Lexington-Fayette Urban County Government
OFFICE OF INTERNAL AUDIT

INTERNAL AUDIT REPORT

DATE: July 21, 2014

TO: Jim Gray, Mayor

CC: Sally Hamilton, Chief Administrative Officer
Glenn Brown, Deputy Chief Administrative Officer
Aldona Valicenti, Chief Information Officer
William O'Mara, Commissioner of Finance & Administration
Clay Mason, Commissioner of Public Safety
Derek Paulsen, Commissioner of Planning, Preservation & Development
Rodney Ballard, Director of Community Corrections
Rusty Cook, Director of Revenue
Phyllis Cooper, Director of Accounting
Brad Frazier, Director of Engineering
Robert Stack, Director of Enhanced 911
Susan Straub, Communications Director
Urban County Council Members
Internal Audit Board Members

FROM: Bruce Sahli, CIA, CFE, Director of Internal Audit
Alicia Boyd, CPA, Internal Auditor

RE: Revenue Collection and Allocation Audit

Background

The Lexington-Fayette Urban County Government (LFUCG), like many state and local governments throughout the United States, utilizes governmental accounting. A major component of governmental accounting is fund accounting which is largely considered the single most distinguishable trait from accounting utilized in the private sector. A fund as defined in the GFOA's Governmental Accounting, Auditing and Financial Reporting

(GAAFR) Publication (better known as the Blue Book) is a fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations. Funds can be divided into three categories: governmental, proprietary and fiduciary. The GAAFR defines these three categories as follows:

Governmental funds used to account for activities supported by taxes, grants, and other similar revenues. General, Urban Services, Federal and State Grants, and Municipal and County Aid Programs are examples of governmental funds.

Proprietary funds used to account for activities primarily supported by fees and charges to users. Sanitary Sewer Systems, Public Facilities Corporation, Landfill, Right of Way, Water Quality, Enhanced 911 and Prisoner's Account are examples of proprietary funds.

Fiduciary funds used to account for resources held by the government on behalf of other outside parties. The government cannot use these resources to support its own programs.

The Division of Revenue is responsible for the collection of certain income, revenues and monies due the Urban County Government. These revenues include:

- LEXServ - Water Quality and Sanitary Sewer Fees
- Occupational License Fees on Wages and Net Profits allocated
- Landfill User Fees
- Ambulance Billings
- Insurance Premiums Tax
- Telecommunications Franchise Tax

Other Divisions are responsible for billing, collecting and depositing or delivering to the Division of Revenue for deposit funds attributable to their office. CAO Policy #40 established cash control procedures that all divisions are required to follow when delivering monies to the Division of Revenue for deposit.

Scope and Objectives

The general control objectives for the audit were to provide reasonable assurance that:

- There is proper allocation of material revenues to the appropriate LFUCG funds

- All LFUCG bank accounts are properly accounted for

Audit results are based on observations, inquiries, transaction examinations, and the examination of other audit evidence on a test basis and provide reasonable, but not absolute, assurance controls are in place and are effective. In addition, effective controls in place during an audit may subsequently become ineffective as a result of technology changes or reduced standards of performance on the part of management.

The scope of our audit included revenues collected and allocated during fiscal year ended June 30, 2013, and any active or dormant bank accounts at June 30, 2013.

Statement of Auditing Standards

We conducted our audit in accordance with the International Standards for the Professional Practice of Internal Auditing. Those standards require that we plan and perform the audit to afford a reasonable basis for our judgments and conclusions regarding the organization, program, activity, or function under audit. An audit also includes assessments of applicable internal controls and compliance with requirements of laws and regulations when necessary to satisfy the audit objectives. We believe that our audit provides a reasonable basis for our conclusions.

Audit Opinion

In our opinion, the controls and procedures provide reasonable assurance that the general control objectives were being met. Opportunities to enhance controls are included in the Summary of Audit Findings.

Priority Rating Process

To assist management in its evaluation, the findings have been assigned a qualitative assessment of the need for corrective action. Each item is assessed a high, moderate, or low priority as follows:

High - Represents a finding requiring immediate action by management to mitigate risks associated with the process being audited.

Moderate – Represents a finding requiring timely action by management to mitigate risks associated with the process being audited.

Low - Represents a finding for consideration by management for correction or implementation associated with the process being audited.

SUMMARY OF AUDIT FINDINGS

Finding # 1: $832,892 of Undeposited Checks in Division of Enhanced 911 Represent a Significant Violation of CAO Policy #40
Priority Rating: High

Condition:
As noted in the Scope & Objectives section of the report, the scope of our audit included revenues collected and allocated during fiscal year ended June 30, 2013, and any active or dormant bank accounts at June 30, 2013. This scope cutoff was necessary in order to tie revenue back to the Funds in the FY 2013 CAFR for population testing purposes.

After audit fieldwork had been completed and the draft report was near the end of the management response phase, we were informed by the Chief Administrative Officer that the Division of Enhanced 911 had just turned over to the Division of Revenue checks totaling $832,892 that had been received by Enhanced 911 during FY 2014 but had not been deposited. The existence of these checks was not disclosed to us during fieldwork conducted at the Division of Enhanced 911.

Working with Division of Revenue personnel who by this time had been given possession of these checks by Enhanced 911 personnel, we examined the checks and validated there were 285 checks totaling $832,892 dated August 9, 2013 through May 21, 2014 that had not been deposited. This included $190,654 in replacement checks dated March 4, 2014 through June 2, 2014 that were obtained by the Division of Enhanced 911 for checks originally dated between the months of September and November 2013 that had become stale-dated and therefore had to be replaced by the issuing companies. The $832,892 also included $14,821 in checks that had become stale-dated for which no replacement check had yet been pursued. The undeposited checks represented 32% of the total revenue budgeted for the FY 2014 Enhanced 911 related fees.

We performed additional audit procedures to obtain reasonable assurance that this was the extent of the undeposited FY 2014 Enhanced 911 checks. Based on the results of our audit procedures, this appears to be the extent of the FY 2014 checks that had not been deposited. We also performed procedures to provide reasonable assurance that there were no missing payments. We reviewed all known, available company folders to determine payments made and the frequency of payments. A total of 68 companies were reviewed. Four companies that have not made a payment during FY 2014 need further investigation to determine why no payments have been made.

It should also be noted that during the time of the un-deposited checks, the Division of Enhanced 911 had only one administrative staff employee in the office, and the Division was also without a Director from August 31, 2013 until February 24, 2014. As a result, a lack of segregation of duties existed since the same employee received the mail, opened the mail, prepared and recorded the deposit (sporadically during the first few months of FY 2014), and delivered the deposits to the Division of Revenue (sporadically during the first few months of FY 2014). It appears there was no management oversight of the Enhanced 911 function for several months leading up to the hiring of the new Director in late February 2014. A second administrative staff employee has just recently been hired. Beginning in mid-June 2014, the Division of Revenue took over the duties of receiving, processing, and depositing Enhanced 911 payments from companies, thereby eliminating the segregation of duties issue noted above.

Effect:

Significant delays in deposits can create cash flow problems for LFUCG and result in lost interest income, and also increases the risk of checks being misplaced or lost. When checks remain un-deposited and eventually become stale, added personnel expense is incurred when attempting to obtain replacement checks. Lost revenue may also result if a replacement check is not obtainable (i.e. the affected company goes out of business). In addition, deposits are subject to misappropriation if a proper segregation of duties is not established. The reputation of LFUCG with companies it does business with and with the citizens of Fayette County may also be at risk if fees collected and submitted are not promptly deposited.

Recommendation:

We recommend the Division of Enhanced 911 contact all remaining companies whose checks have become stale-dated and attempt to obtain replacement checks for the $14,821 in un-deposited revenue noted above. We further recommend the Division of Enhanced 911 conduct research on the four companies indicated above that are not paying any fees to LFUCG to determine if additional payments may be due. The Office of Internal Audit will supply both a stale check list and the non-payment list to the Division of Enhanced 911.

We also recommend the Division of Revenue conduct a survey of all Divisions to specifically identify all Divisions that collect any revenue and to inquire whether any of the Divisions currently have any deposits that have not been deposited in the bank or delivered to the Division of Revenue. This survey will provide the Division of Revenue a current list of all collection activity throughout the LFUCG that can then be used to monitor revenue activity. The Division of Revenue should also coordinate with the Division of Budgeting to include a discussion of projected versus budgeted revenue in the monthly Division Budget meetings.

Although the incident noted in this finding is particularly egregious, it should be noted that it has been a common occurrence for the Office of Internal Audit to identify late deposits when auditing LFUCG functions that collect payments. We therefore recommend that the Chief Administrative Officer issue a memorandum to all Commissioners and Directors instructing them to take whatever steps necessary to ensure consistent compliance with the deposit requirements of CAO Policy #40. We also recommend the LFUCG Uniform Disciplinary Code be amended to include disciplinary action for non-compliance with the deposit requirements of CAO Policy #40.

Director of Enhanced 911 Response:
The Division of Enhanced 911 has reviewed Finding #1 from the audit report. In response to the recommendation located therein, this Division is prepared to contact all remaining companies whose checks have become stale-dated and will attempt to obtain replacement checks for the un-deposited $14,821 in revenue. In addition, the Division of Enhanced 911 will contact the companies that your Division identified as having not paid any fees to the LFUCG to determine what, if any, payments may be due to this government. Please forward the information your Division has identified on outstanding stale-dated checks and the companies identified as not having paid revenue and I and my personnel will promptly make contact with each company. (AUDITOR'S NOTE: This information was provided to the Director of Enhanced 911 on July 14, 2014).

In my initial response to the audit report dated June 11, 2014, I listed various steps that this Division would take in order to come into full compliance with CAO Policy #40 and earlier audit recommendations. Those steps, which include an internal SOP for revenue handling, have been enacted and issued to the appropriate personnel. These steps will help ensure my Division has no further issues with revenue handling. (AUDITOR'S NOTE: The complete initial response mentioned above addresses Finding #2).

Commissioner of Public Safety Response:
I concur with the Director's response.

Director of Revenue Response:
The Division of Revenue concurs with the recommendation to conduct a survey of all Divisions to identify the Divisions that collect revenue. A survey has been created by Revenue to distribute to each division. This survey will identify Divisions that collect Revenue, the individuals responsible for making/entering deposits (if they have deposits)

and sources of revenue. The survey will also inquire on whether they have any deposits that have not been made into a bank or delivered to the Division of Revenue.

The Division of Revenue also concurs with the recommendation that revenue review should be included during the monthly Division of Budget meetings. New Revenue Report design is underway that will be utilized to analyze Revenues. The Division of Revenue will analyze Revenue reports internally each month. This internal review will be in addition to a review as a part of the monthly Budget Meetings between the Division of Budgeting and each Division.

Commissioner of Finance & Administration Response:
I concur with the Director.

Chief Administrative Officer Response:
I concur and will address recommendations as outlined.

Finding #2: CAO Policy #40 Deposit Violations Noted
Priority Rating: High

Condition:
The following CAO Policy #40 violations were noted during the fieldwork test of deposits:

1. Enhanced 911 (Fund 4204) lacks a segregation of duties over mail processing and deposits because the same employee receives the mail, opens the mail, prepares and records the deposit, and takes the deposit to the Division of Revenue;
2. Significant delays (at least two months) were noted for multiple deposits reaching the Division of Revenue from Enhanced 911;
3. Slight delays (a few days) were noted for two deposits reaching the Division of Revenue from Division of Engineering, Right of Way Management Branch (Fund 4201).

Effect:
Deposits are subject to misappropriation if a proper segregation of duties is not established. Additionally, significant delays in deposits can create cash flow problems for LFUCG.

Recommendation:
Mail should be opened and checks logged by an Enhanced 911 employee who is not responsible for recording the deposit. Deposits should be sent to the Division of Revenue within the 24 to 48 hours as established by CAO Policy #40. The CAO should consider sending correspondence to all Divisions stressing the importance of sending all applicable payments to the Division of Revenue for timely deposit.

Director of Enhanced 911 Response:
The Division of Enhanced 911 has reviewed the internal audit recommendations and is implementing measures to comply with CAO Policy #40. While this Division takes full responsibility for its slow processing of checks, it is instructive to note that there was only one Administrative Specialist and no Director in this Division for more than half the fiscal year. The Administrative Specialist Senior vacancy was filled three weeks ago (as of June 11, 2014) and the new employee is being trained by the Administrative Specialist Principal on procedures for handling checks. Since this Division only receives checks, the response omits cash handling procedures. The following practices are being implemented:

- CAO Policy #40 will be an appendix to a Division SOP so that it is always readily available for review and to demonstrate through signature acknowledgement that affected personnel have receive, reviewed and understand the policy.
- Effective immediately, all mail/checks pertaining to 911 fees (Fund 4204) and the CKy911network (Fund 4205) will be routed directly to and processed by the Division of Revenue. This step represents >99% of checks received for Enhanced 911.
- For the occasional check received for Addressing fine payment or an open record request, Administrative Specialists will be trained or retrained on the CAO Policy to include the split duties and responsibility for timely processing of checks.
- Mail will be opened each business day.
- Duties for opening the mail, stamping the checks payable to LFUCG and creating a record of checks received will be handled by one Administrative Specialist. A second Administrative Specialist will be responsible for recording checks in Peoplesoft, generating a receipt with attached tape, and delivering the deposit the same day to the Division of Revenue.
- Administrative Specialists will alternate duties monthly to ensure neither person performs a check handling duty exclusively.
- A GIS Specialist will be trained to open mail and record checks so that the separation of duties is maintained even when one Administrative Specialist is on leave.

If there are additional steps this Division needs to take, or best practices to adopt, I'm highly receptive to making those recommendations part of this corrective plan.

Commissioner of Public Safety Response:
I concur with the Director's response.

Director of Division of Engineering Response:
A better effort will be made to comply with the deposit requirements of CAO Policy #40. Staff will be reminded about the 24 hours limitation through an email notification.

Commissioner of Planning Response:
I concur with the Engineering Director's response.

Chief Administrative Officer Response:
The CAO agrees with the recommendation and will follow up with the appropriate directive.

Finding #3: Revenues for Mineral & Coal Severance Payments Not Received
Priority Rating: High

Condition:
LFUCG receives quarterly mineral and coal severance payments (Funds 1138 and 1139, respectively) from the state. Payments in the amount of $71,150 ($42,466 and $28,684) were not received for fiscal year 2013. Based on check affidavits from the Office of the Kentucky State Treasurer, checks were submitted on October 23, 2012. The checks were written off by the state because they were not cashed as of October 31, 2013. The checks are routinely written to the Fayette County Fiscal Court but submitted to LFUCG. We could not determine if the checks were ever received in Revenue. Revenue did not have any record of the payments and was not aware these payments were outstanding prior to fieldwork. As a result of our inquiry, LFUCG has since been issued two replacement checks totaling $71,150 received on December 27, 2013.

Effect:
If anticipated revenues are not tracked and reconciled, the city may lose revenue or may not receive the timely benefit of revenues.

Recommendation:
The Division of Revenue should devise procedures to ensure that all anticipated revenues are being tracked and received. The Division of Revenue should request future mineral and coal severance payments be submitted directly to them.

<u>Director of Revenue Response:</u>
Due to the nature of who the checks are made payable to, there were some issues with the checks being received by Revenue. As a result of missing payments, we will assign one employee "Staff Assistant Sr." to be responsible for County Coal Severance (Fund 1139) and County Mineral Severance (Fund 1138) monthly/quarterly payments. This person will maintain a record of all payments received each period and this log will be kept on the Revenue Shared drive. This person will review the payment log and reach out to the state to ensure that all required payments have been received.

<u>Commissioner of Finance & Administration Response:</u>
I concur with the Director.

<u>Finding #4:</u> Division of Revenue Standard Operating Procedures Update Needed
Priority Rating: High

Condition:
As part of the audit, we asked for the Division of Revenue's most current standard operating procedures. While the Division did make them available, we were informed the hard copy provided to us was the only copy. Additionally, we were informed by senior management some procedures were outdated and the manual itself is somewhat disorganized.

Effect:
A Division's standard operating procedures are a living document that requires periodic review and update to be effective. Without current, effective procedures the directives and risk responses of the Division are more difficult to obtain and manage.

Recommendation:
The Division of Revenue should make updating the Standard Operating Procedures a priority. As part of the update, particular emphasis should be placed on the organization of the manual for easier reference when questions arise. Once updated, the procedures should be saved electronically and if so desired, in hard copy. The Division should obtain feedback from employees responsible for the procedures to assure what is expected of employees is actually occurring. The Division should also periodically review and update the procedures as circumstances dictate.

<u>Director of Revenue Response:</u>
The operating procedures for the Processing area have been completed and are now updated and maintained on the shared Revenue directory XXXXXX. This file contains

all operating procedures for the Division of Revenue Processing Area. Operating procedures will be updated as updates as needed.

Commissioner of Finance & Administration Response:
I concur with the Director.

Finding #5: Revenue Not Properly Recognized
Priority Rating: High

Condition:
Multiple revenues were not properly recognized and accrued at June 30, 2013, as required by generally accepted accounting principles for state and local governments established by the Governmental Accounting Standards Board. While the first payment received in FYE 2013 for each of these types of revenues, excluding Prisoner's Account Fund, was properly accrued and recorded in FYE 2012, the first payment received in FYE 2014 was not properly accrued and recorded in FYE 2013 and will remain recorded revenue in FYE 2014. For example, the Municipal Road Aid Fund did not include $568,928 in recognized revenue at June 30, 2013 for a payment received after fiscal year end even though the payment received in July 2012 was properly recognized in FYE 2012.

The type of fund for which the revenue is recorded dictates the rules to be followed for revenue recognition/accrual. Governmental funds utilize the modified accrual basis of accounting while proprietary funds utilize the full accrual basis of accounting. Under modified accrual, revenues are recognized when they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period. For this purpose, LFUCG considers revenues to be available if they are collected within 60 days of the end of the period. Revenues susceptible to accrual are intergovernmental revenues, investment earnings, emergency medical services (EMS), insurance revenues and license fees. Revenues are recognized under the full accrual basis when earned regardless of when cash is received.

We noted improper revenue recognition, along with the amount, for the following governmental funds and proprietary funds:

- Municipal Road Aid (Fund 1136)-$568,928, as noted above
- Coal Severance (Fund 1139)-$21,605
- Mineral Severance (Fund 1138)-$58,528
- County Road Aid (Fund 1137)-$79,780

- Enhanced 911 (Fund 4204)-$231,904

Prisoner's Account (Fund 4203) commissions on vending machines and commissary did not have the first payment for FYE 2013 properly accrued and recorded in FYE 2012 or the first payment received in FYE 2014 properly accrued and recorded in FYE 2013. The net effect was an overstatement of 2013 revenue by $1,108.

Effect:
When generally accepted accounting principles are not properly adhered to LFUCG risks releasing materially misstated financial statements. Additionally, in this example revenues are either understated or overstated.

Recommendation:
Division of Accounting should develop procedures to review all applicable revenue accounts after fiscal year end for proper revenue recognition.

Director of Accounting Response:
After the end of a given fiscal year, any deposits made subsequent to June 30th containing receipts dated prior to the end of the fiscal year, are compiled in a spreadsheet by the department of Revenue as they receive them. This spreadsheet is sent to the Division of Accounting weekly. Once Accounting receives the spreadsheet, the deposits are verified and a reversing journal entry is entered to debit the receivable and credit the revenue to recognize the revenue in the correct fiscal year.

Even though Accounting doesn't have hands-on access to the deposits and the supporting documentation that can accompany the deposits, being proactive in looking for material accruals that may be overlooked by Revenue is ultimately the goal. Therefore, Accounting will run queries of material deposits (>$50K) made in months subsequent to the end of a fiscal year (July, August, September). Deposits made in these months greater than $50,000 that haven't been accrued will be researched by Revenue/Accounting to determine the appropriate fiscal year for revenue recognition, and if required an accrual will be done. After September, the Comprehensive Annual Financial Report (CAFR) has been submitted to external auditors' for review and publication.

Commissioner of Finance & Administration Response:
I concur with the recommendation.

<u>Finding #6:</u> Two Bank Accounts and One Certificate of Deposit Unknown to Division of Accounting
Priority Rating: High

Condition:
We contacted 30 banks located throughout Fayette County to search for unknown bank accounts and received responses from 25 of those banks. Correspondence included at least one email and in some cases two emails, in addition to an initial phone call made to each bank. As a result, we found two bank accounts and one certificate of deposit the Division of Accounting was unaware of as follows:

1. Division of Community Corrections Employee Benevolent Fund: This bank account is funded through commissions earned on vending machines located at the detention center and accessible only to employees. Receipts for the year totaled $7,027 and disbursements totaled $8,043 and included sympathy flowers, employee recognition expenses, supplies, decorations, donations, food for employees, etc. Ending balance at June 30, 2013 was $6,299.
2. Friends of Masterson Station Park: According to the bank, this account is dormant and the ending balance at June 30, 2013 was $1,013.
3. Urban County Community Development Corporation: This Certificate of Deposit was opened in 1999 and has a balance of $16,592.

Effect:
This was the first time in several years that banks were directly contacted regarding unknown bank accounts. When bank accounts are unknown to applicable members of management and the Division of Accounting, it creates a situation for money to be diverted from its intended purpose and for funds to be spent without the knowledge of management or the Council.

Recommendation:
The Division of Accounting should adopt an annual procedure requiring all LFUCG Divisions provide notification of any and all bank accounts utilized by them. We also recommend the Friends of Masterson Station Park and Urban County Community Development Corporation accounts be closed with their funds transferred to the LFUCG Concentration Account.

The Office of Internal Audit will also provide the Chief Administrative Officer and the Commissioner of Finance a list of those banks that did not respond to our inquiry.

<u>Director of Accounting Response:</u>
The Division of Accounting's role in banking involves reconciliation of bank statements received and the Government's General Ledger. Notification of new bank accounts is outside the purview. This responsibility conflicts with the separation of duties regarding cash management functions and oversight of the Government's General Ledger.

<u>Commissioner of Finance & Administration Response:</u>
Staff in the Department of Finance will send inquiries to all Divisions for a list of all bank accounts. The two accounts, Friends of Masterson Station Park and UC Community Development Corporation will be closed.

<u>Finding #7:</u> Prisoners' Activity Fund Should be Limited to Commissary Activity
Priority Rating: High

Condition:
Kentucky Revised Statute 441.135 allows the Detention Center to maintain a canteen (commissary) account for inmates of the Detention Center. This is accomplished through the Prisoners' Activity Fund (Fund 4203). LFUCG has a contract with a vendor that supplies items sold to inmates. Per KRS 441.135, all profits (commissions) of the canteen are to be used for the benefit and to enhance the well being of the inmates. The following activity is included in this fund:

1. Commissions on sales to inmates paid to LFUCG by the vendor.
2. Commissions earned on vending machines located at the detention center and accessible to the public and prisoners.
3. Fees collected for drug testing and electronic monitoring by the Community Alternative Program and the Bureau of Programs, Services, and Community Placement.

While items #1 and #2 are acceptable revenue streams for this restricted fund, especially if it is Council's intent to spend the vending machine commissions for the benefit and to enhance the well being of the inmates, item #3 should be removed from the Prisoners' Activity Fund because this activity does not directly relate to the inmates housed at the Detention Center. Additionally, salaries for both offices listed in item three above are budgeted in the General Services Fund.

Effect:
Potential noncompliance with KRS 441.135 exists if the fees collected for each type of service provided in item #3 are not enough to cover expenses because if that occurs, restricted profits might be used for activities that are not specifically for the benefit and to

enhance the well being of the inmates. There is also an incomplete match of revenues and expenses since some are allocated to the General Services Fund while others are allocated to the Prisoners' Activity Fund.

Recommendation:
Fees for drug testing and electronic monitoring, along with expenses budgeted for those services in Prisoners' Activity Fund, should be re-allocated to the General Services Fund.

Director of Accounting Response:
The Prisoner Account System was transferred to the Government in 1994. Fees collected for drug testing and electronic monitoring have been consistently recorded since inception within the Prisoner Activity Fund, using a separate department number. The fund was created to track Prisoner Account Activity. There are two separate department numbers: 505402 – Adult Detention (subject to KRS 441.135 regulations) and department number 505403 – Programs & Community Service (no mandated regulations). KRS 441.135 does not require a separate fund for the operation of a canteen, nor place any restriction on comingling of funds (Appendix A). Beginning July 1, 2014, the Detention Center will begin recording transactions related to drug testing and electronic monitoring in the General Fund. This will eliminate concerns.

Commissioner of Finance & Administration Response:
I concur with the recommendation.

Director of Community Corrections Response:
Management strongly concurs with the audit recommendation. The Division has discussed this issue with the Division of Accounting previously. The Division would like for the commissary account (PAF) to be in a separate fund from the Community Alternative program (CAP) as soon as possible.

Commissioner of Public Safety Response:
I concur with the Director's response.

Finding #8: Drug Testing Fees Handled Multiple Times Before Depositing
Priority Rating: High

Condition:
While testing deposits at the Detention Center, we noted that the Bureau of Programs, Services, and Community Placement collects drug testing fees for court ordered drug tests even though that office does not provide drug testing (the Bureau also collects electronic monitoring fees). The actual drug tests are administered at the office of the Community

Alternative Program, which also collects the drug testing fee. The fees are typically paid in cash, and all payments from both offices are sent to the Detention Center for processing, which then forwards them to the Division of Revenue for deposit.

Effect:
Unnecessary handling of fees by multiple personnel can result in the misplacement, diversion, or theft of funds.

Recommendation:
We recommend all drug testing fees be collected by the office of the Community Alternative Program. The Detention Center should also work with the Division of Revenue to develop procedures that will limit the multiple handling of these fees. A bill payment Kiosk at each office may be one option to consider.

Director of Community Corrections Response:
Management concurs with the audit recommendation. After the audit was completed the Division worked with the Division of Revenue to streamline the deposit process. The Division is processing the deposits for these areas and sending the deposits directly to the bank via an armored car carrier. The deposits are no longer being processed at the Division of Revenue, the income is recorded in Peoplesoft and then reported to Revenue. Additionally, the Division is working with the commissary vendor to provide a kiosk at the Community Alternative Program to accept all cash deposits for drug testing. The kiosk is in place, we are currently working with Computer Services to obtain internet connectivity for the kiosk. The kiosk should be operational in June 2014. Upon the kiosk being operational all monies for drug testing will be collected by the kiosk and will not be collected by various personnel.

Commissioner of Public Safety Response:
I concur with the Director's response.

Finding #9: Annual Financial Reports Not Provided to LFUCG
Priority Rating: High

Condition:
LFUCG (Owner) has a contractual agreement with Kentucky Theater Management Group, Inc. (Manager) to operate and manage the Kentucky Theater. The Manager is required to provide the preceding month's Gross Receipts Report to LFUCG before the 20th of each month. Per the Agreement, the report shall consist of bank statements, including deposit slips and receipts, and copies of all sales tax reports. The Agreement states that 90% of Gross Receipts Excluding Special Events and 95% of Gross Receipts

for Special Events shall be submitted back to Manager as compensation for operating the Kentucky Theater. Total gross receipts reported by the Manager for FY 2013 were $684,457.

The Office of Internal Audit requested the Kentucky Theater Group's most current financial statement audit and was told by Manager that a financial audit has never been performed on the Kentucky Theater's gross receipts. We were also informed that in July 2012 a request for audited financial statements for the Kentucky Theater Group was submitted by the Division of Accounting on behalf of the LFUCG Commissioner of Finance, and the reply from Manager was "I don't believe we are under any obligation to disclose our operating expenses and net profit and loss", and we were told that the requested financial statements were not provided to Accounting. No subsequent action was taken at that time.

The LFUCG contractual agreement with Kentucky Theater Management Group, Inc.(Manager) states in paragraph 7(B): "Manager shall deliver to Owner within ninety (90) days after the end of each calendar year an income statement, a balance sheet and a written report, showing the Gross Receipts and Net Receipts categorized by theater admissions, concessions (listing concession revenue from special events separately from all other concession revenue) and special events, and Management Fee for the preceding year. These reports should be prepared in accordance with generally accepted accounting principles and certified as correct by an officer of Manager." Prior to our receiving the calendar year 2013 unaudited balance sheet and income statement, requested as part of our audit, these annual reports had not been provided to LFUCG by the Manager and LFUCG had not enforced this provision of the contract. At the time of our request Manager stated a balance sheet, income statement, and written report had not been requested by LFUCG in 22 years.

Effect:
Failure to comply and enforce contractual financial reporting requirements makes it more difficult to determine if Gross Receipts have been accurately reported to LFUCG.

Recommendation:
The Kentucky Theater Management Group, Inc. should provide LFUCG with annual financial reports 90 days after the calendar year-end as stated in 7(B) of the Agreement. The LFUCG should enforce this provision of the contract.

The Office of Internal Audit will also bring to the attention of LFUCG Internal Audit Board the possibility of an internal audit project being added to the Internal Audit Plan that would examine accounting records and procedures adopted by the Manager for the purpose of recording and control of all transactions affecting the determination of Gross

Receipts. If there are findings that come from the engagement that bring into question the Manager complying with paragraphs 7(C) , 7(D), or 7(E) of the agreement, then we would further recommend these records be audited by an independent CPA.

Director of Accounting Response:
The Division of Accounting concurs with Internal Audit's recommendation. Kentucky Theatre Annual Financial Statements should be emailed electronically to the Director of Accounting per 7(B) of the Agreement.

Commissioner of Finance & Administration:
I concur with the recommendation.

RISK OBSERVATIONS

Standards for the professional practice of internal audit stipulate that it is the Office of Internal Audit's responsibility to inform management of areas where risk to the organization or those it serves exist. The following observations identify risks associated with the revenue collection and allocation process but do not represent a violation of statutes or policies. They are considered to be of sufficient importance to deserve mention in this report to ensure senior management's awareness.

Risk Observation #1: Council Should Consider Allocating All Bank Franchise Receipts to the General Services Fund

The bank franchise tax is currently split 50/50 between the General Services Fund and Urban Services Fund. Council approved this split December 5, 1996, through Ordinance #244-96. For 2013, the total tax collected was $2,701,330 with the Urban Services Fund receiving $1,350,665. While splitting the bank franchise tax is acceptable, we could not locate any Kentucky Revised Statute placing such a restriction on the bank franchise tax. The only approval for the split appears to be through Ordinance #244-96. Since the Urban Services Fund already receives a significant dedicated tax and there is a need for increased revenues in the General Services Fund, we recommend the option of allocating all bank franchise tax to the General Services Fund be given due consideration. This could result in more than $1,000,000 being added to the General Services Fund annually.

Commissioner of Finance & Administration Response:
The procedure to allocate the taxes collected related to the Bank Franchise tax was adopted to acknowledge that property within Fayette County is both inside and outside the urban service area. Unlike real property, the bank franchise tax cannot be traced to a specific location. Allocating the revenues was seen as a fair and equitable approach. A

change in the allocation of Bank Franchise taxes will be considered after a full discussion with Council during the budget process and implemented at the beginning of a budget year.

Risk Observation #2: Statement on Standards for Attestation Engagements (SSAE) #16 Reporting on Controls for Service Organizations Should Be Requested From Service Organizations

LFUCG utilizes two service organizations for billing and/or collection of EMS ambulance payments and LEXServ, representing two significant revenues. Software Development, Inc. (SDI) provides billing and tracking of EMS accounts receivables, while Greater Cincinnati Water Works provides billing, tracking, and collection of LEXServ accounts receivables. We inquired whether these service organizations have provided a copy of SSAE #16 Reporting on Controls at a Service Organization to the LFUCG, and were informed that no reports exist.

User organizations (in this situation, the LFUCG) that obtain a copy of an SSAE #16 report from their service organizations receive important information, including a detailed description of the service organization's controls and an independent assessment of whether the controls were placed in operation, suitably designed, and operating effectively (depending on the type of engagement).

We recommend management consider requesting SSAE #16 reports from SDI and Greater Cincinnati Water Works. In our opinion, this is particularly important to manage LFUCG's reputational risk against the risk of compromised customer data.

Commissioner of Finance & Administration Response:
The need for LFUCG to have confidence a service organization exercises due diligence in information management, internal controls, and meets minimum standards is important. Small organizations and governmental units are not required to have a SSAE#16. The costs associated with having an outside auditor review and issue a SSAE#16 are material for small business. In lieu of a SSAE#16, Software Development, Inc. (SDI), on its own initiative and in coordination with LFUCG, compiled an Ambulance Billing Process Control, to document their reporting and controls process. Greater Cincinnati Water Works does not have a SSAE#16 report. LFUCG will request they furnish a substitute document addressing internal controls.

APPENDIX A

441.135 Canteen for prisoners -- Books of accounts -- Allowable expenditures -- Jail canteen account balance -- Calculation.

(1) The jailer may maintain a canteen for the benefit of prisoners lodged in the jail and may assign such jail employees and prisoners to operate the canteen as are necessary for efficient operation.

(2) All profits from the canteen shall be used for the benefit and to enhance the well-being of the prisoners. The jailer shall keep books of accounts of all receipts and disbursements from the canteen and shall annually report to the county treasurer on the canteen account.

(3) Allowable expenditures from a canteen account shall include but not be limited to recreational, vocational, and medical purposes.

(4) Except in counties containing an urban-county government or a consolidated local government, in order to ensure adequate, ongoing funding of jail canteen accounts, beginning July 1, 2007, and on the first day of each fiscal year thereafter, the jail canteen account balance shall at least equal the following amounts based on the average daily inmate population of the jail:

(a) 300 prisoners or more
....$6,000

(b) 200 to 299 prisoners
....$4,000

(c) 100 to 199 prisoners
....$2,000

(d) 99 or fewer prisoners
....$1,000

(5) For purposes of calculating the amount to be transferred to the jail canteen account, the average daily number of inmates shall be equal to the average daily inmate population of the jail in the immediately preceding fiscal year.

Effective: June 26, 2007

History: Amended 2007 Ky. Acts ch.64, sec.1, effective June 26, 2007. -- Amended 2006 Ky. Acts ch.147, sec.1, effective July 12, 2006. -- Amended 1998 Ky. Acts ch.171, sec.1, effective July 15, 1998. -- Created 1982 Ky. Acts ch.127, sec.1, effective July 15, 1982.

Formerly codified as KRS 441.067.