



## **INTERNAL AUDIT REPORT**

DATE: June 8, 2023

TO: Linda Gorton, Mayor

CC: Dan Wu, Vice Mayor  
Sally Hamilton, Chief Administrative Officer  
Glenn Brown, Deputy Chief Administrative Officer  
Liz Rodgers, Chief Information Officer  
Erin Hensley, Commissioner of Finance  
Phyllis Cooper, Director of Accounting  
Todd Slatin, Director of Purchasing  
Susan Straub, Communications Director  
Urban County Council  
Internal Audit Board  
Mike Harmon, Kentucky Auditor of Public Accounts  
Jeanna Jones, Partner, Strothman & Company

FROM: Bruce Sahli, CIA, CFE, Director of Internal Audit

RE: Council Expenditures Audit

### **Background**

On January 4, 2023, the Office of Internal Audit was informed by the Auditor of Public Accounts (APA) that their office had received concerns regarding Lexington-Fayette Urban County Government (LFUCG) that they were referring to the LFUCG Office of Internal Audit for further review and consideration. A complainant had informed the APA that Councilmembers are allotted \$16,000 per year to aid their districts and



alleged that certain Council members utilized these funds for personal use. When reviewing an open records request, the complainant indicated they saw purchases for food, items from Amazon, dining room chairs, etc. The complainant also alleged that Councilmembers turned in minimal receipts for items purchased and used the government's tax-exempt status when purchasing these personal items.

The APA stated, "We take no position on the validity of these claims, but are bringing these matters to your attention for further review and action as you may deem appropriate". The APA requested that the LFUCG Office of Internal Audit provide the APA with a written response as to the follow up procedures performed, as well as the result of those procedures. The APA also stated they did not have any other information about these allegations because the complainant did not provide any documentation.

This audit was conducted in response to the APA's request.

For FY 2023, each member of the Urban County Council received \$15,432 in their annual budget for operating activities, including \$10,000 for Neighborhood Development Funds. This amount is expected to increase in FY 2024 to \$24,000 and \$15,000, respectively. According to the LFUCG Code of Ordinances, Appendix A – Rules and Procedures of the Urban County Council, Part 5 – Guidelines and Process for Neighborhood Development Funds, The Urban County Council may allocate Neighborhood Development Funds (NDF), on recommendation of any member, to incorporated non-profit organizations for any lawful public purpose in the best interest of and for the use and benefit of the community. According to those Guidelines, entities are eligible to receive NDF allocations if they are incorporated non-profit organizations in good standing with the Secretary of State. This list includes neighborhood associations, parent-teacher organizations, public purpose civic organizations, Urban County Government operating Divisions for special projects, and other incorporated non-profit public purpose groups. Entities that are not eligible to receive direct NDF allocations include the Fayette County school system, established religious organizations (general "public purpose" uses may be considered), and any for-profit organization.

An NDF allocation requires that a Councilmember submit a request to the full Council via Resolution which is subject to two public readings and votes in order to be approved. Once approved, the Division of Accounting informs the NDF Coordinator in the Council Office (currently the Council Administrator) when the related check is ready for pick-up. The NDF coordinator prepares a legal agreement to accompany the



NDF check, which is then mailed to the organization's designated recipient, along with a memorandum outlining the next steps. Once the organization receives the NDF check, a representative of the organization is required to return signed copies of the agreement to the Council Clerk's Office. The Council Clerk then retains a copy for her files and routes the additional copy to the NDF coordinator to be sent to the recipient organization.

Apart from the NDF allocations, other transactions occurring during the scope of the audit were made with Procurement Cards (P-Cards). The allegation received by the APA raised specific concerns about food purchases, items purchased from Amazon, the purchase of dining room chairs, etc., and these were made with P-Cards. Our examination of P-Card transactions occurring during the scope of this audit noted a number of purchases from Amazon for operating supplies, office related items, and small equipment. With the exception of transactions noted in Finding #5, they did not appear unreasonable. We discussed the use of Amazon for purchasing such items with the Director of Purchasing, who said that this is considered acceptable because Amazon sometimes offers more selections at a better price than what might be found under price contracts. The total cost of the four kitchen/dining room chairs specifically mentioned in the allegation received by the APA was \$106, and they are located in a Councilmember's office surrounding a small round table suitable for small meetings.

### **Scope and Objectives**

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

- Expenditures comply with LFUCG purchasing policies, procedures, and ordinances
- Processes are in place to sufficiently monitor NDF and cost center operating expenditures
- Processes are in place to account for and retrieve any leftover NDF allocations after the recipient has completed the task for which the allocations were provided
- Allegations reported to the Auditor of Public Accounts are sufficiently investigated

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 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 the audit included transactions from January 1, 2021 through December 31, 2022.

### **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 most of 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

### **Finding #1: There is No Accounting for NDF Allocations After Being Issued to Recipients**

**Priority Rating: High**

#### **Condition:**

There is no process to account for NDF allocations once they are disbursed, or to identify and retrieve any unspent allocations. On the front end of the NDF process, controls are in place to approve NDF allocations, to track the status of NDF allocation processing and the disbursement of the related checks, and to track the receipt of executed NDF Agreements from the recipient. Once these steps are completed, there is no further monitoring of the NDF allocation. The recipient is not required to provide a final accounting of the use of the allocation or return any unspent allocation.

#### **Effect:**

NDF allocations may not be used as intended and unused allocations are not recovered for future use by another qualified entity.

#### **Recommendation:**

NDF recipients should be required to account for the use of NDF allocations provided to them. This accounting should include receipts or other itemized documents that demonstrate the NDF allocation was used for the purposes intended by Council. The receipts/itemized documents should be sent to the Council Office for review. In the event the recipient does not spend all of the NDF allocation Council has provided for a particular purpose, the recipient should reimburse the LFUCG for the unspent amount via a payment to the Division of Revenue. The Division of Revenue will process the reimbursement as miscellaneous revenue and designate the appropriate Council District department and section number through a PeopleSoft deposit. Once this occurs, the Council Staff can prepare a budget amendment to recognize the revenue and restore the funds to the original NDF account, thereby making the unspent funds available for additional NDF use. It is also recommended that these changes to the NDF process be incorporated into the Council Rules regarding Neighborhood Development Funds.

#### **Vice Mayor Response:**

I agree with all audit recommendations. I and other Council Members in the General Government & Planning Committee are currently undergoing a thorough review of



Council Rules and these audit recommendations will be seriously considered for inclusion. I expect the review to be completed and a new version of Council Rules to be recommended and adopted by Council by October 31, 2023.

**Finding #2: Executed NDF Agreements Are Not Consistently Returned by the Recipient**

**Priority Rating: High**

**Condition:**

NDF allocations to recipients are made via check and are accompanied by an NDF Letter and three copies of the NDF Grant Agreement. The NDF Letter instructs the recipient to execute two copies of the NDF Agreement and return them to the LFUCG Council Clerk. Once received by the Council Clerk, these are signed by the Mayor and recorded in Legistar in the same manner as other contracts. This process is described in the LFUCG Code of Ordinances, Appendix A – Rules and Procedures of the Urban County Council, Part 5 – Guidelines and Process for Neighborhood Development Funds.

However, the Council Administrator informed us that executed NDF Agreements are not consistently returned, and provided a spreadsheet used to track the receipt of executed NDF Agreements and documenting unreturned NDF Agreements. Our review of this document and communication with the Council Clerk’s Office (to identify any NDF Agreements received by the Council Clerk that were unknown by the Council Administrator) determined that 76 of 365 NDF Agreements (20.8%) issued during the calendar years 2021 and 2022 were not executed and returned by the NDF recipients. The absence of the signed NDF Agreements was confirmed by the Council Clerk’s Office. The Council Administrator confirmed there is no process to follow-up on NDF Agreements that are not executed and returned by the recipients.

The Council Rules regarding NDF allocations states, “The Division of Accounting notifies the NDF coordinator when the checks are ready for pick-up. The NDF coordinator prepares a legal agreement to accompany the NDF check, which is then mailed to the organization's designated recipient, along with a memorandum outlining the next steps. A copy of the fully executed agreement is kept in the council clerk's office and a copy is returned to the organization for their records.” This clearly states an expectation exists on the part of Council that NDF recipients will return an executed Agreement to the LFUCG. The NDF Letter that accompanies NDF Agreements also



specifically instructs the recipient to execute two copies of the Agreement and return them to the Council Clerk.

**Effect:**

The NDF Grant Agreement is a contractual agreement between the LFUCG and NDF recipients. Failure to submit executed copies of the Agreements to the LFUCG violates a requirement for receiving NDF allocations.

**Recommendation:**

Recipients of NDF allocations should consistently comply with the requirement to return an executed NDF Agreement to the LFUCG. To increase compliance with this requirement, the NDF Letter accompanying the Agreement should be amended to state a specific amount of time allowed to execute and return the Agreement (a reasonable time would be 15 business days) and that failure to do so could result in future NDF requests not being approved until this requirement is fulfilled. Council should support the requirement and consider withholding future NDF funds from recipients that do not comply. Council should also consider changing the NDF process to require executed NDF Agreements be returned to LFUCG before the related check is issued.

**Vice Mayor Response:**

I agree with all audit recommendations. I and other Council Members in the General Government & Planning Committee are currently undergoing a thorough review of Council Rules and these audit recommendations will be seriously considered for inclusion. I expect the review to be completed and a new version of Council Rules to be recommended and adopted by Council by October 31, 2023.

**Finding #3: NDF Allocations Should be Issued for Specific Purposes**

**Priority Rating: High**

**Condition:**

We noted that most NDF allocations are provided to recipients for specific purposes. However, eight percent (8%) of NDF allocations were for undefined purposes such as assisting with ongoing expenses, assisting with ongoing costs, or assisting or supporting ongoing operations. Defining specific purposes for all NDF allocations would increase accountability for their proper use.



**Effect:**

By providing NDF allocations for undefined purposes, accountability is diminished.

**Recommendation:**

All NDF allocations should require a specific purpose. This increases recipient accountability and also increases the transparency of NDF allocations.

**Vice Mayor Response:**

I agree with all audit recommendations. Actions taken in response to Finding #1 recommendations will help create accountability for Finding #3. I and other Council Members in the General Government & Planning Committee are currently undergoing a thorough review of Council Rules and these audit recommendations will be seriously considered for inclusion. I expect the review to be completed and a new version of Council Rules to be recommended and adopted by Council by October 31, 2023.

**Finding #4: Support Missing for Significant Number of Procurement Card Transactions**

**Priority Rating: High**

**Condition:**

We examined all available receipts and any other supporting documentation for Council Procurement Card (P-Card) transactions occurring during calendar years 2021 and 2022 provided to us at our request by the Council Administrator. (The receipts and other supporting documentation had previously been copied in response to an open records request. The Council Administrator made another request for P-Card transaction support for the purposes of this audit, and informed us that no additional support was received). Ninety-six (96) of 314 (30.6%) P-Card transactions had no supporting documentation.

LFUCG Procurement Card Procedures state that, “The Lexington-Fayette Urban County Government’s record retention policy requires that records of all procurement card transactions be kept on file for audit purposes for three (3) fiscal years. The documentation must support the propriety of the transaction and contain the following information:

- A. Supplier name.
- B. Detail listing of what was purchased, including item description, quantity and price.
- C. Total dollar amount of the purchase.





- D. Transaction date.
- E. Purpose/explanation for purchase.

Per the LFUCG Procurement Card Procedures, examples of acceptable supporting documentation include, but are not limited to:

- A. Original sales receipt
- B. Original packing slip
- C. Original cash register receipt
- D. Copy of order form or application
- E. Email confirmation of Internet order

Copies of supporting documentation are acceptable only when the original is not available. Imaged documentation is acceptable as original documentation if it meets the criterion set forth.

**Effect:**

Failure to retain P-Card transaction supporting documentation is a violation of the LFUCG Record Retention Policy and Procurement Card Procedures, which P-Card users agree to abide by when they sign the Procurement Card User Agreement.

**Recommendation:**

P-Card supporting documentation containing the information specified in the Procurement Card Procedures should be consistently retained in compliance with the LFUCG Record Retention Policy.

**Vice Mayor Response:**

I agree with all audit recommendations. I and other Council Members in the General Government & Planning Committee are currently undergoing a thorough review of Council Rules and these audit recommendations will be seriously considered for inclusion. I expect the review to be completed and a new version of Council Rules to be recommended and adopted by Council by October 31, 2023. We will also consider centralizing all P-card purchases through the Council Administrator.



**Finding #5: Non-Standard Procurement Card Transactions Noted**  
**Priority Rating: High**

**Condition:**

We examined all available Procurement Card support provided to us by the Council Administrator. Our review determined that most of the supported transactions appeared reasonable. However, 10 of 218 (4.6%) supported P-Card transactions totaling \$688.08 (0.8% of total operating expenses excluding NDF allocations) were considered non-standard because they either had the appearance of being personal expenditures (e.g., Red Bull drinks, Ale-8 drinks, Waterloo sparkling water, Progresso Soup, large bags of beef jerky) or were for Commerce Lexington kayak and biking non-training excursions. Although Council is not subject to CAO Policies, it should be noted that LFUCG Administrative personnel are personally responsible for the cost of non-training excursions of this nature under CAO Policy #4. The non-standard purchases also included a country brunch purchased for a group, and we were told that the intent was for this purchase to be made with a personal credit card, not a P-Card.

We further noted that the non-standard food purchases used the LFUCG's tax-exempt status granted by the State of Kentucky and therefore did not pay sales tax on the transactions. Although the sales tax amounts that were not paid were very small (\$1.29 being the largest among those transactions that had supporting documentation), the use of LFUCG's tax-exempt status to pay for any personal purchases would be a misuse of the tax exemption status.

The P-Card Cardholder User Agreement that must be signed by all P-Card holders states, "I understand the LFUCG Procurement Card is NOT a personal purchasing card and I will not make any personal charges against my card(s) under any circumstances." All expenditures should have a clear business purpose and avoid any appearance of being personal.

**Effect:**

The non-standard purchases have the appearance of personal purchases, which would be a violation of the LFUCG Procurement Cardholder User Agreement.

**Recommendation:**

Council should amend the Council Rules, or establish separate Council procedures, specifying that the Procurement Card User Agreement must be consistently complied with, including the requirement that no personal charges will be made with a P-Card



under any circumstances. Council should also consider whether non-training excursions associated with conferences or seminars are justifiable and address this in Council Rules or a separate Council procedure. The Vice Mayor (and possibly a Council sub-committee) should review P-Card transactions on a quarterly basis to assure compliance.

**Vice Mayor Response:**

I agree with all audit recommendations. I and other Council Members in the General Government & Planning Committee are currently undergoing a thorough review of Council Rules and these audit recommendations will be seriously considered for inclusion. I expect the review to be completed and a new version of Council Rules to be recommended and adopted by Council by October 31, 2023.

**Finding #6: Procurement Card Transactions Often Coded to Wrong Account**  
**Priority Rating: Moderate**

**Condition:**

P-Card transactions examined during the audit were often coded to the wrong General Ledger account. This is likely due to the fact that P-Cards are initially set up for a certain default account (e.g., Office Supplies), which must be changed to the correct account when a different category of purchase actually occurs (e.g., Food & Household Items).

**Effect:**

Charges posted to the wrong General Ledger account will result in the overstatement of that account's balance and an understatement of the General Ledger account the transaction should have been posted to.

**Recommendation:**

The P-Card Requestor should consistently check the General Ledger account a P-Card charge will be posted to when verifying the transaction. If the transaction should be charged to something other than the default account, this should be changed to the correct account during the Verification process or during the Reconciliation process.

**Vice Mayor Response:**

Centralizing all P-card purchases through Council Administrator should alleviate this issue.



## **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 Council expenditures but does not represent a violation of statutes, policies, or procedures. It is considered to be of sufficient importance to deserve mention in this report to ensure senior management's awareness.

### **NDF Grant Agreement Process Benchmarking Opportunity**

As noted above, there are several findings related to the NDF process. We reviewed the NDF process used by the Louisville Metro Government and noted it treats NDF allocations as a grant with significant requirements for eligibility, specific use of the grant, specific timelines for use of the grant, a specific requirement that the executed Agreement be returned within 90 days or it will be revoked, checks are mailed to recipients after the executed Agreement is received by the Louisville Metro Government, and the recipient must complete a Disbursement & Reporting Schedule that demonstrates how and when the NDF allocations were spent. The Louisville Metro Government also specifically states in its NDF training presentation, "NDF is a grant (NOT A GIFT) to your organization, therefore financial reporting is MANDATORY". The Louisville Metro Government also requires the recipient to return any unspent NDF allocation. We verified with the Louisville Audit Director that this is the current NDF process in the Louisville Metro Government.

We recommend that the Council consider the NDF processes used by the Louisville Metro Government as a benchmark for evaluating its own NDF process and improving the internal controls associated with it.

#### **Vice Mayor Response:**

Will take into consideration Louisville Metro Government NDF procedures and develop our procedures through amendments to Council Rules, currently under review as stated in answers above.



## **Compliance with LFUCG Purchasing Procedures Should be Formalized**

In addition to the Professional Services-Neighborhood Development Fund (NDF) account, each Councilmember is provided annual funding for Food & Household Items, Operating Supplies & Expense, Conferences & Other Training, Business Travel, and Equipment Under \$5,000. These operating expense accounts are common within the LFUCG, and the proper use of such operating accounts by employees on the Administrative side of the LFUCG is clearly defined in CAO Policies, Purchasing Policies, etc. As noted in the Background section of this report, the review of the Council expenditures occurring during calendar 2021 and 2022 noted that most expenditures appeared reasonable. However, Council Rules do not specifically require compliance with Division of Purchasing procedures.

We recommend the Council formally incorporate in the Council Rules, or in a separate Council procedure, that Council purchases will consistently comply with LFUCG Purchasing Procedures.

### **Vice Mayor Response:**

Council will take into consideration LFUCG Purchasing Procedures in developing our own purchasing procedures through amendments to Council Rules, currently under review as stated in answers above.

