



Mayor Jim Newberry

LEXINGTON-FAYETTE URBAN COUNTY GOVERNMENT
Office of Internal Audit

INTERNAL AUDIT REPORT

DATE: February 29, 2008

TO: Jim Newberry, Mayor

CC: Joe Kelly, Senior Advisor for Management
Kyna Koch, Commissioner of Finance & Administration
Rama Dhuwaraha, Chief Information Officer
Mary Fister, Director of Accounting
Urban County Council Members
Internal Audit Board Members

FROM: Bruce Sahli, Director of Internal Audit

RE: Division of Accounting Journal Entry Review

Background

The Division of Accounting utilizes the STARS System to post Journal Entries into the financial records of LFUCG. In October, 2007, the Director of Accounting informed this Office that it had come to her attention that during FY 2007 there was a window of time when 238 individuals had the ability to create Journal Entries within the STARS System. Sixty-seven individuals (about half being non-Accounting personnel) did create such Journal Entries that were subsequently posted to STARS by Accounting personnel, apparently without being reviewed for accuracy or appropriateness.

The Director of Accounting was very concerned about the effect these Journal Entries could have on the accuracy of financial reporting, and stated that at least some examination of these Journal Entries needed to occur to detect any significant errors they may have produced in the financial records. The Office of Internal Audit agreed to conduct this review due to the exposure to the financials this practice had created, and to assist with addressing a significant open item in the year-end closing process.

Within the STARS System, Journal Entries are first posted in a Journal Voucher. A Journal Voucher essentially serves as a file containing records (Journal Entry lines) to be posted in the STARS System, and each Journal Voucher may contain an unlimited number of Journal Entry lines. Prior to the STARS System implementation, Journal Vouchers were posted to the Mainframe, which per

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Accounting management limited Journal Voucher entries to 99 per quarter. This Mainframe limitation resulted in a Division of Accounting practice of combining numerous unrelated Journal Entries into large Journal Vouchers. When the STARS System was put into service for financial reporting purposes, the practice of combining numerous unrelated Journal Entries into large Journal Vouchers continued, a practice apparently exacerbated by the transition into the new STARS System. This resulted in many Journal Vouchers being posted in the STARS System in FY 2007 which contained large numbers of unrelated Journal Entry transactions. For example, one Journal Voucher examined during our review contained 127 Journal Entry lines, while even greater numbers of Journal Entry lines were noted in some Journal Vouchers not selected for testing.

Scope and Objectives

The general control objectives for the audit were to determine that:

- Journal Entries were properly supported and posted to the correct accounts
- Journal Entries were properly approved prior to posting
- Journal Entries were posted in a timely manner

Due to the fact the Division of Accounting was in the process of reviewing large groups of material automated and manual Journal Entries affecting non-cash accounts, a decision was jointly made with the Director of Accounting that the scope of this review would be to examine all manually produced Journal Entries affecting Account ##### (Cash in Banks) in amounts of \$100,000 or greater. We therefore examined 79 Journal Vouchers containing Journal Entries to Account ##### in the net amount of \$558,049,235.37.

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 did not provide reasonable assurance that the general control objectives were being met. Opportunities to enhance controls are included in the Summary of Audit Findings.

SUMMARY OF AUDIT FINDINGS

1. Journal Posting Policies & Procedures Needed

There are no written procedures in the Division of Accounting to provide instruction regarding the supporting, recording, and processing of Journal Vouchers and their related Journal Entries in the STARS System. We recommend that the Division of Accounting develop written procedures that clearly describe the requirements for supporting, recording, and processing Journal Vouchers and their related Journal Entries. Findings two through six are likely the direct result of the absence of such policies and procedures.

Director of Accounting Management Response: The Division of Accounting concurs with recommendation. Within the next 6 to 9 months, the Division plans to issue a new procedure manual and create new training related to the requirements for supporting, recording and processing Journal Vouchers and their related Journal Entries.

Commissioner of Finance & Administration Management Response: I concur with the response from the Director of Accounting.

2. Journal Entry Support not Sufficient

In our opinion, the Cash side of the Journal Entries examined in our review generally had adequate support in the form of bank statements, investment statements, etc. However, this support generally did not include adequate descriptions or other supporting documentation to provide reasonable assurance that the non-cash side was correctly posted. Although we noted no instances where Journal Entries were clearly NOT accurately posted, the lack of supporting documentation precludes any assurance regarding the accuracy of the non-cash portion of the Journal Entries examined in our review, and therefore we make no such assurance.

It was noted that End User Forum notes conveyed to us after the audit fieldwork was completed indicated that Accounting is now requiring the Journal Voucher requestor attach backup documentation, including “proof of the charge and reasons for the Journal”. We recommend that additional guidance be provided in the form of a written procedure to ensure the proper recording of Journal Vouchers to the financial records.

Director of Accounting Management Response: The Division of Accounting concurs with recommendation. Within the next 6 to 9 months, the Division plans to issue a new procedure manual and create new training related to the requirements for supporting, recording and processing Journal Vouchers and their related Journal Entries.

Commissioner of Finance & Administration Management Response: I concur with the response from the Director of Accounting.

3. Source Documentation Standards need to be Established

Accounting staff maintained various forms of Journal Entry supporting documentation, ranging from bank statements to requester e-mails to screen prints. In some cases we noted documentation for original entries but none for subsequent correcting entries. It therefore appears there were inconsistent expectations as to what constituted supporting documentation. We also noted that Journal Entry documentation was dispersed among the various accountants, which appeared to add to the lack of continuity in the type of support found.

Journal Entry supporting documentation should consist of independent source documents when practical (e.g., bank statements, invoices, payroll vouchers), and should clearly define the source and nature of the transaction to be posted in the Journal Entry. Division of Accounting management should establish consistent Journal Entry documentation standards and include them in written Division Policies and Procedures to ensure that all Journal Entries have sufficient documentation prior to being posted in the STARS System. Centralized filing of the documentation to improve retention practices and ease of retrieval is also recommended.

Director of Accounting Management Response: The Division of Accounting concurs with recommendation. Within the next 6 to 9 months, the Division plans to issue a new procedure manual and create new training related to the requirements for supporting, recording and processing Journal Vouchers and their related Journal Entries.

Commissioner of Finance & Administration Management Response: I concur with the response from the Director of Accounting.

4. Journal Vouchers Not Posted Timely

We noted that Journal Vouchers were often posted several weeks after their creation date. A review of 126 Journal Entries within the various Journal Vouchers noted that 30 (23.8%) were posted 60 or more days after creation, including 14 (11%) posted 90 or more days after creation. Generally Accepted Accounting Principles (GAAP) states that transactions should be posted in the accounting period in which they occurred, and we based our review on the concept of a standard monthly accounting period.

The Division of Accounting should establish written procedures to ensure that all journal entry transactions are posted in a timely manner to ensure compliance with Generally Accepted Accounting Principles, and to provide accurate and timely updates to financial information.

Director of Accounting Management Response: The Division of Accounting agrees with this recommendation. The Accounting Division has been actively working to catch up on the backlog of month end close activity. Once the Division has closed each month, it will begin to perform month end close by the 10th day of the following month. It is anticipated that the Division will be able to meet this objective for the March 2008 closing and there after.

Commissioner of Finance & Administration Management Response: I concur with the response from the Director of Accounting.

5. Journal Vouchers Contain too many Unrelated Journal Entries

We noted that Journal Vouchers often contained numerous Journal Entries posted for many unrelated purposes. Grouping numerous unrelated Journal Entries into one Journal Voucher, while providing unrelated or generic Journal Voucher descriptions, creates significant confusion in the record of financial transactions. It also makes the proper review of such transactions more cumbersome and difficult.

As noted in the Background Section of this report, the STARS System does not have limits on the number of Journal Vouchers that can be posted during a given accounting period. It is therefore recommended that Journal Vouchers only contain related Journal Entries, and that the Journal Voucher descriptions accurately describe the nature of Journal Entries contained therein. This requirement should be stated in written policies and procedures for the posting of Journal Entries.

Director of Accounting Management Response: The Division of Accounting concurs with this recommendation. Accounting staff has already been instructed to only post “single purpose” journals. This will also be addressed in the new procedure manual and training which will be completed in the next 6 to 9 months.

Commissioner of Finance & Administration Management Response: I concur with the response from the Director of Accounting.

6. Journal Entry Explanations too Generic

It was noted that Journal Entries posted in individual Journal Vouchers often contained generic explanations. The most notable example was a Journal Entry containing 127 lines of debits and credits to various accounts for various purposes described simply as “bank reconciliation”. Such non-descript explanations make the proper review of such transactions more cumbersome and difficult.

It is recommended that the description field contain a clear, concise explanation of the nature of the Journal Entry to provide improved transaction documentation. This requirement should be stated in written policies and procedures for the posting of Journal Entries.

Director of Accounting Management Response: The Division of Accounting concurs with this recommendation. This will be addressed in the new procedure manual and training which will be completed in the next 6 to 9 months.

Commissioner of Finance & Administration Management Response: I concur with the response from the Director of Accounting.

7. STARS Workflow Process not Activated

As stated in the Background section of this report, we had been informed by the Director of Accounting that during FY 2007 many Journal Vouchers containing numerous Journal Entries were posted in the STARS System, apparently without approval by Division of Accounting management. However, it was not possible to determine which of these Journal Vouchers were in fact posted without such approvals as the STARS Workflow process (which provides systematic tracking of Journal Voucher approvals) was not activated during that time. Hard copy support maintained for some Journal Vouchers also lacked evidence of review or approval.

We recommend that the Workflow process in STARS be activated and the approval process be established and followed. The Workflow process should not be deactivated without written approval from senior management.

Chief Information Officer Management Response: Previous Accounting management deemed journal work flow not necessary and chose not to utilize that functionality. We would be happy to work with Accounting to define and implement work flow for Journal Vouchers. Resolution Date: It is out of our control. IT will need to work with someone in Accounting to define the work flow. Once defined, the programming will take two weeks and testing should take about a week. Twenty-one working days to complete.

Director of Accounting Management Response: The Division of Accounting with the Director of Internal Audit has met with IT to discuss the ability to turn on the Work flow functionality related to Journal Vouchers. The Director of Accounting plans to implement Work flow to ensure proper review of all journals processed. Specifically, work flow will ensure Grant compliance, enhance Fixed Asset Accounting and most importantly ensure that all journals are reviewed by appropriate personnel prior to posting to the general ledger.

As a temporary internal control measure, access to post general ledger journals has been limited to the Director and one Senior Accountant until such time as work flow can be implemented.

Commissioner of Finance & Administration Management Response: I concur with the response from the Director of Accounting.

8. User ID Field not Updating

The User ID Field in the STARS System ##### screen did not update when transactions occurred. We were therefore unable to determine who posted a Journal Voucher or if anyone had edited it. We recommend the User ID Field be programmed to track originating and editing entries to improve Journal Voucher review and oversight.

Chief Information Officer Management Response: I do not believe Accounting ever reported this as an issue, probably because they were not reviewing Journals in the first place. This should be an easy fix to track the originator but tracking changes may prove to be more challenging. Resolution Date: We could start on this today, and should have it wrapped up by the middle of next week. Seven days to complete.

AUDITOR'S NOTE: Current Accounting management determined that FY 2007 Journal Vouchers had not been reviewed prior to posting, and was therefore instrumental in creating awareness of this control weakness.

Director of Accounting Management Response: The Director of Accounting has had discussions with Metaformers staff regarding this weakness and determined that by turning on work flow the tracking of journal activity should be captured.

Commissioner of Finance & Administration Management Response: I concur with the response from the Director of Accounting.

9. Journal Voucher IDs Should be System Generated

It appears that Journal Voucher ID's were sometimes selected by the originators of the transactions rather than being created by the STARS System. We recommend the STARS System be programmed to generate the Journal Voucher ID exclusively to prevent the possible duplication of IDs and to improve transaction tracking.

Chief Information Officer Management Response: Management previously responsible for implementing this feature had chose not to do so. This will be an easy fix. Resolution Date: We can implement this today. Two days to complete.

Director of Accounting Management Response: This issue will need future discussions between IT, Accounting and Metaformers. The Accounting Division utilizes electronic entry of data for journals and it is the understanding of current Accounting Management that this feature requires naming of the voucher prior to upload. Accounting Management agrees that standard naming conventions and sequential number of journals is critical. Once it is determined what options are available regarding uploaded journals, Accounting Management will develop procedures to ensure that the system generates all journal IDs and/or that upload journals are sequentially numbered to prevent possible duplication of IDs.

Commissioner of Finance & Administration Management Response: I concur with the response from the Director of Accounting.