



Mayor Jim Newberry

LEXINGTON-FAYETTE URBAN COUNTY GOVERNMENT

Office of Internal Audit

INTERNAL AUDIT REPORT

DATE: May 29, 2008

TO: Jim Newberry, Mayor

CC: Joe Kelly, Senior Advisor for Management
Kyna Koch, Commissioner of Finance & Administration
Mary Fister, Director of Accounting
Mike Gilmore, Explorium Executive Director
Urban County Council Members
Internal Audit Board Members

FROM: Bruce Sahli, Director of Internal Audit

RE: Explorium Internal Audit Report

Background

The Explorium of Lexington (formerly named the Lexington Children's Museum) provides interactive learning for children of all ages through exhibits and galleries. As such, Explorium offers a variety of opportunities for performances, programs, and education by volunteers and teachers. For FY 2008, the LFUCG budgeted \$237,500 to the Explorium to support museum salaries and general operations.

In March 2008, the Commissioner of Finance & Administration requested that the Office of Internal Audit review revenue reporting at the Explorium because of discrepancies noted by the Division of Accounting during the reconciliation of reported collections to related bank statement activity. This review was conducted because of that request. The review was then expanded to include a limited examination of Explorium expenditures when it was noted that internal controls over certain Explorium disbursements were insufficient to ensure the appropriateness of purchases.

Scope and Objectives

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

H O R S E C A P I T A L O F T H E W O R L D

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- Sales were accurately reported in a timely manner
- Deposits were accurately made on a timely basis
- Collections were properly secured prior to deposit
- Expenditures were reasonable and properly authorized

The period of review was FY 2007 and FY 2008 through March 2008.

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. LFUCG Business Relationship with Explorium

LFUCG provides Accounting, Purchasing, and Payroll processing services to Explorium through its Divisions of Accounting, Purchasing, and Human Resources. LFUCG receives quarterly financial reports from Explorium summarizing its admissions, revenues, and activities for the previous quarter, which is then entered into LFUCG's financial accounting system (PeopleSoft). Explorium purchases are typically processed through LFUCG's purchasing system, and LFUCG pays those vendors for Explorium's purchases. LFUCG also pays Explorium personnel salaries through the LFUCG payroll system, and provides health, dental, life, and worker's compensation insurance to Explorium employees. In return, the Explorium deposits all their collections and donations into a National City Bank account, which is swept daily by LFUCG and transferred into LFUCG's Concentration Account. This arrangement has apparently existed for a number of years as created and then carried forward by prior Administrations, and is defined in Explorium's Purchase of Service Agreement (PSA) with LFUCG. As noted in the Background section of this report, for FY 2008 LFUCG budgeted \$237,500 for Explorium to support museum salaries and general operations.

Department of Finance & Administration personnel determined that Explorium began overspending its budgeted funds in FY 2005, with FY 2006 experiencing overspending of \$105,652. The

Department of Finance & Administration has further calculated that this overspending has culminated in an overall balance owed to LFUCG of \$147,995 through FY 2007. The Commissioner of Finance & Administration is considering granting one-time debt forgiveness to the Explorium for this amount owed, a possibility discussed in the October 25, 2007 Explorium Board of Directors meeting. It is her position that LFUCG shares some responsibility for the lack of budgetary control.

Providing Explorium's accounting, purchasing, and payroll services represents a significant ongoing cost to LFUCG. LFUCG appoints the members of the Explorium's Board of Directors but otherwise has no governing authority with Explorium. Explorium employees are not hired, supervised, or otherwise affiliated with LFUCG, and LFUCG has no authority to direct their actions or discipline violations of LFUCG accounting, purchasing, or payroll policies.

It is the opinion of the Office of Internal Audit that accounting, purchasing, and payroll functions should become the sole responsibility of the Explorium. It is recommended that LFUCG begin funding Explorium with an annual payment and cease providing accounting, purchasing, and payroll services to Explorium. The transfer of these responsibilities to Explorium should occur as soon as reasonably possible in FY 2009. It is also the opinion of the Office of Internal Audit that similar administrative services provided to other Component Agencies, to the extent they exist, also be transferred to those Agencies.

Commissioner of Finance & Administration Management Response: I concur with the recommendation of the Office of Internal Audit.

Explorium Executive Director Management Response: The relationship with LFUCG has been so vital in the Explorium's development as a Children's museum. In my short time here as Executive Director it appears that the relationship experienced a number of challenges around 2005. Then or about that time PeopleSoft was either being implemented or talked about and the processing of financial records and reporting of those records became labored. Decisions on purchasing and budgeting became more challenging. On and about the same time staff turnovers increased through 2008 including the Executive Director and Development Director and a viable history of the relationship between LFUCG and Explorium was lost. There developed gaps in the flow of information for new employees at the Explorium as to what it meant to be a Satellite or as it is referred to now a partner agency. The shock of losing both executive leaders and the turnover of staff resulting in poorly trained replacements has exasperated the situation.

I have begun discussions with the Finance & Administration Department, Office of Internal Audit, have an appointment with Mayor Newberry (May 29th) and Ex-Mayor Miller to "right" the relationship and address from the Explorium's end the need for training, creation of financial and new personnel policies and ongoing dialogue with LFUCG.

I speak for the Board when I say that would welcome discussions with LFUCG on the transfer of accounting, purchasing, and payroll services to Explorium. There are several issues to discuss as to the possibility of this transfer not the least of which is the need for all expenses and revenues to be loaded into PeopleSoft so that an accurate picture of the Explorium's finances would be available and part of the decision process.

2. Explorium Bank Account Reconciliation not Performed Timely

Reconciliation of the Explorium's bank account for FY 2007 activity did not begin until March 2008, and the reconciliation process for FY 2008 is also several months behind. Reconciliations are an important control in identifying anomalies in bank account deposits, withdrawals, and other transactions affecting the account balance. It is recommended the Division of Accounting and Explorium jointly establish procedures to reconcile this account to reported activity on a monthly basis.

Commissioner of Finance & Administration Management Response: I concur with the recommendation of the Office of Internal Audit.

Explorium Executive Director Management Response: The issue of bank reconciliation is being addressed. As I have been at the Explorium only a month I immediately set out to understand the financial situation at the Explorium.

It was initially pointed out to me that in the early stages of addressing reconciliation that bank statements were being sent directly to LFUCG and that we were waiting for copies to be sent to us from LFUCG. This process wasn't always expeditious and my pointing this out is not intended to say this alone is the problem.

The Explorium will begin to pay the bank to send a copy of the bank statement to us in a regular manner.

As part of initiating a new financial policy at the Explorium a regular mandatory system of entering daily deposits, expenses, and other revenues has begun. To accomplish this we have added an additional staff person who will organize all data entries, bank statements, admissions recap sheets, etc. for entry into the various databases by LFUCG.

It is further obvious from my assessment of our situation that additional training is needed of our staff in PeopleSoft and that we have weekly financial reviews led by me of our progress in keeping current in the reconciliation process so that accurate balances might be kept.

It does need to be said that to be able to reconcile our work with LFUCG and the PeopleSoft system, LFUCG will need to be current in their data entries of expenses and revenues. At the time of this writing we still do not have all revenues for FY 2008 loaded in the database.

3. Current Purchase of Service Agreement (PSA) Needed

The most current PSA with Explorium was effective July 1, 2006. It is recommended that PSA's be obtained each Fiscal Year to reflect the annual funding to be provided to the Explorium by LFUCG and the legal responsibilities the Explorium and the LFUCG owe to one another.

Commissioner of Finance & Administration Management Response: I concur with the recommendation of the Office of Internal Audit.

Explorium Executive Director Management Response: From the Explorium's standpoint we are ready to sign/negotiate a new PSA. It is the understanding of this Board that LFUCG initiated this process, but I intend to bring this up with the necessary persons at LFUCG.

4. Explorium Control Issues

The following points summarize the numerous and varied internal control, management issues, and unusual transactions noted during the audit. Taken as a whole, they clearly indicate significant improvements are needed in the areas of securing and depositing funds, activity reporting, transaction monitoring, and overall governance of Explorium's operations. Several recommendations are made to improve controls and governance over these specific issues noted during the audit. Those recommendations related to violations of LFUCG policies would only apply if the recommendation for the LFUCG Business Relationship with Explorium is not implemented.

1. There are no written procedures defining standard operating practices. Written procedures are an important control that provides process instruction, performance standards, and a basis for measuring compliance with management expectations. It is recommended Explorium develop a Standard Operating Procedures Manual (SOP). The SOP should clearly define requirements for collecting, securing, recording, and depositing funds. It should also define policies and procedures regarding the use of procurement cards, check writing controls, expenditure policies, payroll policies, and other issues identified in this audit. In addition, the Executive Director should also evaluate other administrative, accounting, and operational aspects of Explorium not examined in this audit and include relevant procedures addressing their functions in the SOP Manual.

Explorium Executive Director Management Response: An S.O.P (standard operation practices) will be created for the Explorium. This S.O.P. is already being created in collaboration with the whole staff. Previous executive leadership had neglected to create such a document, or to inform staff of any oral policies concerning the holding of money, deposits, etc. I say this to point out that the staff is eager to adopt an S.O.P. The S.O.P. will be completed by June 30, 2008, shown to the Board in its June meeting, and the staff will receive training related to the S.O.P. by June 30, 2008.

2. Late deposits were noted in nearly every month within the period reviewed, with most months having several deposits that were seven or more calendar days late. Late deposits were particularly numerous during the period December 2007 through February 2008. December 2007 had 20 deposits seven or more calendar days late (including some almost a month late). Every deposit made in January 2008 was seven or more calendar days late (including 15 deposits that were four to six weeks late, and six deposits that were two months late). February 2008 had 19 deposits that were seven or more calendar days late. The late deposits during these three months had an average value of \$387.90. While all reported deposits eventually matched with the bank statement, holding deposits for such an extended period of time should be completely unacceptable and cause for significant disciplinary action. This matter was brought to the Board Treasurer's attention during fieldwork, who

established a new policy for timely depositing of funds. It is recommended an Explorium employee with no responsibility for preparing reports or deposits, or for making deposits, be assigned to compare actual deposits to reported activity on a regular basis (e.g., weekly) to determine deposits are made accurately and timely. Late deposits should be promptly investigated.

Explorium Executive Director Management Response: A staff person not responsible for creating deposits (new administrative secretary) or reports has been hired and is being trained to monitor actual deposits to reported activity, as well as the timeliness of said deposits. The Administrative Secretary will report regularly to the Executive Director her findings.

3. In February 2008, 14 Explorium employees received pay increases ranging from 7.1% to 21.7% without Board approval.

Explorium Executive Director Management Response: This has been addressed with the staff directors involved in this decision. No such raises will happen without Board approval (during an interim) again. To insure that this not happen a succession of leadership document will be created spelling out the responsibilities of the Board and staff in the absence of an Executive Director.

4. Five people had access to the safe in which funds awaiting deposit were stored. The Executive Director should implement new procedures during the audit to limit this access to individuals directly responsible for deposit activity.

Explorium Executive Director Management Response: The Safe is compartmentalized and there are only 2 keys held by 2 individuals that access the deposit section of the safe. Besides the key a code must be entered to access the safe. No one with a key will have an access code, thus opening the safe will require two people. Five individuals have access to cash drawers so as to begin their daily work. There are 2 drawers that have a certain beginning balance for everyday and that is validated by the one retrieving the drawer for that day's work, again a code is required, different with each of the five to get a drawer. All monies over and above that starting amount are packaged for deposit and dropped in the secure portion of the deposit section of the safe at the end of each day. We can revisit who accesses this money drawer section of the safe if need be.

5. Explorium's Financial Director wrote \$9,759.66 in checks during calendar 2008 (88.1% of total checks written since 7/13/06). Going back to 7/13/06, the largest check written out of this account prior to January 2008 was for \$282.76. The following notable checks are included:

<u>Payee</u>	<u>Date</u>	<u>Amount</u>	<u>Notes</u>
Cash	1/28/08	\$2,000.00	CNY* expenses
KY State Treasurer	2/14/08	\$1,270.59	Jan. 2008 K-1
KY State Treasurer	3/14/08	\$1,185.41	149492
KY State Treasurer	1/29/08	\$1,111.22	149942 Dec. 2007 K-3
Employee A	1/29/08	\$1,079.00	vacation & sick payout
Cash	2/14/08	\$842.88	Petty cash/CNY*
Party City	3/14/08	\$510.13	Birthdays

*Chinese New Year

LFUCG pays the salaries of Explorium workers. Former Explorium Employee A terminated her employment on November 25, 2007, and Finance Director paid Employee A for accumulated sick and vacation time via a \$1,079.00 check written on the Explorium's bank account, with no payroll taxes withheld. Employee A was a part-time employee, and under LFUCG ordinance-driven payroll policies, was not entitled to sick and vacation payout. The appropriateness of the other checks listed above was not specifically evaluated. It is recommended the Executive Director establish procedures for the approval and monitoring of checks written from Explorium's account.

Explorium Executive Director Management Response: I am told by the directors here that individuals with tenure of over two years part time were eligible for vacation pay out (according to LFUCG personnel manual). Employee A was not eligible for the sick pay she was given. This was a decision made by the Finance Director alone. The whole process of wiping out of the National City account has been addressed with the Financial Director and is being addressed by the S.O.P.

6. Significant variances were noted between reported and actual credit card sales. As these variances essentially net out over time, this issue is likely driven by timing issues, possibly due (at least in part) to a failure to close out register Z-Tapes and the credit card terminal at the same time. Both steps should occur simultaneously at the end of each day's business.

Explorium Executive Director Management Response: The issue of end of day close out procedures has been modified to include the assignment of particular terminals to specific staff and the close out of each terminal regardless of amount of activity that day. Previously, the staff was told if one register had less than \$50.00 activity to close it out the next day.

7. For FY 2007 we noted \$42,904.25 more in deposits than reported collections. For FY 2008 through March 2008 we noted \$72,242.07 more in deposits than reported collections. All unreported collections were from the various areas not related to Admissions and the Explorium Store.

Explorium Executive Director Management Response: I am still investigating this area of the report and am concluding that most of these monies are education fees, grants, sponsorship monies, received by the Explorium. The Finance Director was depositing these monies and that has been stopped and deposits in the future will be deposited by a staff person other than the Administrative Secretary and the Financial Director. I have instructed the Administrative Secretary to begin to open all mail, remove the checks (where applicable) keep a journal of the check, photocopy the check, then give the check and supporting material from the envelope to the Financial Director to prepare the deposit. When the deposit is made by the other designated staff person they will return the deposit slip from bank to the Administrative Secretary to compare deposit to journal entries.

8. We noted there was no sales activity reported for the following dates (does not include Mondays when the Explorium is closed): 9/5/06 through 9/10/06, 1/5/07, 2/7/07, 4/8/07, 5/26/07, 9/5/07 through 9/9/07, 2/12/08 & 2/13/08, 3/23/08. Reason(s) for the absence of reported sales activity on these dates are unknown.

Explorium Executive Director Management Response: All of the days noted were dates that the Museum was closed, but one May 26, 2007. The Museum closes for a week each year in September

for painting, cleaning and repair. The Museum was closed 9/5/06-9/10/06 and 9/5/07-9/9/07 for these cleaning days. The days of 1/5/07, 2/7/0, 2/12/07, 2/13/08 and 3/23/08 were snow days and we were closed. All daily activity sheets generated at the Admission Counter are being duplicated for the Administrative Secretary, Executive Director, Director of Visitor Services and the Finance Director and each files their report.

9. There is no assurance that all Z tapes are account for. A missing Z tape number is one of the primary attributes associated with revenue losses from the abuse of manual and computer cash registers by employees. It is recommended that the registers be programmed to utilize a daily sequential control number already existing on the registers but not currently activated. Management should also establish a procedure to ensure all breaks in the Z-Tape number sequence (an indication of missing Z-Tapes) are properly investigated.

Explorium Executive Director Management Response: I have contacted the vendors who service our registers to recalibrate them and to ensure that each register identifies itself (1 or 2) on each daily Z tape. He will calibrate them to utilize a daily sequential control number, too. The Director of Visitor Services will alert the Executive Director of breaks in any Z tape sequence. This was addressed on May 27, 2008.

10. There are two cash registers at the Explorium. If both are used, two daily sales reports are generated (one for each Z Tape). It is recommended that the daily sales report format be amended to require an indication of how many registers were used, and that the amended forms also specify which register's activity they are summarizing.

Explorium Executive Director Management Response: This has been enacted and two daily reports are being generated specifying which register's activity is being summarized.

11. A surveillance camera monitors the cashier area where money is collected. However, the images are not archived to tape or otherwise retained, and during the audit this camera ceased to function. It is recommended a system for retaining taped images for thirty days be developed to enhance management's ability to review cashier transactions.

Explorium Executive Director Management Response: We will contact LFUCG's security/IT department to seek their assistance in correcting this faulty camera. A 30 day tape inventory will be maintained of the camera's activity.

12. The Explorium uses the LFUCG's purchasing system to post collections and disbursements. Explorium personnel also use procurement cards from time to time to purchase items from certain retailers, in violation of LFUCG purchasing procedures. The Finance Director stated during the audit that she had previously closed some procurement accounts at the request of LFUCG's Director of Purchasing, and that Kroger and that the Home Depot procurement card accounts were subsequently opened.

Explorium Executive Director Management Response: All procurement is now in compliance with LFUCG. All other use of credit cards is in the process of ceasing; with the Kroger card being last used for groceries for an overnight camp here at the Museum.