the Legislative Division of Post Audit.

The report includes recommendations for improving the process of preparing the State's financial statements and for improving financial controls over payroll at the University of Kansas. We would be happy to discuss these recommendations or any other items in the report with any legislative committees, individual legislators, or other State officials.

Barbara J. Hinton
Legislative Post Auditor



December 23, 2005

To the Legislative Post Audit Committee
Kansas State Legislature
Topeka, Kansas

This letter is intended to inform the Audit Committee of the State of Kansas of significant matters related to the conduct of the annual audit so it can appropriately discharge its oversight responsibility and that we comply with our professional responsibilities to the Audit Committee.

REQUIRED COMMUNICATIONS

The following summarizes various matters which must be communicated to you under auditing standards generally accepted in the United States of America.

The Auditor's Responsibility Under Auditing Standards Generally Accepted in the United States of America

Our audit of the financial statements of the State of Kansas (State) for the year ended June 30, 2005 was conducted in accordance with auditing standards generally accepted in the United States of America, *Government Auditing Standards* issued by the Comptroller General of the United States, the provisions of the Single Audit Act, OMB Circular A-133 and OMB's Compliance Supplement. Those standards, circulars, and the supplement require we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error, fraudulent financial reporting or misappropriation of assets. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. Accordingly, the audit was designed to obtain reasonable, rather than absolute, assurance about the financial statements. We believe our audit accomplished that objective.

In accordance with *Government Auditing Standards*, we have also performed tests of controls and compliance with laws and regulations that contribute to the evidence supporting our opinion on the financial statements. However, they do not provide a basis for opining on the State's internal control or compliance with laws and regulations.

Management Judgments and Accounting Estimates

Accounting estimates are an integral part of the preparation of financial statements and are based upon management's current judgment. The process used by management encompasses their knowledge and experience about past and current events and certain assumptions about future events. Management has informed us they used all the relevant facts available to them at the time to make the best judgments about accounting estimates and we considered this information in the scope of our audit. Estimates significant to the financial statements include such items as:

- Taxes receivable
- Incurred but not reported claims
- Arbitrage liabilities
- Depreciation

Audit Adjustments

There were several audit adjustments made to the preliminary financial statements presented to us for audit. None, either individually or in the aggregate, were deemed to have a significant effect on the financial statements.

Uncorrected Misstatements

The State recorded all of the identified uncorrected misstatements, whether material or immaterial, to the financial statements.

Accounting Policies and Alternative Treatments

Management has the ultimate responsibility for the appropriateness of the accounting policies used by the State. The State did not adopt any significant new accounting policies, nor have there been any changes in existing significant accounting policies, during the current period which should be brought to your attention.

Other Information in Documents Containing Audited Financial Statements

We are not aware of any other documents that contain the audited basic financial statements. If such documents were to be published, we would have a responsibility to determine that such financial information was not materially inconsistent with the audited statements of the State.

Disagreements with Management

We encountered no disagreements with management over the application of significant accounting principles, the basis for management's judgments on any significant matters, the scope of the audit or significant disclosures to be included in the financial statements.

Consultations with Other Accountants

We are not aware of any consultations management had with other accountants about accounting or auditing matters.

Major Issues Discussed with Management Prior to Retention

No major issues were discussed with management prior to our retention to perform the aforementioned audit.

Difficulties Encountered in Performing the Audit

We did not encounter any difficulties in dealing with management relating to the performance of the audit.

INTERNAL CONTROL MATTERS

In planning and performing our audit of the financial statements of the State of Kansas, for the year ended June 30, 2005, we considered the State's internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on internal control. However, we noted certain matters involving internal control and its operations that we would like to bring to your attention and provide recommendations for improvements.

Because of the inherent limitation of internal control, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the internal control to future periods is subject to the risk that internal controls may become inadequate because of changes in conditions or the degree of compliance may deteriorate.

Financial Statement Preparation

Condition: Controls over preparation of financial statements.

The prior year report included a reportable condition related to the preparation of the financial statements. During the current year, management took corrective action and implemented appropriate controls over the financial statement process. As a result, the reportable condition was resolved. However, during the current year audit, we noted that the financial statement preparation process is highly dependent upon the unique skills and knowledge of two key members of the Financial Integrity Team. One member designed and has the expertise to operate and manage the complex reporting database which is used to prepare the financial statements and the other member has greater expertise in governmental accounting and financial reporting necessary for the preparation of the financial statements. It is our understanding that no other skilled employees are available to cross train in these two vital financial statement preparation processes.

Effect: The absence of either of the two key employees would result in the likely inability of the Department of Administration to timely prepare the required financial statements and ultimately the comprehensive annual financial report.

Recommendation: The Department of Administration should provide resources for cross training in these two vital areas.

Management Response: The Division of Accounts and Reports (A&R) recognizes the importance of maintaining an educated, well-trained staff possessing the necessary skills and expertise to successfully prepare the Comprehensive Annual Financial Report (CAFR) each year in conformance with Generally Accepted Accounting Principles (GAAP).

In preparing the FY 2005 CAFR, no significant staff turnover occurred from the previous year which has not been the case in recent years. In addition, existing staff have continued to initiate process and data management improvements. This has resulted in more standardized and less complex work processes in preparing the CAFR. A&R is also taking steps to ensure all necessary work processes and procedures are well documented. Additional areas for improvement continue to be explored.

A&R intends to continue to use improved well-documented work processes and cross-train either existing staff or add additional staff as needed and to the extent fiscal and budgetary conditions allow to build additional knowledge experts and reduce the reliance on a limited number of individuals.

University of Kansas Payroll Issue

Condition: There is not a proper segregation of duties over the payroll process at the University of Kansas. Several payroll personnel have the authority and access to records which enable them to enter new employees, revise appointments (positions), enter time worked, change and correct time and distribute hourly payroll checks.

Cause: Current accounting controls do not require the segregation of the various payroll processes.

Effect: No known material effect on the financial statements. However, the lack of segregation of duties creates the potential for fraudulent payroll transactions.

Recommendation: Establish a proper segregation of duties related to the payroll process.

Management Response: The University of Kansas recognizes the need to improve our segregation of duties related to the payroll process, specifically the level of security access given to payroll personnel. The KU Comptroller's Office has developed an action plan to better segregate security access within the payroll department. Within this action plan security access to the time and leave panels as well as to the direct deposit panels within the HRSA database will be better segregated. To further enhance the segregation of duties within the payroll process, the distribution of student paper paychecks will also be moved out of the payroll office.

As a University, we recognize the importance of analyzing and strengthening our internal controls, which include proper segregation of duties. We will continue to review our policies and procedures to determine where opportunities for improvement exist.

Closing

This report is intended solely for the information and use of the Committee and management, and is not intended to be and should not be used by anyone other than the specified parties.

Allen, Gibbs & Houlik, L.C.

Berberich Trahan & Co., P.A.