

# **INTERNAL AUDIT REPORT**

DATE: May 2, 2012

TO: Jim Gray, Mayor

Sandy Canon, Human Rights Commission Chair

CC: Richard Moloney, CAO

Jane Driskell, Commissioner of Finance & Administration

Phyllis Cooper, Director of Accounting Susan Straub, Communications Director

Urban County Council Members Internal Audit Board Members

FROM: Bruce Sahli, Director of Internal Audit

RE: Human Rights Commission Follow-up Review

# **Background**

On June 24, 2010, the Office of Internal Audit issued an audit report on the Lexington-Fayette Urban County Human Rights Commission (HRC). The HRC is a local independent agency created by the charter of the Lexington-Fayette Urban County Government to enforce anti-discrimination local ordinances 199-94 and 201-99. The report contained several significant findings related to HRC's business operations and financial oversight and governance by the HRC's Executive Committee.

# Scope & Objectives

200 East Main Street

This follow-up review was conducted to evaluate controls put in place by management to address the specific findings from the June 24, 2010 report as summarized below:

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- Past due account payable issues
- Late and unpaid employee benefit contributions
- Issues regarding the financial reporting of the HRC to its Commission
- Bank reconciliations not completed timely
- Inadequate segregation of duties
- Late depositing of funds received
- An absence of written procedures for many HRC business functions
- Systematic grant and contract tracking needed
- Check and check stock security improvements needed
- Travel expenditure support and approval issues
- Inappropriate use of sick leave by employees
- Payroll deductions lacked supporting documentation

Audit results are based on observations, inquiries, transaction examinations, and the examination of other audit evidence 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 period of review included transactions occurring from July 2010 through November 2011.

# **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 provided reasonable assurance that the general control objectives were being met. Opportunities to improve 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 and/or costs associated with the process being audited.

Moderate – Represents a finding requiring timely action by management to mitigate risks and/or costs 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**

# <u>Finding #1:</u> Various Expenditure Issues Noted Priority Rating: High

#### **Condition:**

We selected 22 expenditures incurred by the HRC during the period under examination and reviewed them for timeliness, adequate supporting documentation, payment accuracy, and proper management approval.

Supporting documentation for one of the expenditures selected for review could not be located. Of these 21 expenditures we were able to test, 11 lacked sufficient supporting documentation such as invoices, expense reports, or receipts. Six were supported by nothing more than check requests issued by the Office Manager, who also prepares checks (three of these lacked information on the time period for which services were being paid). Six were paid after the payment terms indicated on the vendor invoice, and the late payments were not approved by the Executive Committee as required under HRC's Budget and Fiscal Policy. Two were made out to "Petty Cash" in the amounts of \$300 and \$500 without sufficient supporting documentation.

#### Effect:

Without sufficient supporting documentation, expenditures cannot be properly evaluated, validated, and approved by management. The Executive Committee cannot address the

issue of past due bills if they are not made aware of them by management. The risk of fraudulent transactions increases with checks written to "Petty Cash". Allowing the same employee to issue checks for check requests she has submitted as payment support creates an inadequate separation of duties and the increases the risk of inappropriate transactions.

#### Recommendation:

The HRC should not expend funds for services procured unless sufficient and complete documentation exists beforehand. All bills should be paid within the payment terms indicated by the vendor as required by HRC fiscal policy, and any exceptions should be reported to the Executive Committee as soon as possible to obtain their approval for delaying payment. The Executive Committee should consider implementing a formal reporting mechanism so that these exceptions can be documented and forwarded to the appropriate Commissioners for their review and approval on a timely basis.

The HRC should consider eliminating the Petty Cash fund in favor of a procurement card with a prescribed spending limit for small purchases to reduce the risk of theft or fraud associated with a Petty Cash fund. Since the Office Manager is responsible for preparing checks, check requests should be made by other HRC personnel to ensure a proper segregation of duties. Additionally, such requests should not serve as the only supporting documentation for expenditures. Expenditures should not be made if appropriate supporting documentation from a vendor cannot be obtained.

## **Human Rights Commission Chair Response:**

Supporting documentation: Clear internal processes have been established requiring appropriate and sufficient documentation for every check written. These processes have been shared with the Office Manager as first level, Executive Director, second level, and Executive Committee members with check signing responsibility as a third and fourth check of documentation.

Late payments: Any payment that the Office Manager and/or Executive Director deems may be late beyond the payment terms will be reported with reason(s) to the Executive Committee via email as soon as it is known.

Petty cash: The Commission is currently exploring several options to completely eliminate petty cash in the office. For supplies, the Commission will be having conversations with Office Max to open a line of credit for in-store purchases. With respect to the postage fund, the Commission is investigating a couple of different options to utilize a pre-paid credit system for postal purchases.

# <u>Finding #2:</u> Financial Reports Differ With Supporting Documents Priority Rating: High

#### **Condition:**

The HRC fund balances (income net expenses) as reported on the monthly financial reports provided to the Executive Committee should agree with the reconciled HRC monthly check register and bank statement balances. We noted four consecutive months at the beginning of FY 2012 in which these balances did not agree, at times substantially.

## Effect:

The Executive Committee's financial decisions may be impaired if HRC financial reports are not accurate, reliable, and complete.

#### Recommendation:

HRC personnel should reconcile the fund balances shown on the monthly financial reports with its reconciled bank statement and check register balances before providing these reports to the Executive Committee or other users.

## **Human Rights Commission Chair Response:**

Monthly financial reports: A process involving the Office Manager and the Treasurer have been implanted requiring reconciliation of fund balances with the bank statement and check register balances prior to submission to the Executive Committee or full Commission. The Commission will also move to a dual-reporting system for the monthly meetings. At the monthly, all Commissioners will receive a cash report and an accrual report for their review. In addition, both reports will be reconciled with the fund balances.

# <u>Finding #3:</u> Grant & Contract Tracking Process Not Complete Priority Rating: High

## Condition:

In Finding #8 of the June 2010 audit report, we recommended HRC implement an accounts receivable aging schedule to track pending grant and contract funds due HRC, with a procedure for the monitoring and timely follow up of past due expected payments that also incorporated appropriate filing deadlines to ensure HRC applies on time for all grant and contract funds it may be eligible to receive. The Human Rights Commission Chair agreed to implement this recommendation.

Our review noted that the log of grants and contracts developed by HRC to comply with this recommendation only includes payments received from CDBG, and did not include any information on funding and payments from other agencies such as EEOC and HUD. The log also had no receivable information to track when applications or vouchers were submitted for payment, when receipts of payments are expected, or how long applications or request for payments are outstanding.

#### **Effect:**

Without a complete and comprehensive tracking log or schedule, HRC cannot properly monitor when funds from agencies are expected to be received, and therefore cannot follow up if such payments are not received in a timely manner. The absence of such tracking also increases the risk the HRC will miss another filing deadline and lose funding as a result.

#### **Recommendation:**

HRC should revise its grant and contract tracking log to identify when applications or vouchers are due to be submitted to funding agencies for payment, when these documents are submitted for payment, when payments are expected, and when payments are received. These logs should include information concerning all funding sources, including EEOC and HUD.

## **Human Rights Commission Chair Response:**

Grant and contract tracking: The log has been updated to include filing deadlines, date of submission, anticipated receipt of funds of all grant and contract funds. This log will be reviewed and signed by the Executive Director on a monthly basis. The Executive Committee will be informed of grant and contract process on a monthly basis. Both EEOC and HUD funding and payment information will be added to the tracking log. In addition, explanatory notes will be included on the log with respect to timing of payment, etc.

# <u>Finding #4:</u> HRC Has Not Converted to Accrual Accounting System Priority Rating: High

### **Condition:**

In the June 2010 report we noted that the HRC had not converted from cash basis accounting to accrual basis accounting as recommended in the 2008 external auditor's report, and we concurred with the external auditor's recommendation that accrual basis accounting should be used. Our review of HRC's financial records and discussions with HRC staff determined that HRC still maintains a cash basis accounting system.

### Effect:

The accrual basis of accounting would improve HRC's understanding of its true financial status by recording financial transactions when events that generate revenue and expense occur, rather than the cash basis of accounting which records such transactions only when funds are actually received and expenditure payments are actually made.

#### Recommendation:

HRC should convert to the accrual basis of accounting as previously recommended and agreed to by the Human Rights Commission Chair in the June 2010 report.

## **Human Rights Commission Chair Response:**

Cash to accrual basis: It is anticipated that the full transition to an accrual accounting system will be completed by May 30, 2012. With assistance of an outside accountant, all financial records and subsequent discussions will be based on this accrual system.

# <u>Finding #5:</u> Improved Controls Needed Over Deposits Priority Rating: High

### **Condition:**

Checks received by the HRC were not stamped with receipt dates for seven of the 14 (50%) manual deposits examined. In addition, two of the 14 manual deposits examined lacked sufficient supporting documentation, including a bank receipt, a check remittance advice, etc.

#### Effect:

Deposits cannot be monitored for timeliness if the checks received for deposit are not date stamped when received. Without sufficient supporting documentation, HRC may not be able to successfully dispute bank errors on their bank accounts. The lack of supporting documentation also increases the chances deposit amounts could be incorrectly entered into HRC's financial records.

#### Recommendation:

Receipt date should be stamped on the supporting documentation for all checks received so that management can monitor the timeliness of deposits. HRC should also retain all documentation associated with deposits in order to provide back-up should any disputes arise with the bank regarding HRC's accounts.

# **Human Rights Commission Chair Response:**

Deposits: Training has occurred with the Office Manager and Executive Director to ensure appropriate supporting documentation. All documentation will be held for the legal term for any disputes.

# <u>Finding #6:</u> Budget Variances Not Clearly Identified in Financial Reports Priority Rating: Moderate

### **Condition:**

In its response to Finding #3 in the June 2010 audit report (Financial Reporting to Commission Needs Improvement), the Human Rights Commission Chair stated, "The Commission will be provided with monthly statements that itemize actual income and expenses, variances from the budget, and updated projections for the coming months". Presently, variances from the budget are not highlighted in financial reports being presented to the Executive Committee.

#### Effect:

This report format may not adequately convey HRC's budgeted versus actual financial results to management and the Executive Committee.

### **Recommendation:**

The monthly financial reports should clearly indicate variances between budgeted and actual amounts (over or under) for each income and expense category included on the reports. Ideally, a percentage amount of variance should be included as well. Management can only reallocate resources if it is clearly communicated in these reports where the HRC is exceeding or coming in below budget for different income and expense categories. Reporting variances as recommended above is also consistent with common best business and financial reporting practices, and should aid management and the Commissioners in assessing HRC's financial situation each month.

# Human Rights Commission Chair Response:

Budget variances: It is anticipated that the full transition to our new accrual accounting system will include budgeted and actual (over or under) for each expense and income category by May 30, 2012. These reports will be provided monthly to the full Commission. Any internal budget reporting systems will include a separate column indicating the amount over or under budget.