EXAMINATION OF CERTAIN POLICIES, PROCEDURES, CONTROLS, AND FINANCIAL ACTIVITY OF THE CITY OF COVINGTON

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Embargoed Until 10:00am Thursday February 13, 2014

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ADAM H. EDELEN
AUDITOR OF PUBLIC ACCOUNTS

February 13, 2014

Sherry Carran, Mayor
Larry Klein, City Manager
City of Covington
20 West Pike Street
Covington, KY 41011

Dear Mayor Carran and Mr. Klein:

The Auditor of Public Accounts (APA) has completed an examination of the City of Covington (City). Our office received concerns and media reports relating to alleged embezzlement by the City's former finance director. This letter summarizes the procedures performed and communicates the results of those procedures.

The APA reviewed certain activities for the period February 1999 to August 2013. The procedures performed include reviewing expenditure transactions, bank statements, cancelled checks, and confirming information with third parties. In addition, our examination consisted of interviews with various staff.

The purpose of this examination was not to provide an opinion on financial statements, but to attempt to identify the dollar amount of misappropriated assets to the extent they could be determined through these procedures, and also identify weaknesses in internal controls that resulted in the failure to detect the misappropriation of assets by an employee.

Detailed findings and recommendations are attached to this letter to assist all parties involved in improving procedures and internal controls. Overall, the findings indicate serious weaknesses impacting the financial management of the City. These weaknesses indicate internal controls were so lax that the risk of fraud was increased, which ultimately led to a misappropriation of assets for more than a decade. We recognize since identifying the alleged embezzlement, the City has taken actions to improve internal controls. It should take the findings in this report seriously, and continue to make improvements in its internal controls aimed at deterring and detecting waste, fraud, and abuse. In addition to the findings, your management responses to the findings are included.

This report is being referred to the Commonwealth Attorney for the 16th Judicial Circuit.

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If you have any questions, contact Libby Carlin, Assistant Auditor of Public Accounts, or me.

Sincerely,

Adam H. Edelen
Auditor of Public Accounts

c: Commission Members, City of Covington

ADAM H. EDELEN
AUDITOR OF PUBLIC ACCOUNTS

Executive Summary
February 13, 2014

EXAMINATION OF CERTAIN POLICIES, PROCEDURES, CONTROLS, AND FINANCIAL ACTIVITY OF THE CITY OF COVINGTON

Examination Objectives

On August 23, 2013, the former Finance Director for the City of Covington (City) was arrested and charged with theft, unlawful access to a computer, criminal possession of a forged instrument, and official misconduct. At that time, a rough estimate of $300,000 was reported to have been stolen. The Auditor of Public Accounts (APA) accepted a request from the Commonwealth's Attorney for the 16th Judicial Circuit on September 5, 2013, to perform a special examination of the alleged theft of funds by the former Finance Director.

City of Covington Background

Located in northern Kentucky, the City of Covington is a second class city and one of two county seats of Kenton County, along with the City of Independence. The City is organized and governed under the City Manager form of government. Legislative authority is vested in the City Board of Commissioners, consisting of the Mayor and four City Commission members. The current Mayor and City Commission took office on January 1, 2013.

The City Manager is the chief administrative official of the City, and is appointed by and reports to the Board of Commissioners. The City Manager is responsible for carrying out policies and ordinances of the City Board of Commissioners and for the development of short and long range planning, capital improvement programs, and running the day-to-day operations of the City, including fire and police, public improvements, recreation, and budgeting and finance.

Findings and Recommendations

Finding 1: The former finance director wrote 68 checks to himself, his spouse, his aunt, and a vendor under his control totaling $793,127. The examination identified 68 checks totaling $793,127 made payable to the former finance director, his spouse, his aunt and a fictitious vendor created by the former finance director between August 2001 and August 2013. The checks were the result of a circumvention of controls and manipulation of accounting records perpetrated by the former finance director. In addition, the examination identified the former finance director had complete control of the financial software, acting as the system administrator, which gave him the ability to manipulate the accounting records in a manner that avoided detection by former auditors, other staff of the city's finance department, elected commissioners, the Mayor's office, or the City Manager's office.

Recommendations: We recommend the City attempt to recoup the funds that were identified in checks written to the former finance director and affiliated parties for fictitious transactions. We further recommend the City strengthen internal controls and accounting processes in the finance department to deter and reduce the risk of waste, fraud, and abuse as discussed in findings throughout this report.

Finding 2: The finance department had lax internal controls, which increased opportunities for misappropriation of assets. Auditors documented weaknesses in the overall internal control environment as well as all of the significant processing areas of the City of Covington Finance Department. These weaknesses contributed to the ability of former finance director to initiate fictitious transactions, write checks to himself and related parties, and hide the activity. The finding addresses overall control environment weaknesses, and also attributes weaknesses noted elsewhere in the report for raising the former director's ability to misappropriate assets, including inadequate IT security, with the former finance director also

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acting as IT administrator, ineffective control related to dual signatures, and segregation of duties weaknesses.

Recommendations: Because the finance department has such significant internal control weaknesses, the City should implement improvements as soon as possible. These include: develop policies and procedures to address all significant functions of the finance department; segregate duties; create job descriptions for finance department staff; train employees adequately; implement sufficient supervisory review of key functions; structure the finance department so that the finance director serves as oversight and supervisory review of other staff, and increase oversight by the City Manager's office of the finance department's accounting and budgetary activities.

Finding 3: The former finance director also acted as IT Administrator. The former finance director was also the IT administrator for the accounting system and had complete access to user information. Further, all key personnel in the finance department were set up as "power users" which allowed them much more control and access than needed for the performance of their duties. With this access, the former finance director was able to set up new user identifications (IDs), as well as access the user IDs of other employees and post transactions using those accounts. Using access that should have been restricted, the former finance director was also able to manipulate vendor information to make the fictitious transactions appear to be for a legitimate vendor.

Recommendations: The City should consider hiring a separate IT administrator that reports directly to the City Manager. This function should not be under the control of the City's finance director. The City should also consider hiring a consultant to help evaluate the appropriate level of access for each employee within the City. Within the finance department, key functions, such as vendor creation/update duties, check processing, etc, should be properly segregated and protected so employees with non-compatible job duties do not have unauthorized access. The finance department should also implement procedures for documenting and maintaining information related to all vendor file changes.

Finding 4: Numerous weaknesses related to purchasing and payables were identified. Review of this process determined that while purchases that originated outside the finance department are subjected to review and approval, and are required to have supporting documentation, internal controls break down once the process reaches the finance department. Weaknesses were noted related to check processing; failure to maintain a check register or log to compare last check number in a batch to the beginning check number in the next batch; ineffective dual signature control; lack of controls over vendor creation or alteration; and numerous non-routine special check runs.

Recommendations: We recommend the City:

- Update purchasing policies and procedures manual.
- Develop a policy to address checks processed between check runs and determine what circumstances would necessitate a special check run.
- Reevaluate the dual signature system for checks, and implement policies and procedures to insure the control is working as intended.
- Account for all checks in numerical sequence by maintaining a check register or other check log system.
- Limit vendor creation and vendor file changes to authorized personnel.
- Improve system security to prevent users from accessing another user's ID.
- Segregate the IT administrator from the finance department.
- Ensure procedures exist to maintain sufficient, accurate supporting approved, documentation.

Finding 5: The city should improve revenue and collections procedures. The City's finance department had no written policies and procedures for revenue and collection procedures. Information about procedures for processing revenue collection activity is passed along verbally from one employee to another. Also, the revenue/collections manager does not have a role in review and supervision of daily collection

processes, and additional weaknesses were noted related to revenue processing. Also, the City does not have adequate policies in place for detection and collection of delinquent taxes.

Recommendations: We recommend:

- All mail addressed to the City should be opened by designated staff in each department, with all checks removed and processed in the regular daily deposit process.
- The revenue/collections manager should determine the source of unknown revenue and provide accurate accounting coding to staff to ensure that all revenue received by the City is properly recorded and deposited.
- All revenue should be processed by designated revenue/receipts staff and be included in the daily deposit. All revenue should be posted to consistent account codes approved by the revenue/collections manager. All checks should be stamped with a restrictive endorsement as soon as they are processed. Appropriate segregation of duties should be implemented in regards to bank receipts and deposits.
- The City should develop a formal process for any department that collects funds from the public.
- The City should determine whether the accounting system can be modified to include the needed components to identify and track delinquent taxpayers, or if a stand-alone system to handle the process is feasible. Effort should be made to get delinquent tax collections up-to-date.

Finding 6: Internal controls over bank accounts, bank reconciliations, and adjusting journal entries need improvement. The list of bank accounts maintained by the City and provided to auditors was incomplete and inaccurate. The accounting operations manager, the staff accountant, and the purchasing/office manager were unaware of three checking accounts in the City's name and tax identification number. Two of these checking accounts should not have been in the City's name or under its tax identification number. Also, the finance department's List of Accounts excluded a loan in the City's name.

The examination also identified there is a lack of segregation of duties without sufficient oversight in the area of bank account activity and bank reconciliations. The City's bank reconciliations are prepared by the same staff accountant who also posts month end journal entries and adjusting journal entries. This same staff accountant is also responsible for posting and depositing some of the revenue received by the City, as well as making transfers between funds. Additionally, the examination found that adjusting journal entries were not always supported by documentation to explain the need for the entry, nor were the entries' descriptions in the accounting system sufficiently descriptive.

Recommendations: We recommend:

- An accurate list of bank accounts be maintained.
- Bank reconciliations should be prepared for all accounts on a monthly basis upon receiving the bank statements, and should be reviewed for completeness and accuracy by a supervisor. Procedures should exist to properly investigate and correct reconciling differences.
- Adjustments that result from bank reconciliations should be posted by someone other than the person performing bank reconciliations, and should be reviewed and approved by a supervisor before they are posted. Journal entries should be prepared promptly and accurately and should have accurate descriptions and sufficient supporting documentation to justify the entry.

Finding 7: The city should improve internal controls and oversight for pension funds. The former finance director handled the pension fund accounting himself, and therefore, finance department employees were unable to provide answers to auditors' questions about the funds. In reviewing the information that was available, auditors determined that the recommended contributions to the pension funds were not made regularly. It is not clear if this decision was made entirely by the former finance

director or was a funding decision at the direction of the City Commission. There were no controls in place to ensure the accuracy or timeliness of required pension transactions. Further, there were no procedures in place to provide oversight from either the City Manager's office or the pension boards to monitor actual pension fund accounting.

Recommendations: We recommend the City review the Actuarial Valuation Report provided by Fund Evaluation Group and implement the boards' recommended annual contributions for each fund. When funding is not sufficient to meet its annual required contributions, the minutes of the City Commission should clearly identify its funding decision. Also, the finance department should ensure accurate financial reports are provided to the pension board of trustees and City Commission. In addition, the City should establish procedures for sound internal controls and sufficient oversight to ensure the accounts are being managed as intended.

Finding 8: The city should improve accounting and accountability for the Devou Park funds. There was not regular communication between the City's Programs and Strategic Projects manager and the former finance director to monitor the budget to compare actual versus projected spending, or to verify documentation for the City's expenditures supporting reimbursement requests from the park funds.

Some of the payments from Devou Properties, Inc. meant for the Devou Park Master Plan, fund 45, were posted as receipts to other accounts. There is no supporting documentation available to justify the reason for posting revenue into inaccurate funds. Finance department staff could only explain that it was done at the direction of the former finance director.

Recommendations: We recommend:

- The City should implement policies and procedures to ensure that all revenue and expenditures related to projects at Devou Park are coded accurately.
- The new finance director should meet regularly with the Programs and Strategic Projects Division manager to compare actual expenditures to budgeted expenditures. Because the funds are received from a third-party and are restricted for a specific use, an effort should be made to ensure the funds are only expended on approved projects.
- When reimbursement or fund distributions requests are made, the City should provide a report of expenditures and progress on approved projects to the oversight boards.
- The City should ensure that control of these funds is not limited to a single person without oversight or review.

Finding 9: The city did not have a credit card policy and did not properly track issued cards. Various City staff had been issued credit cards, although the City did not have an established policy regarding the use of credit cards. In addition, the city's Purchasing/Office Manager was unaware of the exact number of existing credit cards or who had access to these cards.

Recommendations: We recommend the City adopt a credit card policy that includes specific identification of unallowable expenses, detailed listing of any expenses requiring management approval prior to use, requirements that the credit card receipt be signed and reviewed by the employee's supervisor, requirement for finance staff to reconcile credit card receipts to the statements, and requirements that employees are responsible for reimbursing the City for any unsupported expenditures.

We also recommend the City implement procedures to obtain and maintain a list of all credit cards issued to employees, and also identify and maintain a list of all approved users and supervisors.

Finding 10: Payroll duties were not adequately segregated and personal information related to payroll was not maintained in a secure manner. The examination identified there is a lack of segregation of duties and inadequate supervisory review in the City's payroll process. The person responsible for processing payroll and pension payments is also responsible for setting up new employees in the payroll system and changing pay rates when necessary. There is no supervisory review of any of the payroll functions, from setting up new employees, changing pay rates, calculations of overtime or leave time, supplemental payments,

withholdings payments, pension checks or corrections of errors. Auditors also noted during a review of the accounting system security that several key finance personnel, including the former finance director had the capability of setting up new employees in the payroll system.

Additionally, a review of payroll reports found that payroll reports are filed in an unlocked filing cabinet in the finance department. It was also noted that older payroll reports were being stored in boxes in the basement of the building, which is not a secured area.

Recommendations: We recommend the City take the following actions:

- Duties should be segregated so that payroll employees do not have the ability to add new employees to the payroll module or change pay rates. Also, adequate supervisory review should be implemented, and the review should be documented and maintained. Computer access should be restricted so that only necessary personnel can add new employees and change pay rates.
- Payroll reports and personnel files contain secure information that should be restricted to only those involved in the payroll and human resources process. Personnel files should be maintained by HR but access should also be restricted to only those that work in that area.

Finding 11: Accounting procedures are unclear, increasing the risk of undetected errors. Auditors noted certain accounting procedures in use that do not result in a clear and accurate recording of transactions. These include: excessive use of "due to/due from" transactions to account for the City's deposit practices; practice of writing checks from revenue accounts; and numerous adjusting journal entries.

Recommendations: We recommend the City update accounting policies and procedures to address these weaknesses, including the following:

- The use of "Due to/Due from" entries should be eliminated as routine transactions in favor of a more direct, transparent approach to posting cash deposits. "Due to/Due from" entries should be used sparingly, and transfers should be documented and reviewed/approved by a supervisor before the entry is made.
- Checks should only be written from disbursement accounts, with the exception of instances permitted by accounting principles.
- Policies and procedures should identify the circumstances that would necessitate the use of adjusting journal entries. Entries should only be created and posted by authorized personnel, only after supervisory review and approval.

Finding 12: The city should improve oversight of processes outsourced to third party organizations. The City contracts with third party organizations for the management of parking garages and the payment of health insurance claims. Finance department staff indicated the former finance director provided oversight for these activities.

Auditors noted the monthly bank reconciliations for the parking garage revenue account appeared to force balances. Each month, there was an entry labeled "DIT" (Deposit in Transit) added to the bank statement balance to balance to the book balance. Auditors could not trace the DIT amount to actual deposits in transit.

Recommendations: We recommend the City improve oversight of third party organizations by implementing internal controls to ensure a sufficient review of documentation and reconciliation to actual cash received or paid.

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Impetus and Objectives for Examination

On August 23, 2013, the former finance director for the City of Covington (City) was arrested and charged with theft, unlawful access to a computer, criminal possession of a forged instrument, and official misconduct. At that time, a rough estimate of $300,000 was reported to have been stolen. The Auditor of Public Accounts (APA) accepted a request from the Commonwealth's Attorney for the 16th Judicial Circuit on September 5, 2013, to perform a special examination of the alleged theft of funds by the former finance director.

This examination was designed to determine:

- An amount of misappropriated funds that could be identified through examination procedures. It is important to note that the examination would not likely identify 100% of all misappropriated funds due to inherent limitations in timing given the longevity of the former finance director's tenure, and the likelihood of missing or undocumented evidence during that period.

- The internal control systems in place were either ignored or nonexistent, such as the absence of systems that needed to be in place to prevent fraud and abuse. Identifying these weaknesses is important to help the City improve its internal controls to reduce risks of waste, fraud, and abuse in the future.

Scope and Methodology

The scope of this examination includes records, activities, and information for the period February 1999 through August 2013; however, the time periods related to specific incidents noted in the report vary due to the timing of the issues and the availability of the information.

To complete this examination, the APA reviewed documents, conducted interviews, examined bank statements and cancelled checks, confirmed information with vendors and banks, and tested expenditures. Documents, including invoices, cancelled checks, reports, bank statements, and personnel files were provided by the City. These and other items were analyzed in relation to the objectives of this examination. The findings, or results from this examination are discussed in detail in Chapter 2.

The APA conducted interviews with City staff and others, often following up on the initial interviews with phone conversations, emails, and additional meetings when necessary.

Limitations on the Examination

The examination is limited by the following:

- Complete records of the City have not been maintained for the entire period.
- Access to the former finance director's personal bank information was limited.
- Access to the former finance director's family's bank information was not provided.

- Although the City identified specific methods for misappropriating funds which were reportedly acknowledged by the former finance director, auditors detected at least one additional method in which funds were misappropriated, and also identified additional significant weaknesses in internal controls that could have permitted waste, fraud, or abuse to occur without detection. Therefore, there is significant risks that additional funds could have been misappropriated that have not yet been identified.

Governmental Body/Organization

Located in northern Kentucky, the City of Covington is a second class city and one of two county seats of Kenton County, along with the City of Independence. The City is organized and governed under the City Manager form of government. Legislative authority is vested in the City Board of Commissioners, consisting of the Mayor and four City Commission members. The Board of Commissioners is responsible for, among other tasks, passing ordinances, adopting the budget, appointing members to various boards, and approving the hiring of all full time employees. The City Board of Commissioners is elected on a non-partisan basis. The Mayor serves a four year term and the City Commissioners serve two year terms. The current Mayor and City Commission took office on January 1, 2013. The Commission meets every other week on Tuesday evenings.

The City Manager is the chief administrative official of the City, and is appointed by and reports to the Board of Commissioners. The City Manager is responsible for carrying out policies and ordinances of the City Board of Commissioners and for the development of short and long range planning, capital improvement programs, and running the day-to-day operations of the City, including fire and police, public improvements, recreation, and budgeting and finance. The City Manager delegates responsibility and coordinates the many tasks performed daily by City employees.

Finance Department

The City finance department is responsible for general accounting, bill paying, expenditures, payroll, accounts receivable, and collections of taxes and fees, and reports directly to the City Manager's office. The Finance Department was reorganized in March 2013 and consists of a staff of eleven employees including: a finance director, an accounting/operations manager, a revenue/collections manager, an office/purchasing manager, auditors, and staff accountants.

Devou Park Advisory Committee

In ordinance O/R-18-96, the City established the Devou Park Advisory Committee. This Board provides oversight for the maintenance of the physical structures of Devou Park. The Board consists of 12 voting members, five ex-officio non-voting members, and one institutional voting member. The five ex-officio members provide information and advice to the Board. The five ex-officio members include: the Covington Parks and Recreation Director, a representative from the Covington Children's Home, two representatives from the William P. Devou Trust,

and a representative of the Devou Park Course facility/licensee. The ex-officio members are appointed by their respective entities' governing bodies. The institutional member is a representative of the Behringer-Crawford Museum who is appointed by the museum's governing board.

Devou Properties Inc.

Devou Properties Inc. is a Kentucky non-stock, non-profit corporation, created for the purpose of operating and managing the conference/reception center and other facilities in Devou Park. It was created by ordinance O/R-99-03 in May 2003. The initial directors and members of the board were appointed by ordinance O/R-100-03. The board meets monthly.

Finding 1: The Former Finance Director Wrote 68 Checks To Himself, His Spouse, His Aunt, And A Vendor Under His Control Totaling $793,127

The examination identified 68 checks totaling $793,127 made payable to the former finance director, his spouse, his aunt and a fictitious vendor created by the former finance director between August 2001 and August 2013. The checks were the result of a circumvention of controls and manipulation of accounting records perpetrated by the former finance director. In addition, the examination identified the former finance director had complete control of the financial software, acting as the system administrator, which gave him the ability to manipulate the accounting records in a manner that avoided detection by former auditors, other staff of the city's finance department, elected commissioners, the Mayor's office, or the City Manager's office.

Table 2.1 shows the total amount and number of checks each year that were made payable to the former finance director and related parties as the result of fictitious transactions.

Table 2.1 - Total Misappropriation Detected By Year

Calendar Year	Amount	Number of Checks
2001	$20,000.00	3
2002	35,650.00	7
2003	16,500.00	3
2004	37,750.00	5
2005	48,500.00	7
2006	44,000.00	3
2007	61,533.50	3
2008	142,898.72	4
2009	57,250.00	2
2010	80,700.00	4
2011	111,400.00	11
2012	59,920.00	7
2013	77,025.00	9
Total	**$793,127.22**	**68**

The scheme was perpetrated by the former financial director by using five vendors listed on the vendor master file in the City's accounting system to disguise the activity. Fictitious transactions were entered into the financial system and coded to these vendors. The five vendors utilized to code fictitious transactions in the accounting ledger included three legitimate vendors of the city, and two additional fake vendors established by the former finance director. Checks were not printed with these vendor names, but instead the payee would be changed prior to printing to one of four recipients, as noted in Table 2.2. After printing the checks, the accounting ledgers were changed back to the original vendor to conceal the change in payee. Appendix A details the checks written, including vendors utilized in the accounting ledgers and payees for each payment.

During the review of cancelled checks, we noted checks written to a vendor, Management Solutions, which were coded in the accounting

ledgers to other legitimate vendors of the City with similar names. Based on information provided by the auditors from these checks, the Commonwealth's Attorney requested information via subpoena from the depository bank. When the information from the subpoena was reviewed, the former finance director was identified as the owner of the Management Solutions bank account. The signature card also provided the former finance director's home address as the address of the company, a sole proprietorship. Therefore, we have included all checks payable to Management Solutions as part of the 68 checks in question.

Table 2.2 - Total Misappropriation Detected By Payee

Recipient	Amount Paid to Each Recipient
Former Finance Director	$ 25,500.00
Former Finance Director's Wife	275,045.00
Former Finance Director's Aunt	290,182.22
Management Solutions	202,400.00
Total	**$793,127.22**

These transactions appear to have been initiated and approved solely by the former finance director. As noted above, the former finance director was also, in effect, the IT administrator for the finance department which gave him complete access to passwords and login names of all finance department staff. Based on information reviewed, it appears that in some cases he used the login names and passwords of finance department staff to initiate and enter the transactions, print the checks, then manipulate the records to cover the activity.

The former finance director had complete control of the accounting records and could manipulate accounts by directing revenue to be posted in any account he deemed necessary, and also by creating adjusting journal entries to move revenue and expenditures between funds and accounts with little to no explanation or supporting documentation for the entries. As noted below, he repeatedly used the same funds and accounts to post the fictitious transactions.

Table 2.3 - Total Misappropriation By Fund and Account

Fund	Account	Amount
General Fund	Accounts Receivable - Devou Golf Expansion	$ 195,645.00
General Fund	City Manager Dept - various accounts	90,250.00
Devou Park Maintenance	Various accounts	188,246.17
Self-Insurance Fund	Various accounts	98,250.00
General Fund	Accounts Receivable - Stewart Ironworks	67,250.00
General Fund	Miscellaneous Accounts Payable	63,783.50

General Fund	Payroll Tax Revenue	81,552.55
General Fund	Bid Escrow - liability account	5,000.00
General Fund	Other Contractual Expenses	3,150.00
	Total	**$ 793,127.22**

Weaknesses in key internal control and accounting processes allowed the former finance director to write checks to himself and related parties, and manipulate the accounting system to hide the activity for over a decade. The remaining findings in this report describe the most significant weaknesses that led to a control environment that did not sufficiently reduce fraud risks to an acceptable level.

Recommendations

We recommend the City attempt to recoup the funds that were identified in checks written to the former finance director and affiliated parties for fictitious transactions. We further recommend the City strengthen internal controls and accounting processes in the finance department to deter and reduce the risk of waste, fraud, and abuse as discussed in findings throughout this report.

Finding 2: The Finance Department Had Lax Internal Controls, Which Increased Opportunities For Misappropriation Of Assets

During the examination, auditors identified weaknesses in the overall internal control environment as well as all of the significant processing areas of the City's finance department. These weaknesses contributed to the ability of former finance director to initiate fictitious transactions, write checks to himself and related parties, and hide the activity. In this report we have documented each area outlining significant issues and provided recommendations for improvement.

Overall Control Environment Weaknesses

The former finance director was able to override and bypass internal controls because the controls were weak, easily manipulated, and in some cases, nonexistent. It is not clear whether he identified the weaknesses already in existence when he began working for the City in 1999, or created these weaknesses by desegregating duties, and by circumventing and removing controls.

The finance department staffing structure, even after the reorganization in the spring of 2013, allowed the former finance director complete control over the City's financial activity without sufficient oversight or governance to prevent or detect fraudulent activity. Further, the lack of adequate segregation of duties in key processes and the lack of sufficient supervisory review created an environment where almost anyone in the finance department could have committed fraud or material errors and it would not have been prevented or detected.

During interviews and review of processes, staff often could not answer auditor's questions about processes or transactions. Staff often responded to questions about processing certain transactions by stating the former finance director "handled that himself". Areas for which auditors were unable to get a clear description of the process or reason for the transaction included: processing non-routine revenue, accounting related

to pension systems, many of the adjusting journal entries, debt, and the Devou Park funds.

Also, the examination identified the City has not updated purchasing policies and procedures since the year 2000. Further, there are no written policies and procedures for other significant finance department activities such as payroll, receipts and collections, reconciliations or month end balancing. Staff rely on verbal discussion and hands-on training to communicate processes to each other, without clear direction about why certain processes are used. The reason given for many of the processes was that "this is the way it has always been done."

Auditors also found that job descriptions were not available for review during the examination. When staff was asked about their job duties, there was some hesitation in describing exactly what they were responsible for or what they had assumed responsibility for. Whether due to short staffing or to the former finance director's inattention to the department, staff had absorbed varies duties, sometimes unrelated to their primary workload. In some cases, this lead to increased internal control weaknesses by allowing someone the ability to post transactions and also to create adjusting entries that would correct or offset the transactions.

Inquiries with management staff identified insufficient knowledge of what constituted good internal controls and sufficiently segregated duties. There was also little concern about the lack of supervisory review over daily work. During discussions with management regarding supervision, one manager indicated that subordinate employees are not monitored or questioned about their work because those individuals had been with the office for a longer period of time. Overall, management staff did not appear to be operating as functional supervisors, but management in title only.

One of the most significant issues noted is that the former finance director had the ability to create fictitious transactions, write checks, and conceal the activity because he had complete access to all accounting system functions. He had access within the accounting system to create transactions, print to the dedicated check printer, manipulate vendor files, post and adjust transactions, direct revenue to be posted to incorrect funds and accounts, and adjust the book balance as needed to hide the activity. The former finance director used various funds and accounts to post fictitious transactions, even using the department of the City Manager for some transactions. The lack of structure in revenue and expenditure processing and coding contributed to the ability of this activity to go undetected.

Additional Weaknesses

Numerous other weaknesses that significantly increased the risk of fraud and gave the former finance director the ability to misappropriate assets without detection for more than a decade are presented in this report, including:

- Inadequate IT security, with the former City finance director acting in an IT administrator capacity.
- The internal control related to dual signatures on checks was not functioning properly, thereby negating its effectiveness.
- Lack of segregation of duties for key functions.

Recommendations

Because the finance department has such significant internal control weaknesses, the City should implement improvements as soon as possible. The following recommendations are supplemented by additional recommendations presented throughout this report. The City should:

- Develop policies and procedures to address all significant functions of the finance department. Update these policies and procedures regularly.
- Segregate duties so that no one person can both create and conceal fraudulent activity or commit a material error that would go undetected.
- Create job descriptions outlining duties that have been assigned to each position and provide these documents to employees.
- Train employees to ensure that each employee understands both the activities and the accounting principles needed for their positions.
- Implement sufficient supervisory review of key functions and activities, and ensure managers clearly understand their roles in the supervisory process. All supervisory reviews should be evidenced in writing.
- Structure the finance department so that the finance director does not post transactions to the system, but instead serves as oversight and supervisory review of other staff in these duties.
- Increase oversight by the City Manager's office of the finance department's accounting and budgetary activities.

Finding 3: The Former Finance Director Also Acted As IT Administrator

As noted above, the former finance director was also the IT administrator for the accounting system and had complete access to user information. Further, all key personnel in the finance department were set up as "power users" which allowed them much more control and access than needed for the performance of their duties. The status of power user meant the user had the ability to "create," "read," "update," and "delete" in any module in the accounting system, including, among others: budget, general ledger, purchase order, and vendor master file. Also, power users were able to change any employee's password. Information is presented in Appendix B to present the functions a power user can perform.

With this access, the former finance director was able to set up new user identifications (IDs), as well as access the user IDs of other employees and post transactions using those accounts. As noted in Finding 1, using an ID he created or another staff person's ID, he was able to write checks to himself and related parties, and then delete the checks from the check printer spooler, thus hiding them from the payable check run. Additionally, auditors learned the password for the secure check writing

software was "password" and this was common knowledge in the finance department.

Using access that should have been restricted, the former finance director was also able to manipulate vendor information to make the fictitious transactions appear to be for a legitimate vendor. He was also able to create vendor files for fictitious vendors.

Having complete control and access to the accounting system was likely the most significant weakness that allowed the former finance director to process fictitious transactions and then conceal the activity. The accounting system in use is an older system which may have contributed to the former finance director's ability to carry out and conceal the activity. However, even with the limitations of the system, it appears there was an ability to implement safeguards and restrict access to users to only those processes necessary to carry out their functions.

Recommendations

Based on the review of computer technology access in the City's finance department, we recommend the following:

- The City should consider hiring a separate IT administrator that reports directly to the City Manager. This function should not be under the control of the City's finance director.
- The City should also consider hiring a consultant to help evaluate the appropriate level of access for each employee within the City. Power user access should be restricted to employees having a legitimate need for such access, and should be segregated from employees with non-compatible financial controls.
- Within the finance department, key functions, such as vendor creation/update duties, check processing, etc, should be properly segregated and protected so employees with non-compatible job duties do not have unauthorized access.
- The finance department should also implement procedures for documenting and maintaining information related to all vendor file changes.

Finding 4: Numerous Weaknesses Related To Purchasing And Payables Were Identified

The City has a decentralized purchase order system (identified as vouchers in this system) that allows City departments to order goods and supplies. Designated city employees in each department have the ability to place orders and request checks by setting up purchase vouchers in the accounting system. The purchase vouchers are reviewed and approved by managers in those departments then are processed by the finance department. Several staff in the finance department have the ability to determine correct account coding for purchases and provide this information to the office/purchasing manager, who is responsible for processing payments and preparing checks. The office/purchasing manager requires that departments provide invoices, bids or copies of contracts in order to release a purchase voucher for payment. These supporting documents are maintained in vendor files in the finance

department. Once checks are processed and printed, the documentation copies are filed and checks are mailed without another review.

Review of this process determined that while purchases that originated outside the finance department are subjected to review and approval, and are required to have supporting documentation, internal controls break down once the process reaches the finance department.

Check Processing Issues

The most serious internal control weaknesses in this process relates to disbursements originating in the finance department. While the office/purchasing manager is responsible for disbursements for the City, other staff regularly processed payments and printed checks. Checks could be processed and printed without review and/or approval of the office/purchasing manager. In fact, checks could be processed and printed entirely without the office/purchasing manager's knowledge.

The former finance director and the accounting/operations manager both had the ability to print checks themselves. A check writer report provided to auditors detailing checks written by the accounting/operations manager included some of the fraudulent check that the former finance director processed using the accounting/operations manager's user ID. However, it also included checks written by the accounting/operations manager as part of his regular duties.

Lack of Check Register and Ineffective Dual Signature Control

The examination identified that a check register or other check control system was not in place, and there was no procedure to verify the ending check number for the previous check batch prior to printing a new batch of checks. Because several staff could process and print checks, as noted above, and because a check register or listing of checks was not maintained to keep track of check numbers used, the former finance director was able to commit and conceal the fictitious transactions and write checks to himself.

Further, although the City had a dual signature policy, requiring checks to contain signatures of both the former finance director and the City Manager, this control did not function as intended and therefore, was not effective because both of the dual signatures required to cash checks were already printed on the checks. Therefore, once a check was printed, it could be used by anyone. Checks were processed, printed, and mailed without a supervisory or even a cursory review by a second person. This nullifies the potentially very effective control of dual signatures for expenditures. The purpose of dual signatures is to ensure that two individuals review and approve expenditures. If checks are printed with the signatures already on them and are processed and mailed without being checked by both signatories, the control is not working. This is evidenced by the fact that the former finance director was able to write over $25,000 in checks to himself and over $767,000 to related parties, which he later cashed, without detection.

Vendor Set Up and Alteration

As documented in Finding 3, the ability to add and change vendor information in the system aided the former finance director in being able to prepare the fictitious transactions and code them to legitimate vendors. He also was able to create new vendor files for fictitious vendors.

Special Check Runs

The examination also identified that while the finance department's intention is to have one weekly check run every week, there are numerous checks written between check runs. According to inquiry with the finance department staff, there is no policy prohibiting city employees from demanding checks be cut between check runs. Typically these checks are for travel advances or travel reimbursements. Multiple, special check runs increase the likelihood of fraud or error and make monitoring more difficult. Therefore, check runs should be limited to a standard processing schedule unless absolutely necessary.

Recommendations

Based on the internal control weaknesses identified, we recommend the City:

- Update the purchasing policies and procedures manual, including a clear policy regarding employees responsible for check processing and permitted to access checks and check writing software. The policy should address penalties for check access by non-authorized personnel.
- Develop a policy to address checks processed between check runs and determine what circumstances would necessitate a special check run.
- Reevaluate the dual signature system for checks, and implement policies and procedures to insure the control is working as intended. In any event, the City should implement a supervisory review of checks before they are mailed. The reviewer should compare the check to the supporting documentation for accuracy and approval.
- Account for all checks in numerical sequence by maintaining a check register or other check log system.
- Limit vendor creation and vendor file changes to authorized personnel.
- Improve system security to prevent users from accessing another user's ID.
- As noted above, segregate the IT administrator from the finance department.
- Ensure procedures exist to maintain sufficient, accurate supporting approved, documentation, i.e. an invoice, contract, or bid sheet, for all payments, corrections, and other adjustments.

Finding 5: The City Should Improve Revenue And Collections Procedures

During the examination, auditors interviewed staff related to the City's revenue and receipt process and examined procedures in place. It was noted that the City's finance department had no written policies and procedures for this area. Information about procedures for processing revenue collection activity is passed along verbally from one employee to another. In December 2012, a reorganization plan for the finance department was approved by the City Commission, leading to the creation of the position of revenue/collections manager in March 2013, which was filled by an existing finance department employee. According to this

employee, the former finance director showed her a list of job duties but did not provide the list to her to keep. She was not provided any training to help familiarize her with the additional duties of revenue/collections manager or direction in how to complete the additional duties. In reviewing the daily receipt/revenue collection process, it was apparent that the revenue/collections manager does not have a role in review and supervision of the activity. Additionally, the employees that process revenue and receipts were not all being supervised by the revenue/collections manager; auditors noted that two staff are supervised by the office/purchasing manager.

The most common revenues received by the City are: payroll taxes, insurance premium tax, waste bills, parking ticket payment, and other miscellaneous revenues. The finance department receives revenue by mail, through the payment window, from other departments sending payments in, and from direct Automatic Clearing House (ACH) deposits into the City's bank accounts.

Mailed Checks

During the review of revenue and receipts processing, numerous additional concerns were also identified. For instance, auditors noted that not all mail received by the finance department is opened by finance staff. If an envelope is addressed to the City but has a person's name included, finance staff do not open that envelope. This increases the risk that checks meant for City receipts could be given to various staff. Staff noted that mail was often addressed to the former finance director and likely included checks meant for the City. Because of this weakness, we cannot rule out the possibility that the former finance director intercepted revenue meant for the City and deposited into personal accounts.

Check Tracking

Also, revenue was occasionally received by the finance department that was not clearly identifiable. When this happened, the check would be given to the former finance director or a staff accountant to determine the source and provide a revenue code. No tracking or check logging process existed to ensure that every check given to someone else was returned for processing in the regular daily deposit process.

Daily Deposit Process

The examination also detected weaknesses in the City's daily deposit process. In the finance department, checks, cash, and credit card payments are received and processed by staff. This process includes the posting of revenue to the revenue module of the accounting system and providing a receipt to customers. Some of the staff stamp checks with a restrictive endorsement when the check is processed; however, the examination identified that not all finance department staff restrictively endorsed checks upon receipt. All of the funds are batched and put into a deposit bag and secured overnight. A daily deposit report is created in the computer system for each day's activity. The next morning, one staff member balances the cash and checks in the deposit to the daily deposit report in the system. A bank deposit slip is then prepared. There is no review by another person to ensure that mistakes were not made, or that

the deposit is correctly totaled. Also, the daily deposit report is not printed, so there is no evidence that the deposit was balanced.

During review and testing, auditors noted that not all revenue is included in the daily deposit process. Checks were routinely processed, posted to the system, and taken to the bank outside the normal deposit process. Checks received directly by the former finance director or the staff accountant either in the mail or in person were often not included in the daily deposit process. The staff accountant would stamp the check with a restrictive endorsement and prepare a separate deposit ticket. He would then "walk over" the deposit to the bank. There was not a reason provided that would explain the need to process some of the revenue outside the regular daily deposit process, other than to get checks deposited sooner than the next morning.

In one month tested, 19 separate deposits were made outside the normal process. This led to those receipts/deposits to be excluded from the daily deposit report prepared in the accounting system. These deposits were often posted at month end during the monthly journal entries postings. Deposits that are processed outside the normal system are at an increased risk for fraud and errors. We noted some of these deposits were posted to inaccurate revenue codes, which may have been used to hide the former finance director's fictitious transactions.

Funds Collected by Other Departments

The examination also identified that several other City departments routinely collect revenue from customers. The City does not have a formal process for funds collected outside the finance department. During discussion with revenue/collections staff, it was determined that the finance department routinely receives money from the legal department, the parks and recreation departments, and code enforcement. It was not known if other departments receive money from customers or if any other department maintains bank accounts for these funds. Some of the departments that collect funds provide a copy of each receipt to the finance department. However, there is not a process in place for the finance department to ensure that all customers receive receipts, that all receipts are accounted for, or that voided receipts are maintained. There is also no standard pre-numbered receipt issued with the City's identifying information.

Delinquent Tax Collection Process

Significant weaknesses were identified in regards to the City's delinquent tax collection. The City does not have adequate policies and procedures in place for detection and collection of delinquent taxes. Further complicating the concern is that the finance department's accounting system lacks any mechanism to identify taxpayers that did not pay occupational or payroll taxes in a given year. Identification of late taxpayers results only from a review of paper files and returns, with the identified late taxpayers then tracked in an Excel spreadsheet. Because of this, the collection process is time-consuming and prone to errors. While the revenue/collections manager has identified delinquent tax collections

as a significant area that needs attention, the lack of a computerized system of tracking tax payments has made collection efforts years behind and laborious. During the examination, inquiry with staff indicated during the fall 2013, finance department staff was working on 2011 taxes, and hoping to begin working on 2012 shortly thereafter. Because of these delays, the City is missing out on revenue from the collection of these late tax payments, and may ultimately lose them altogether as collection efforts get further behind and taxpayers move or go out of business.

Recommendations

We recommend the following related to the City's revenue/collection processes:

- All mail addressed to the City should be opened by designated staff in each department. Procedures should be established to ensure checks are removed and processed in the regular daily deposit process. If necessary, a copy of the check could be made and given to the person to whom the mail was originally addressed.

- One of the primary duties of the revenue/collections manager should be to determine the source of unknown revenue and provide accurate accounting coding to staff to ensure that all revenue received by the City is properly recorded and deposited. If research is necessary to perform this task, a copy of the check should be given to the revenue/collections manager and the original check should be deposited in the regular daily deposit process. The revenue could be temporarily coded to a holding account while it is being researched. Checks should not be held for days or weeks while a coding is determined.

- All revenue should be processed by designated revenue/receipts staff and be included in the daily deposit. All revenue should be posted to consistent account codes approved by the revenue/collections manager. All checks should be stamped with a restrictive endorsement as soon as they are processed. Appropriate segregation of duties should be implemented in regards to bank receipts and deposits. For instance, the same person should not balance the receipts, prepare the deposit, make the deposit and then verify/reconcile the deposit to the bank and accounting system. The balancing and review of receipts should be evidenced by printing the total page for the daily deposit report and attaching it to the City's copy of the bank deposit slip. This daily record should then be maintained according to the City's records retention policy. Any checks processed outside the normal deposit process should only be done so rarely, should have a valid reason documented, and should have supervisory approval.

- The City should develop a formal process for any department that collects funds from the public. The City should consider either utilizing a City-wide automated system whereby receipt activity from all departments is posted and monitored by the finance department, or

if manual procedures are necessary the City should implement procedures utilizing a standard, three-part, pre-numbered receipt with the City's identifying information. Pre-numbered receipts should be maintained by the finance department, logged and provided to each department as needed. Under such a manual system, one copy of the receipt should be provided to the customer, one to the finance department with the funds, and one should be maintained by the department. Departments should be instructed to issue receipts in order, maintain voided receipts and provide a copy of each receipt to the finance department with the funds collected on a regular basis (as established in the policy). The finance department should balance the batch of receipts to the funds and ensure that all receipts have been included. Departments that do not follow these procedures should not be allowed to collect funds from the public and customers should be directed to the finance department to make payments.

- The City should determine whether the accounting system can be modified to include the needed components to identify and track delinquent taxpayers, or if a stand-alone system to handle the process is feasible. Effort should be made to get delinquent tax collections up-to-date, and processed in a timely manner going forward so that collection efforts can begin as soon as the delinquency is identified. Policies and procedures should be developed to standardize the collection efforts, including the charging of penalties and interest, the option of a payment plan and the legal actions that would be taken if taxpayers continue to refuse to pay.

Finding 6: Internal Controls Over Bank Accounts, Bank Reconciliations and Adjusting Journal Entries Need Improvement

During the review of bank accounts and bank reconciliations, auditors noted the list of bank accounts maintained by the City and provided to auditors was incomplete and inaccurate. The accounting operations manager, the staff accountant, and the purchasing/office manager were unaware of three checking accounts in the City's name and tax identification number. Two of these checking accounts should not have been in the City's name or under its tax identification number. One belonged to a fire district and the other to the Covington Police Chaplain. The other checking account was a legitimate City account that was not being reconciled or monitored. Also, the finance department's List of Accounts excluded a loan in the City's name. Based on inquiries, City personnel were aware of this loan, but did not include it on the list given to auditors.

Lack of Segregation of Duties

Also, the examination identified there is a lack of segregation of duties without sufficient oversight in the area of bank account activity and bank reconciliations. The City's bank reconciliations are prepared by the same staff accountant who also posts month end journal entries and adjusting journal entries. This same staff accountant is also responsible for posting and depositing some of the revenue received by the City, as well as making transfers between funds and ACH transfers between bank accounts. Bank reconciliations, transfers and adjusting journal entries are

not reviewed by another person after preparation and posting. The performance of all of these activities by a single person poses a significant fraud risk, and provides sufficient opportunity for potential fraud to be concealed.

Timeliness of Reconciliations and Excessive Adjustments

Auditors also noted that bank reconciliations were not always performed timely, sometimes as much as two months after month-end. Recurring journal entries were made after month-end and excessive journal entries were necessary for correcting errors made throughout each month. Some reconciling items on the bank reconciliations were not clearly identified, with many requiring reconciling items and/or journal entries to correct ledgers, for errors previously made, with one as much as $573,500. Examples of errors noted in the bank reconciliations include:

- Two reconciling items noted on bank reconciliation labeled "Unidentified Deposits," one for $29,164 and another for $47,507.
- A bank reimbursement in the amount of $16,517, for a check the bank determined to have been intercepted by an individual not associated with the City of Covington, was posted as "Parking Meter Revenue."
- Twelve reconciling items were labeled "Unidentified Variances," some in excess of $2,700.

While it is important to reconcile the bank account balance to the book balance, it is important to ensure that the books are not "force balanced" due to unknown variances. Based on these errors, it appears the bank reconciliations were performed with a focus on mathematical balancing, without appropriate investigation for errors and reconciling items. Sufficient reconciliation procedures may help deter and detect misappropriation of assets.

Questionable and Unsupported Adjustments

Additionally, the examination found that adjusting journal entries were not always supported by documentation to explain the need for the entry, nor were the entries' descriptions in the accounting system sufficiently descriptive. Examples of questionable and unsupported journal entry labels identified during the review are in Table 2.4.

Table 2.4 - Examples of Adjusting Journal Entries with Questionable Descriptions

Fiscal Year	Fund	Amount	Description of Adjusting Journal Entry
2006	45	$ 46,000.00	HOUSEKEEPING
2007	01	137,117.50	BANK REC
2009	01	103,991.14	BOB'S ACCRUALS
2010	40	18,967.60	BOB'S ADJ'S
2010	40	23,584.00	BOB'S ACCRUALS
2010	45	131,255.25	BOB'S ADJ'S
2010	01	88,207.91	ACC PR INCENTIVES - BOB'S ADJ'S
2010	01	80,000.00	A/P CPX BOB'S ADJ'S
2011	40	91,674.40	DEVOU TRUST - BOB'S ADJ'S

A lack of sufficient oversight of bank accounts, excessive and unclear journal entries, and failure to prepare accurate bank reconciliations on a monthly basis could result in unrecorded receipts and disbursements, thus causing inaccuracy in accounting records and an increased risk of fraud or misappropriated funds that may go undetected.

Recommendations

We recommend:

- An accurate list of bank accounts be maintained. The City should implement a policy for departments to request a bank account through the finance department, and follow finance department policies for opening, maintaining, reporting and closing those accounts.
- Bank reconciliations should be prepared for all accounts on a monthly basis upon receiving the bank statements, and should be reviewed for completeness and accuracy by a supervisor. The City's policies regarding bank accounts maintained by other departments should establish policies for the reconciliation of those accounts, either by personnel within the department or someone within the finance department. Procedures should exist to properly investigate and correct reconciling differences.
- Adjustments that result from bank reconciliations should be posted by someone other than the person performing bank reconciliations, and should be reviewed and approved by a supervisor before they are posted. Journal entries should be prepared promptly and accurately and should have accurate descriptions and sufficient supporting documentation to justify the entry.

Finding 7: The City Should Improve Internal Controls And Oversight For Pension Funds

The City currently manages two pension funds, the City Employee Retirement Fund and the City Police and Fire Retirement Fund. The City created a board of trustees for each retirement fund. Both boards meet monthly to discuss unfunded pension liability, and to review investment reports. Approved minutes for each pension fund specifically detail plans and recommendations for replenishing the unfunded liabilities of the funds.

Inquiry with finance department employees indicated the former finance director handled the pension fund accounting himself, and they were

unable to provide answers to auditors' questions about the funds. In reviewing the information that was available, auditors determined that the recommended contributions to the pension funds were not made regularly. No contributions were made by the City to the pension funds during fiscal years 2011, 2012, or 2013. It is not clear if this decision was made entirely by the former finance director or if it was a funding decision at the direction of the City Commission.

It was the practice of the former finance director to request the sale of the pension fund's investments through the Fund Evaluation Group (FEG). FEG would then directly deposit the proceeds into each of the two pension funds. This was done approximately every three months. At the direction of the former finance director, the staff accountant would periodically check both bank accounts and transfer money from the City's General Fund bank account to ensure there would be sufficient funds in the bank account for pension checks to retirees. These transfers from the General Fund were considered to be loans to the pension funds and would be transferred back to the general fund after investments were sold to increase the pension fund balances.

There were no controls in place to ensure the accuracy or timeliness of required pension transactions. Further, there were no procedures in place to provide oversight from either the City Manager's office or the pension boards to monitor actual pension fund accounting. Currently, the pension funds are not managed proactively to ensure that the investment balances will be able to support pension payments for the remaining life of the retirees in the plans.

While we noted no specific instances of potential fraudulent activity related to the pension funds during the examination, the weaknesses in internal controls create a significant fraud risk. Furthermore, there is not sufficient monitoring and oversight in place to deter or detect fraud or material error.

Recommendations

We recommend the City review the Actuarial Valuation Report provided by Fund Evaluation Group and implement the boards' recommended annual contributions for each fund. When funding is not sufficient to meet its annual required contributions, the minutes of the City Commission should clearly identify its funding decision. Also, the finance department should ensure that accurate financial reports are provided to the pension boards of trustees and City Commission. In addition, the City should establish procedures for sound internal controls and sufficient oversight to ensure the accounts are being managed as intended.

Finding 8: The City Should Improve Accounting And Accountability For The Devou Park Funds

The City maintains two funds related to upkeep and improvement projects at Devou Park. Fund 40, the Devou Park Maintenance Fund, receives distributions from the William P. Devou Trust fund and Fund 45, Devou Park Master Plan, receives an annual contribution from Devou Properties, Inc.

According to the City's website, the Devou Park Advisory Committee was established by the Board of Commissioners with O/R-18-96. It provides oversight for the maintenance of the physical structures of Devou Park. Devou Properties, Inc. was created for the purpose of operating and maintaining the conference/reception center and other facilities in Devou Park. It is overseen by a board as well.

The Boards meet annually and determine the extent of allocations to the City for Devou Park projects. The City's Programs and Strategic Projects Division manager meets with the Boards to present potential projects and expenditure needs. This manager also oversees the work done to ensure projects were bid appropriately and completed timely and to monitor progress of long-term projects. However, there was not regular communication between this manager and the former finance director to monitor the budget to compare actual versus projected spending, or to verify documentation of the City's expenditures to support the reimbursement request from the park funds. Based on interviews with City staff, this was not unusual as the former finance director did not encourage or welcome regular communication about accounting issues.

During review of the Devou Park Funds activity, we confirmed payments from Devou Properties, Inc. meant for the Devou Park Master Plan, fund 45. The review found that some of these payments were posted as receipts to other accounts. Table 2.5 identifies all payments from Devou Properties, Inc., and the first seven payments listed were posted as receipts to other accounts. There is no supporting documentation available to justify the reason for posting revenue into inaccurate funds. Finance department staff could only explain that it was done at the direction of the former finance director.

Table 2.5 - Payments From Devou Properties, Inc.

Date	Check Number	Amount	Where posted
7/29/04	1312	$ 30,245.88	Fund 001 - A/R Stewart Ironworks
11/4/04	1645	50,000.00	Fund 001 - A/R Stewart Ironworks
12/20/04	1727	25,000.00	Fund 001 - A/R Stewart Ironworks
10/4/06	3032	75,000.00	Fund 001 - A/R Stewart Ironworks
5/24/07	3525	50,000.00	Fund 001 - A/R Stewart Ironworks
12/8/07	3991	200,000.00	Fund 040 - Devou Park Maint. Fund
9/17/08	4579	133,949.00	Fund 001 - A/R Stewart Ironworks
8/18/10	6152	650,000.00	Fund 045 - Devou Park Master Plan
9/15/11	7060	250,000.00	Fund 045 - Devou Park Master Plan
9/10/12	7835	750,000.00	Fund 045 - Devou Park Master Plan
6/18/13	8417	500,000.00	Fund 045 - Devou Park Master Plan

It is also important to note that the former finance director posted $108,400 in 2011 and $79,846.17 in 2008 in checks that he wrote to himself and related parties to Fund 40, the Devou Park Maintenance Fund. In addition, a total of $67,250 from 2004 to 2007 in checks written to himself and related parties were coded to Fund 001 - A/R Stewart Ironworks, where it appears he diverted Devou Park, Inc. revenue, according to Table 2.5.

From this activity it is possible to assume that the former finance director took advantage of the complete control and access he had to the two Devou Park Funds. Further, he was not required to provide supporting documentation when requesting contributions or reimbursements from the Boards, and no internal controls existed to ensure the receipts and disbursements for the park funds were monitored to the extent needed to prevent or detect fraud or material error.

Recommendations

Based on the concerns noted in the review of the two Devou Park Funds, we recommend the following:

- The City should implement policies and procedures to ensure that all revenue and expenditures related to projects at Devou Park are coded accurately.
- The new finance director should meet regularly with the Programs and Strategic Projects Division manager to compare actual expenditures to budgeted expenditures. Because the funds are received from a third-party and are restricted for a specific use, an effort should be made to ensure the funds are only expended on approved projects.
- When reimbursement or fund distributions requests are made, the City should provide a report of expenditures and progress on approved projects to the oversight boards.
- The City should ensure that control of these funds is not limited to a single person without oversight or review.

Finding 9: The City Did Not Have A Credit Card Policy And Did Not Properly Track Issued Cards

During the examination, auditors noted that various staff had been issued credit cards, although the City did not have an established policy regarding the use of credit cards. The most recent Procurement Policy (revised in 2000) did not address credit cards. In addition, the City's purchasing/office manager was unaware of the exact number of existing credit cards or who had access to these cards. A review of 16 months of transactions did not identify any obvious fraudulent incidents by the former financial director; however, weak oversight regarding the use of the credit cards was noted.

Allowing staff to use credit cards for purchases without a strong credit card use policy in place increases the risk of a card being used inappropriately and not being detected. This also increases the risk of the credit card being used to bypass the established procurement policies and procedures.

Recommendations

We recommend the City adopt a credit card policy that includes:

- Specific identification of unallowable expenses that should not be charged on a credit card.
- Detail listing of any expenses that require approval by management prior to the credit card being used, i.e. overnight travel, out-of-state travel, or purchases over a specified dollar amount.
- Limitations on the types of purchases made with credit cards in favor

of more deliberative purchase methods, such as purchase orders, bids, etc.

- Requirement that the cardholder's supervisor or director review and sign the receipt prior to the review by the purchasing/office manager. By signing the supervisor should attest that proper documentation was provided and the expenses were for legitimate city expenses.
- Requirement that the purchasing/office manager or other employee reconcile signed receipts to credit card statements prior to authorizing payment of the credit card statement.
- Requirement that employees are responsible for reimbursing the City for any unsupported expenditures. The policy should provide for a process to obtain the reimbursement and also address penalties for employees that misuse credit cards or fail to follow the policy.

We also recommend the City implement procedures to obtain and maintain a list of all credit cards issued to employees, and also identify and maintain a list of all approved users and supervisors. This list should be updated regularly as changes are needed, and policies should be implanted to retrieve credit cards from individuals that leave employment of the City.

Finding 10: Payroll Duties Were Not Adequately Segregated And Personal Information Related To Payroll Was Not Maintained In A Secure Manner

The examination identified there is a lack of segregation of duties and inadequate supervisory review in the City's payroll process. The person responsible for processing payroll and pension payments is also responsible for setting up new employees in the payroll system and changing pay rates when necessary. There is no supervisory review of any of the payroll functions, from setting up new employees, changing pay rates, calculations of overtime or leave time, supplemental payments, withholdings payments, pension checks or corrections of errors. Auditors also noted during a review of the accounting system security that several key finance personnel, including the former finance director had the capability of setting up new employees in the payroll system. This weakness significantly increases the risk of fraud since fictitious employees could be added and deleted without detection. This issue is discussed further in Finding 3.

Additionally, a review of payroll reports found that payroll reports are filed in an unlocked filing cabinet in the finance department. It was also noted that older payroll reports were being stored in boxes in the basement of the building, which is not a secured area. A review of personnel files found that files were in unlocked filing cabinets in an open office area in the Human Resources (HR) department. The HR department was sharing space with another department, so access was not restricted to only authorized HR personnel.

Recommendations

Because of the weaknesses in internal control identified during a review of the payroll process, we recommend the City take the following actions:

- Duties should be segregated so that payroll employees do not have the

ability to add new employees to the payroll module or change pay rates. Also, adequate supervisory review should be implemented, and the review should be documented and maintained. Computer access should be restricted so that only necessary personnel can add new employees and change pay rates.

- Payroll reports and personnel files contain secure information that should be restricted to only those involved in the payroll and human resources process. Payroll reports can be maintained in the finance department where they are used, but should be secured in a locked cabinet. Personnel files should be maintained by HR but access should also be restricted to only those that work in that area. Current files should be in locked cabinets in HR and older, archived files should be maintained in a secured location.

Finding 11: Accounting Procedures Are Unclear, Increasing The Risk Of Undetected Errors

During the review of significant activities and functions of the City's finance department, auditors noted certain accounting procedures in use that do not result in a clear and accurate recording of transactions.

Due To/Due From Transactions

The City uses a method of accounting for transfers between funds by posting "due to" and "due from" transactions. The City has established a bank account for each of its funds. However, the City uses one primary bank account, the general fund bank account, for all deposits and disbursements. Revenue deposited into the general fund bank account for other funds is posted in the accounting system to the fund where the cash was intended. Then a "due to" is set up in the system to document the need to transfer the cash from the general fund to the other fund. Similarly, disbursements from other funds are made using the general fund bank account checks and a "due from" is set up to account for the cash that needs to be reimbursed to the general fund from the other fund. During our review, auditors noted and questioned numerous "due to" and "due from" entries posted in the general fund and the Devou Parks funds. Some of the transactions were "cleared" by an actual transfer of cash from one bank account to another, but most often they were not.

A conversation with a finance department employee highlighted the frustration involved in dealing with this complex type of accounting, with the employee acknowledging that because of these overly complex and numerous "due to/due from" entries, it was not easy to determine the City's actual cash balance in each fund on a given day. Although in governmental accounting, the use of "due to/due from" accounts are not uncommon, the City appears to be using this methodology for routine accounting. However, the complexity of the process and historical lack of oversight creates a risk that the methodology may be used to obscure details and increases the risk that waste, fraud, and abuse could occur and not be detected. Furthermore, in this case, the methodology increases the risk of material error because of the excessive activity and difficulty balancing cash accounts.

Writing Checks From Revenue Accounts

As noted in Finding 8, Table 2.5, the former finance director wrote checks to himself and related parties from the Payroll Tax Revenue account and two receivable accounts. Among these were two payments in fiscal year 2009 in the Payroll Tax Revenue Account totaling $34,477.25 and $28,575.30 documented in the system as "Vacant Prop Reimb" and "Vacant Prop Tax Reimb," respectively.

While reviewing these transactions, we noted numerous other checks written from the Payroll Tax Account. It is the City's standard accounting practice to write checks for refunds of overpayments, tax incentive payments, payroll credits, tax rebates, vacant property rebates, and other various rebates and refunds from revenue accounts. This practice not only reduces the total tax revenue and other revenues by the amounts of the checks, it does not provide for a clear accounting of tax refunds, rebates and incentives processed by the City and may also distort the matching of revenues when rebates or refunds are paid in a different fiscal year than when it was deposited. For example, one business was paid $241,416.07 in fiscal year 2012 in a check described as "Covington Jobs Incentive Program" but because it was netted against payroll tax revenue, this information was not easily identified. The City did not have controls in place to restrict checks paid from revenue accounts to appropriately related refunds.

We also noted in Finding 8 that the former finance director wrote six checks from the "A/R Stewart Ironworks" accounts receivable account and 20 checks from the "A/R Devou Golf Expansion" accounts receivable account. It is not clear why he selected these accounts, although it is unlikely accounts receivable accounts are often monitored for expense payments.

Checks that are posted as reductions of revenue and receivable balances do not provide an accurate record of disbursements, and can be overlooked by supervisors and external auditors. Accurate recording of these transactions as disbursements in expenditure account codes would provide transparency and a good audit trail.

Numerous Adjusting Journal Entries

The examination identified numerous adjustments and adjusting journal entries in the various funds and accounts reviewed during the examination. Some of the adjustments were clearly identified and sufficient documentation was maintained to support the entries. Others were identified with vague descriptions and did not have sufficient documentation as to the purpose of the entries. Also, there is no guidance for staff in the form of written policies and procedures for the use of adjusting journal entries. The City also does not require adjusting journal entries to be reviewed by a second person before or after the entry is posted. The lack of supervisory review and approval in the important task of adjusting the City's accounting records is a significant internal control weakness.

Recommendations

We recommend the City update accounting policies and procedures to address these weaknesses, including the following:

- The use of "Due to/Due from" entries should be eliminated as routine transactions in favor of a more direct, transparent approach to posting cash deposits. "Due to/Due from" entries should be used sparingly, and transfers should be documented and reviewed/approved by a supervisor before the entry is made.
- Checks should only be written from disbursement accounts, with the exception of instances in which it is permissible by accounting standards (certain refunds). The City should set up disbursement accounts to separately account for other tax overpayments, rebates and incentives.
- Policies and procedures should identify the circumstances that would necessitate the use of adjusting journal entries. Entries should only be created and posted by authorized personnel only after supervisory review and approval.

Finding 12: The City Should Improve Oversight Of Processes Outsourced To Third Party Organizations

The City contracts with third party organizations for the management of parking garages and the payment of health insurance claims. According to finance department staff, the former finance director provided oversight for these activities. The examination identified that monthly bank reconciliations for the parking garage revenue bank account appeared to force balanced. Each month there was an entry labeled "DIT" presumed to mean "deposit in transit" added to the bank statement balance to balance to the book balance. We could not trace these deposits in transit to actual deposits made in subsequent months.

A staff accountant that reconciles the bank statement indicated the entry was necessary because the amount of revenue per the report received from the third party organization did not agree to the amount of revenue received in the bank account. When asked if this difference had been investigated, the staff accountant stated the former finance director said he was going to look into it. There is no documentation available to determine if the difference was ever investigated, but the problem was not resolved since the difference continues to be an issue.

The City also contracts with a third party organization to process and pay health care expenses for the City's self-insured health plan for employees. We reviewed an electronic funds transfer authorization for this organization that documented a total amount of health claims to be paid for one month. There was no detailed report provided for review to ensure the City was being properly charged for the medical claims. The staff accountant interviewed told us he did not think the former finance director reviewed a detailed report, and that he authorized the transfer to the medical claims organization without question.

Recommendations

While it is common for a governmental entity to outsource some processes, there should be oversight within the City to ensure the revenue

collected or expenditures paid are free of material misstatement or error. We recommend the City improve oversight of third party organizations by implementing internal controls to ensure a sufficient review of documentation and reconciliation to actual cash received or paid. This review should be evidenced in writing and reconciliations should not be forced balanced.

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APPENDICES

VENDOR NAME USED	PAYEE	DESCRIPTION	CHECK DATE	AMOUNT
MANAGEMENT PARTNERS INC.	MANAGEMENT SOLUTIONS [2]	Riverfront West Project	8/29/2001	$ 7,500.00
MANAGEMENT PARTNERS INC.	MANAGEMENT SOLUTIONS [2]	Fees Work on joint dispatch Service	9/17/2001	5,000.00
MANAGEMENT PARTNERS INC.	MANAGEMENT SOLUTIONS [2]	Dispatch Analysis	11/20/2001	7,500.00
MANAGEMENT PARTNERS INC.	MANAGEMENT SOLUTIONS [2]	Fees for exec. Salary and benefit survey	2/6/2002	5,000.00
S & F MANAGEMENT	MANAGEMENT SOLUTIONS [2]	1ST INSTALLMENT DEV OF RISK ASSESSMENT	3/20/2002	8,500.00
S & F MANAGEMENT	MANAGEMENT SOLUTIONS [2]	DEV. OF RISK ASSESSMENT PLAN PROG.	6/19/2002	7,500.00
S & F MANAGEMENT	MANAGEMENT SOLUTIONS [2]	REFUND BID BOND ON ZONING PLAN	8/30/2002	5,000.00
MANAGEMENT PARTNERS INC.	MANAGEMENT SOLUTIONS [2]	Scheper Report Plan update	10/2/2002	3,500.00
MANAGEMENT PARTNERS INC.	MANAGEMENT SOLUTIONS [2]	Farmers Market Study	11/12/2002	3,000.00
MANAGEMENT PARTNERS INC.	MANAGEMENT SOLUTIONS [2]	Evaluation- Portfolio Perf. Pension	12/11/2002	3,150.00
MANAGEMENT PARTNERS INC.	MANAGEMENT SOLUTIONS [2]	Consultant	3/12/2003	7,000.00
MANAGEMENT PARTNERS INC.	MANAGEMENT SOLUTIONS [2]	Market Study Devou Park Lodge	5/27/2003	6,000.00
MANAGEMENT PARTNERS INC.	MANAGEMENT SOLUTIONS [2]	Riverfront West Project	7/25/2003	3,500.00
MANAGEMENT PARTNERS INC.	MANAGEMENT SOLUTIONS [2]	Zoning code rewrite/review Austin	2/12/2004	3,250.00
MANAGEMENT PARTNERS INC.	MANAGEMENT SOLUTIONS [2]	Management Consultant Drees	3/10/2004	12,000.00
S & F MANAGEMENT	MANAGEMENT SOLUTIONS [2]	PROFESSIONAL SERVICES - DREES PAVILLION	4/6/2004	9,000.00
S & F MANAGEMENT	MANAGEMENT SOLUTIONS [2]	PROFESSIONAL SERVICES	10/15/2004	7,500.00
S & F MANAGEMENT	MANAGEMENT SOLUTIONS [2]	CONSULTANT	12/14/2004	6,000.00
S & F MANAGEMENT	MANAGEMENT SOLUTIONS [2]	MANAGEMENT CONSULTANT	1/21/2005	4,500.00
S & F MANAGEMENT	MANAGEMENT SOLUTIONS [2]	MANAGEMENT CONSULTANT	1/21/2005	3,500.00
S & F MANAGEMENT	MANAGEMENT SOLUTIONS [2]	MANAGEMENT CONSULTANT	2/25/2005	4,000.00
S & F MANAGEMENT	MANAGEMENT SOLUTIONS [2]	INSTALL SOFTWARE- DREES PAVILON	7/14/2005	4,500.00
S & F MANAGEMENT	MANAGEMENT SOLUTIONS [2]	CONSULTING	8/25/2005	7,500.00
S & F MANAGEMENT	MANAGEMENT SOLUTIONS [2]	CONSULTING SERVICES	9/2/2005	8,500.00
S & F MANAGEMENT	MANAGEMENT SOLUTIONS [2]	MANAGEMENT CONSULTING SERVICES	11/17/2005	8,500.00
S & F MANAGEMENT	MANAGEMENT SOLUTIONS [2]	MANAGEMENT CONSULT	12/19/2005	7,500.00
S & F MANAGEMENT	MANAGEMENT SOLUTIONS [2]	MANAGEMENT CONSULTING MERGER OF COMM.	2/17/2006	7,500.00
S & F MANAGEMENT	MANAGEMENT SOLUTIONS [2]	WATER PARK LITAGATION	3/13/2006	18,000.00
S & F MANAGEMENT	MANAGEMENT SOLUTIONS [2]	REFUND 2005 EST OCCUPATIONAL LISECNCE	6/12/2006	18,500.00
V L MOLIQUE [1]	V L MOLIQUE	SCULPTURE/DESIGN WORK COV BUS COUNCIL	3/30/2007	23,283.50
V L MOLIQUE [1]	V L MOLIQUE	MURAL/SCULPTURE/DREES PAV/ BEH MUS	7/23/2007	6,250.00
V L MOLIQUE [1]	V L MOLIQUE	ARTWORK/ SCULPTURE DESIGN	8/17/2007	32,000.00
V L MOLIQUE [1]	V L MOLIQUE	BEHRINGER CRAWFORD EXPANSION	1/8/2008	41,346.17
V L MOLIQUE [1]	V L MOLIQUE	BEHRINGER CRAWFORD PLAN DESIGN	5/22/2008	38,500.00
VIRGIL L MULLINS [1]	V L MOLIQUE	PAYROLL TAXES	9/25/2008	34,477.25
VIRGIL L MULLINS [1]	V L MOLIQUE	PAYROLL TAXES	12/15/2008	28,575.30
VIRGIL L MULLINS [1]	V L MOLIQUE	A/R - DEVOU GOLF EXPANSION	4/13/2009	28,750.00
VIRGIL L MULLINS [1]	V L MOLIQUE	JUDGEMENTS & COURTS COSTS	11/16/2009	28,500.00
VIRGIL L MULLINS [1]	V L MOLIQUE	JUDGEMENTS & COURTS COSTS	2/22/2010	28,500.00
PARK NATIONAL BANK	J H PATTERSON	PROF & TECHNICAL FEES	09/27/2010	18,750.00
PARK NATIONAL BANK	J H PATTERSON	PROF & TECHNICAL FEES	10/26/2010	14,350.00
PARK NATIONAL BANK	J H PATTERSON	PROF & TECHNICAL FEES	11/15/2010	19,100.00
PARK NATIONAL BANK	J H PATTERSON	PROF & TECHNICAL FEES	01/07/2011	16,250.00
PARK NATIONAL BANK	J H PATTERSON	PROF & TECHNICAL FEES	03/25/2011	14,750.00
PARK NATIONAL BANK	J H PATTERSON	PROF & TECHNICAL FEES	04/25/2011	8,600.00
PARK NATIONAL BANK	J H PATTERSON	PROF & TECHNICAL FEES	05/23/2011	8,200.00
PARK NATIONAL BANK	J H PATTERSON	PROF & TECHNICAL FEES	06/07/2011	8,400.00
PARK NATIONAL BANK	J H PATTERSON	A/R - DEVOU GOLF EXPANSION	08/17/2011	8,850.00
PARK NATIONAL BANK	J H PATTERSON	A/R - DEVOU GOLF EXPANSION	10/06/2011	6,860.00
PARK NATIONAL BANK	J H PATTERSON	A/R - DEVOU GOLF EXPANSION	10/18/2011	9,240.00
PARK NATIONAL BANK	J H PATTERSON	A/R - DEVOU GOLF EXPANSION	11/11/2011	15,650.00
PARK NATIONAL BANK	J H PATTERSON	A/R - DEVOU GOLF EXPANSION	12/13/2011	7,850.00
PARK NATIONAL BANK	J H PATTERSON	A/R - DEVOU GOLF EXPANSION	12/28/2011	6,750.00
PARK NATIONAL BANK	ROBERT DUE	A/R - DEVOU GOLF EXPANSION	03/06/2012	8,500.00
PARK NATIONAL BANK	J H PATTERSON	A/R - DEVOU GOLF EXPANSION	05/08/2012	9,000.00
PARK NATIONAL BANK	J H PATTERSON	JUDGEMENTS & COURTS COSTS	08/07/2012	8,250.00
PARK NATIONAL BANK	J H PATTERSON	A/R - DEVOU GOLF EXPANSION	10/09/2012	9,125.00
PARK NATIONAL BANK	J H PATTERSON	A/R - DEVOU GOLF EXPANSION	12/06/2012	8,750.00
PARK NATIONAL BANK	J H PATTERSON	A/R - DEVOU GOLF EXPANSION	12/20/2012	8,425.00
PARK NATIONAL BANK	J H PATTERSON	A/R - DEVOU GOLF EXPANSION	12/27/2012	7,870.00
PARK NATIONAL BANK	J H PATTERSON	A/R - DEVOU GOLF EXPANSION	02/12/2013	8,800.00
PARK NATIONAL BANK	J H PATTERSON	A/R - DEVOU GOLF EXPANSION	02/19/2013	8,500.00
PARK NATIONAL BANK	J H PATTERSON	A/R - DEVOU GOLF EXPANSION	03/15/2013	7,850.00
PARK NATIONAL BANK	J H PATTERSON	A/R - DEVOU GOLF EXPANSION	04/09/2013	9,125.00
PARK NATIONAL BANK	J H PATTERSON	A/R - DEVOU GOLF EXPANSION	04/23/2013	7,800.00
PARK NATIONAL BANK	J H PATTERSON	A/R - DEVOU GOLF EXPANSION	05/29/2013	9,250.00
PARK NATIONAL BANK	J H PATTERSON	A/R - DEVOU GOLF EXPANSION	06/18/2013	8,700.00
PARK NATIONAL BANK	ROBERT DUE	JUDGEMENTS & COURTS COSTS	8/16/2013	8,500.00
MANAGEMENT PARTNERS INC.	ROBERT DUE	Second of Three Installments	8/20/2013	8,500.00
			TOTAL	**$ 793,127.22**

1 Denotes fake vendors established by the former finance director in the City's accounting system.
2 Examination identified the authorized signature for this vendor's bank account was former finance director.
3 Although there are 69 transactions listed above, these transactions resulted in 68 printed checks.

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CITY OF COVINGTON, KY

User Security Report

User ID	Full Name	User Initial
[redacted]	[redacted]	[redacted]

User

Remarks:
Login Expire:
Default Municipality: CITY — CITY OF COVINGTON, KY
Phone No.: **Ext.:** **Location:**
WF Code: ALL — ALL USERS
Default Printer:
Created: 10/03/2011 — [redacted]
Disabled: 10/31/2013 — KVS_ADMIN/MAX LOGIN FAILURE
Email Address: [redacted]
Email Server: **Port:**
Login:

Power User: Yes **Disabled:** Yes **Change Password:** Yes
View All Spooled Files: Yes **Save Spooled Files:** Yes **VCQ User:** No **VCQ Full Access:** No

Municipality

Muni Code		Group Security	
CITY	CITY OF COVINGTON, KY	POWER USER 2	POWER USER 2

System

System ID	Description
BUD	Budget Preparation

Module No.	Description	Create	Read	Update	Delete
BUD0000	BUDGET MAIN MENU	Y	Y	Y	Y
BUD1040	BUDGET DETAIL TYPE	Y	Y	Y	Y
BUD2010	BUDGET PREPARATION	Y	Y	Y	Y
BUD4010	BUDGET PREPARATION REPORT	Y	Y	Y	Y
BUD4050	BUDGET PREPARATION PUBLICATION	Y	Y	Y	Y

FIX — Fixed Assets

Module No.	Description	Create	Read	Update	Delete
FA0000	FA MAIN MENU	Y	Y	Y	Y
FA1010A	FIXED ASSET PROFILE	Y	Y	Y	Y
FA1120	ASSETS MASTER FILE MAINTENANCE	Y	Y	Y	Y
FA1130	USER DEFINED FIELDS SETUP	Y	Y	Y	Y
FA1140	VENDOR MASTER FILE	Y	Y	Y	Y

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CITY OF COVINGTON, KY

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User Security Report

User ID	Full Name	User Initial
[redacted]	[redacted]	[redacted]

System

System ID	Description
FIX	Fixed Assets

Module No.	Description	Create	Read	Update	Delete
FA1150	DEPARTMENT MASTER FILE	Y	Y	Y	Y
FAR4010	ASSET MASTER DETAIL REPORT	Y	Y	Y	Y
FAR4020	ACQUIRED ASSETS REPORT	Y	Y	Y	Y
FAR4030	DISPOSED ASSETS REPORT	Y	Y	Y	Y
FAR4040	TRANSFERRED ASSETS REPORT	Y	Y	Y	Y
FAR4050	DEPRECIATION PROJECTION REPORT	Y	Y	Y	Y
FAR4060	DEPRECIATION HISTORY REPORT	Y	Y	Y	Y
FAR4090	ASSET INVENTORY REPORT	Y	Y	Y	Y

KVS — Common Interface System

Module No.	Description	Create	Read	Update	Delete
KVS0010	KVS MAIN SCREEN	Y	Y	Y	Y
KVS2020A	USER PREFERENCE	Y	Y	Y	Y
KVS2070	PRINTER SPOOLER	Y	Y	Y	Y

MGL — General Ledger

Module No.	Description	Create	Read	Update	Delete
GL0000	G/L MAIN MENU	Y	Y	Y	Y
GL1010A	G/L PROFILE	Y	Y	Y	Y
GL1020	GRANT/CAPEX FILE MAINTENANCE	Y	Y	Y	Y
GL1030	JOURNAL CATEGORY	Y	Y	Y	Y
GL1040	ACCOUNT COMPONENT	Y	Y	Y	Y
GL1050	CHART OF ACCOUNTS FILE MAINTENANCE	Y	Y	Y	Y
GL1060	ACCOUNT LEDGER	Y	Y	Y	Y
GL1070	ALTERNATE SORT	Y	Y	Y	Y
GL1080	ACCOUNT TABLE	Y	Y	Y	Y
GL1090	APPROVAL GROUP	Y	Y	Y	Y
GL1100	ALT SORT TABLE	Y	Y	Y	Y
GL1110	JOURNAL UPLOAD FORMAT	Y	Y	Y	Y
GL2010	FOREX RATE	Y	Y	Y	Y
GL2020	JOURNAL ENTRY	Y	Y	Y	Y
GL2020B	JOURNAL ENTRY TEMPLATE	Y	Y	Y	Y

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System

System ID	Description
MGL	General Ledger

Module No.	Description	Create	Read	Update	Delete
GL2030	RECURRING ENTRY	Y	Y	Y	Y
GL2040	ENCUMBRANCE ADJUSTMENT	Y	Y	Y	Y
GL2050	BUDGET PREP	Y	Y	Y	Y
GL2060	BUDGET ADJUSTMENT	Y	Y	Y	Y
GL3010	PERIOD END CLOSE	Y	Y	Y	Y
GL3020	YEAR-END CLOSE	Y	Y	Y	Y
GL3030	POST JOURNAL ENTRIES	Y	Y	Y	Y
GL3040	IMPORT JOURNAL ENTRY	Y	Y	Y	Y
GL3050	CREATE RECURRING / REVERSING ENTRIES	Y	Y	Y	Y
GL3060	POST BUDGET ADJUSTMENTS	Y	Y	Y	Y
GL3070	TRANSFER ACCOUNT NO.	Y	Y	Y	Y
GL3080	CROSS-POST PROCESS	Y	Y	Y	Y
GL5010	IMPORT FROM TEXT FILE	Y	Y	Y	Y
GLR0101	ACCOUNT LIST REPORT	Y	Y	Y	Y
GLR0102	JE REGISTER	Y	Y	Y	Y
GLR0104	BATCH G/L UPDATE PRELIMINARY REPORT	Y	Y	Y	Y
GLR0105	GENERAL LEDGER REPORT	Y	Y	Y	Y
GLR0106	RECEIPTS STATEMENT	Y	Y	Y	Y
GLR0107	BALANCE SHEET REPORT	Y	Y	Y	Y
GLR0108	TRIAL BALANCE REPORT	Y	Y	Y	Y
GLR0109	BUDGET ADJUSTMENT REPORT	Y	Y	Y	Y
GLR0114	WORKING TRIAL BALANCE REPORT	Y	Y	Y	Y
GLR0116	REVENUE CONTROL REPORT	Y	Y	Y	Y
GLR0122	EXPENSE CONTROL REPORT	Y	Y	Y	Y
GLR0124	REVENUE LEDGER REPORT	Y	Y	Y	Y
GLR0125	EXPENSE LEDGER	Y	Y	Y	Y
GLR0130	REVENUE/EXPENSE CONTROL REPORT	Y	Y	Y	Y
GLR0140	YTD FUND SUMMARY REPORT	Y	Y	Y	Y
GLR4010	CROSS-POST ACCOUNT LIST	Y	Y	Y	Y
GLR4030	VIEW IMPORT ERRORS	Y	Y	Y	Y

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CITY OF COVINGTON, KY

User Security Report

User ID	Full Name	User Initial
[redacted]	[redacted]	[redacted]

System

System ID	Description
MGL	General Ledger

Module No.	Description	Create	Read	Update	Delete
GLR4050	PRINT JE FORM	Y	Y	Y	Y
GLR4060	COMPONENT LIST REPORT	Y	Y	Y	Y
GLR4160	EXPENSE COMPARISON CONTROL REPORT	Y	Y	Y	Y
GLR4170	DUE TO/DUE FROM REPORT	Y	Y	Y	Y

PO — Purchase Order

Module No.	Description	Create	Read	Update	Delete
PUR2030	PURCHASE ORDER	Y	Y	Y	Y
PUR2030B	PO TEMPLATE	Y	Y	Y	Y
PUR4050	PO FORMS	Y	Y	Y	Y
PUR4060	PO RECEIVED REPORT	Y	Y	Y	Y
PUR4070	PO G/L DISTRIBUTION REPORT	Y	Y	Y	Y
PUR4230	PO DETAIL REPORT	Y	Y	Y	Y

PUR — Purchasing

Module No.	Description	Create	Read	Update	Delete
PUR0000	PURCHASING MAIN MENU	Y	Y	Y	Y
PUR1010A	PURCHASING PROFILE	Y	Y	Y	Y
PUR1020	SHIPPING TERMS	Y	Y	Y	Y
PUR1030	BILL TO ADDRESS	Y	Y	Y	Y
PUR1040	SHIP TO ADDRESS	Y	Y	Y	Y
PUR1050	1099 CODE	Y	Y	Y	Y
PUR1060	COMMODITY CODE	Y	Y	Y	Y
PUR1070	VENDOR MASTER FILE	Y	Y	Y	Y
PUR1080	VENDOR TYPE	Y	Y	Y	Y
PUR1090	HANDLING COST	Y	Y	Y	Y
PUR1100	APPROVAL GROUP	Y	Y	Y	Y
PUR1110	CHECK ID CODES	Y	Y	Y	Y
PUR1120	USER DEFINED FIELDS	Y	Y	Y	Y
PUR1130	VENDOR ACTIVITY DISPLAY	Y	Y	Y	Y
PUR1140	DEPARTMENT MASTER FILE	Y	Y	Y	Y
PUR1150	ACCOUNT LEDGER	Y	Y	Y	Y

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User Security Report

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User ID	Full Name	User Initial
[redacted]	[redacted]	[redacted]

System

System ID	Description
PUR	Purchasing

Module No.	Description	Create	Read	Update	Delete
PUR1180	BANK CODE F/M	Y	Y	Y	Y
PUR1190	VOUCHER UPLOAD FORMAT	Y	Y	Y	Y
PUR1200	PO FORM TEMPLATE	Y	Y	Y	Y
PUR1210	REQ FORM TEMPLATE	Y	Y	Y	Y
PUR1220	VOUCHER FORM TEMPLATE	Y	Y	Y	Y
PUR2010	QUOTES	Y	Y	Y	Y
PUR2040	VOUCHER	Y	Y	Y	Y
PUR2040B	VOUCHER TEMPLATE	Y	Y	Y	Y
PUR3020	BANK RECONCILIATION	Y	Y	Y	Y
PUR3030	CHECK F/M	Y	Y	Y	Y
PUR3050	A/P CHECK PROCESS	Y	Y	Y	Y
PUR3060	CREATE RECURRING VOUCHERS	Y	Y	Y	Y
PUR3070	PURGE PURCHASING DATA	Y	Y	Y	Y
PUR3080	CREATE BANK CHECK MEDIA	Y	Y	Y	Y
PUR3090	IMPORT VOUCHER	Y	Y	Y	Y
PUR3100	CREATE 1099 CODE FILE	Y	Y	Y	Y
PUR3110	YE PO TRANSFER	Y	Y	Y	Y
PUR4080	PURCHASING EXCEPTION REPORT	Y	Y	Y	Y
PUR4090	VOUCHER DETAIL/VENDOR HISTORY REPORT	Y	Y	Y	Y
PUR4100	PRE-CHECK WRITING REPORT	Y	Y	Y	Y
PUR4110	CASH REQUIREMENT REPORT	Y	Y	Y	Y
PUR4120	1099 FORMS	Y	Y	Y	Y
PUR4130	AP G/L DISTRIBUTION REPORT	Y	Y	Y	Y
PUR4140	AP AGED TRIAL BALANCE	Y	Y	Y	Y
PUR4150	AP CHECK REPORT BY ID	Y	Y	Y	Y
PUR4160	PROVIDER INFORMATION REPORT	Y	Y	Y	Y
PUR4170	DEPARTMENT COMMODITY REPORT	Y	Y	Y	Y
PUR4180	VOUCHER FORMS	Y	Y	Y	Y
PUR4190	VENDOR ACTIVITY REPORT	Y	Y	Y	Y
PUR4200	VENDOR MASTER FILE REPORT	Y	Y	Y	Y

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[redacted]	[redacted]	[redacted]

System

System ID	Description
PUR	Purchasing

Module No.	Description	Create	Read	Update	Delete
PUR4240	AP CHECK LISTING REPORT	Y	Y	Y	Y
PUR4430	YTD BANK REPORT	Y	Y	Y	Y
PUR5010	IMPORT FROM TEXT FILE	Y	Y	Y	Y

System ID	Description
REQ	Requisition

Module No.	Description	Create	Read	Update	Delete
PUR2020	REQUISITION	Y	Y	Y	Y
PUR2020B	REQ TEMPLATE	Y	Y	Y	Y
PUR4030	REQUISITION FORMS	Y	Y	Y	Y
PUR4040	REQUISITION DETAIL REPORT	Y	Y	Y	Y
PUR4420	REQUISITION DISTRIBUTION REPORT	Y	Y	Y	Y

[redacted] [redacted] [redacted]

CITY OF COVINGTON
Office of the City Manager

Community Services
Development
Finance
Fire
Human Resources
Legal
Police
Public Improvements
Section 8 Housing Choice Voucher

February 11, 2014

The Honorable Adam H. Edelen
Auditor of Public Accounts
Commonwealth of Kentucky
209 Saint Clair Street
Frankfort, Kentucky 40601-1817

Re: Response to Examination Report

Dear Mr. Edelen:

On behalf of the Board of Commissioners, City Management and Staff for the City of Covington, we would like to thank you for this opportunity to respond to the Auditor of Public Accounts' (APA) report of the "Examination of Certain Policies, Procedures, Controls, and Financial Activity of the City of Covington."

We appreciate the quick response of your office to the City's request of last August for the special examination. We also appreciate the professionalism and thoroughness that your staff exhibited throughout this process. After reviewing your report, the management of the City remains fully confident in its ability to implement necessary changes, many of which have already occurred and others that are in process, to meet the challenges and deficiencies identified in the report.

The APA set forth in its report that the purpose was to perform a special examination of the alleged theft of funds by the former Finance Director. The APA report accurately describes the conditions of the City's Finance Department at the time of the theft of the funds; however, the City has already made great strides in correcting many of the findings described in the report. The City would like to provide an explanation, management response and Corrective Action Plan (CAP) for each of the findings and recommendations as outlined below. The APA report and CAP will also be submitted to the Mayor's Task Force to Restore Public Confidence, which was established by the Mayor and City Management with approval by the Board of Commissioners last August to "review the City's policies and procedures related to City finances" for its review and recommendations. The Task Force will assist the City by providing independent and objective oversight to the implementation of the CAP. The Task Force includes the Mayor and Mayor Pro Tem; the chair of the City's Audit Committee; a previous Covington Finance Director; Florence

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Finance Director, and citizens, and chaired by retired Kenton County Circuit Judge Douglas M. Stephens. Throughout the management response below we will attempt to explain how the City acted immediately to stop the embezzlement, recover misappropriated funds, and implement changes for greater internal control, and continues to implement procedures to help avoid any and all future circumventions of controls or manipulation of City accounts.

MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN

Finding 1: The former Finance Director wrote 68 checks to himself, his spouse, his aunt, and a vendor under his control totaling $793,127.

Auditor's Recommendations: We recommend the City attempt to recoup the funds that were identified in checks written to the former Finance Director and affiliated parties for fictitious transactions. We further recommend the City strengthen internal controls and accounting processes in the Finance Department to deter and reduce the risk of waste, fraud, and abuse as discussed in findings throughout this report.

The City's Response and Corrective Action Plan:

A. The APA recommends that the City attempt to recoup the funds that were identified in checks written to the former Finance Director and affiliated parties for fictitious transactions.

1. Process to recoup funds. The process to recoup the funds was immediately set in motion upon discovery of the theft. Lawsuits were filed within 10 days of the report of the theft to City management. . The history relating to this process is as follows:

a. On the evening of August 22, 2013, the City Administration was advised by Finance Department employees that they discovered improprieties related to the use of City funds. Within 24 hours the former Finance Director was placed under arrest on the basis of the documentation organized by City Management and the Finance Department staff, which was promptly provided to the Commonwealth Attorney's office. The former Finance Director's access to all City accounts and assets, computers, records and communications was immediately disabled. Minutes after Mr. Due's arrest, the City conducted a press conference to inform the public.

b. On August 30, 2013, a civil lawsuit to recover the City's funds was filed against Bob Due, Janet H. Patterson (spouse of Bob Due), Joseph DeCosimo and Company, LLC, Von Lehman & Company, Inc., U.S. Bankcorp Investments, Inc., Fifth Third Bank, Inc., KVS Information Systems, Inc., Chas H. Bilz Insurance Agency, Inc., Kentucky Retirement Systems, Kentucky County Employment Systems (CERS), Kentucky Retirement Systems, Estate of Virginia Molique, John Does 1-3 and Jane Does 1-3 (Bob

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Due's children) and Unidentified Financial Institutions 1-2. The case is styled *City of Covington, Kentucky vs. Robert James Due*, Third Div., Kenton Cir. Ct., Case No. 13-CI-1846. The lawsuit is pending.

c. On August 30, 2013, an Order Granting Plaintiff's Motion for Temporary Restraining Order Against Defendants Robert J. Due, Janet H. Patterson, John Does 1-3, Jane Does 1-3, and the Estate of Virginia Molique was entered of record in the above case restraining the named parties from alienating any person property, cash, investment securities, business entity interests, or real estate assets without permission of the Court for good cause shown.

d. Proof of Loss Fidelity Bond claims have been filed with the Ohio Casualty Insurance Company, the City's fidelity bond insurer, seeking recovery of the misappropriated funds.

B. The APA recommends that the City strengthen internal controls and accounting processes in the Finance Department to deter and reduce the risk of waste, fraud, and abuse as discussed in findings throughout this report.

1. Findings related to the former Finance Director's control over the Accounting Records. Upon investigating the former Finance Director's fraud, City Management became aware of the weaknesses in Finance Department's internal controls. Management recognizes that the former Finance Director's had complete control of the accounting records and could manipulate accounts. However, the day after Mr. Due's arrest, the City took steps to implement the following measures in order to reduce this risk of future misconduct:

   a. All users of the City's accounting software were instructed to change their passwords.

   b. Check writing privileges were limited to a primary and a backup check writer. All printed checks are manually reviewed, and the check register must be approved by a staff accountant. Moreover, all check registers are placed in a universal drive viewable by all Finance Department staff.

   c. All current and past vendor accounts are reviewed for irregularities including indications of misappropriation.

2. Findings related to the Check Writing Process. The APA's first finding specifically addressed the check writing process. In addition to addressing a variety of internal control risk factors, which will be explained though out the Response, Management has addressed internal control weaknesses related to the check writing process in the following manner:

   a. The City has implemented an improved approval, review and release policy for all checks printed. The City Manager and Finance Director are and will continue to review all requisition reports before these are converted into a

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purchase order. This review process is in line with the expenditure approval process that is currently in place citywide. As was stated above, all check registers are and will be reviewed by the City Manager, and all check registers and supporting documents are subject to the Finance Director's oversight prior to the issuance of any check. Lastly, all checks are and will be initialed by the Finance Director.

b. The City, in conjunction with the current accounting software provider, has begun to implement risk-reducing measures that include restricting the ability to change the vendor payee after a check has been printed. As a preliminary stopgap measure, the City has investigated the possibility of working with banking institutions to implement additional fraud protection measures that would be managed by third parties. Under these processes, cancelled checks would be reviewed and subject to payee verification pursuant to the bank's external reconciliation processes.

c. Only two individuals have the ability to print checks in the Finance Department, the Accounts Payable Manager and the Payroll Specialist. This feature was changed by Management immediately after it discovered the former Finance Director's fraud. Since that time, the check stock is guarded, password protection is required, and the Accounts Payable Manager and Payroll Specialist are the only individuals who can print checks. For their part, passwords must be changed every 90 days, approved check registers are scanned and saved, and the check number sequence is monitored. As an additional safeguard, the software warns of repeat check numbers and ensures that check numbers are kept in sequential order.

d. The New Vendor setup function has been restricted to select individuals and preapproval processes are being developed to help reduce the risk of fraudulent vendor setup. Importantly, the Finance Director no longer has full access to the financial accounting software, and sharing of passwords among Finance Department staff members is strictly prohibited.

Finding 2: The Finance Department had lax internal controls, which increased opportunities for misappropriation of assets.

Auditor's Recommendations: Because the Finance Department has such significant internal control weaknesses, the City should implement improvements as soon as possible. These include: develop policies and procedures to address all significant functions of the Finance Department: segregate duties; create job descriptions for Finance Department staff; train employees adequately; implement sufficient supervisory review of key functions accounting and budgetary activities.

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City's Response and Corrective Action Plan:

A. The APA recommends developing policies and procedures to address all significant functions of the Finance Department and to update these policies and procedures regularly.

1. Department Policies and Procedures. The City is in the process of developing a new updated accounting procedure manual. This document will be a living document that reflects the changes that are currently taking place and that accounts for the evolution that the Department will experience.

2. Segregation of Duties: Management, in conjunction with the Finance Department has begun segregating duties so that no one person can both create and conceal fraudulent activity or commit a material error that would go undetected. Access to specific functions will have restrictions.

3. Staff and Accounting Professionals: In order to implement the above changes, the City has created new positions, and has hired, or is the process of hiring qualified individuals to fill those positions as follows:

   a. An Internal Auditor position was created in the City Manager's recommended FY 14 budget, which was adopted by the City in June of 2013, two months before the embezzlement was detected.

   b. An Interim Finance Director was hired effective September 3, 2013, with 34 years of County Finance experience and of impeccable character;

   c. A permanent Internal Auditor, a new position within the City, was hired effective December 30, 2013, who is responsible for reviewing and ensuring that city-wide policies and procedures are followed;

   d. A permanent Finance Director, with government accounting and public audit experience, a Certified Public Auditor who assumed her duties on January 2, 2014; and

   e. An Assistant Finance Director, a new position within the Finance Department that will augment the Department's supervisory and oversight functions, who begins work with the City in February, 2014.

After assessing current staff's job functions and hiring a new Revenue Manager (imminent) the City is confident that proper segregation of duties can be accomplished. Under the current Finance Department setup, duties are segregated as appropriate and possible.

4. Finance Department Job Descriptions. Create job descriptions outlining duties that have been assigned to each position and provide these documents to employees.

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The City did have job descriptions for Finance Department positions, and all staff members have a copy of his or her applicable job description. Each employee was directed to write a list of his or her job tasks by the new Finance Director for further assessment. Job descriptions will be reviewed and maintained as necessary.

5. Employee Training. Train employees to ensure that each understands both the activities and the accounting principles needed for his and position.

    a. The City is committed to providing current and future staff with the tools and support that are necessary for employees to effectively perform their newly defined duties. As a priority measure, the Finance Director has scheduled an on-site accounting software demonstration that will be held this month.

6. Supervisory Review. Implement sufficient supervisory review of key functions and activities, and ensure managers clearly understand their roles in the supervisory process. As part of the implementation of the new accounting manual and the revisions to the organizational chart, the Finance Director is committed to training and educating managers on the importance of segregating duties, and the necessity for maintaining of internal controls.

7. Reorganization of the Finance Department. Management in conjunction with the Director of Finance has undertaken the reorganization of the Finance Department paying specific attention to the implementation of an effective chain of command and supervisory processes.

8. City Management Oversight. For its part, the City Manager's Office has increased its oversight of the Finance Department's accounting and budgetary activities, since the breach of confidence by the former Finance Director in the following notable ways:

    a. The City Manager is now reviewing all purchase requisition reports and all check registers.

    b. No checks are released without the approval of both the City Manager and Finance Director of the City.

    c. The City Manager is also involved in all budgetary meetings and planning sessions with all Department heads. The City's budget process and format is going through a complete overhaul that will provide much more transparency and accountability.

9. Transparency. The City holds monthly Finance Committee meetings open to the public, Commission, and Department directors.

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Finding 3: The former Finance Director also acted as IT Administrator.

Auditor's Recommendations: The City should consider hiring a separate IT Administrator that reports directly to the City Manager. This function should not be under the control of the City's Finance Director. The City should also consider hiring a consultant to help evaluate the appropriate level of access for each employee within the City. Within the Finance Department, key functions, such as vendor creation/update duties, check processing, et cet. should be properly segregated and protected so employees with non-compatible job duties do not have unauthorized access. The Finance Department should also implement procedures for documenting and maintaining information related to all vendor file changes.

City's Response and Corrective Action Plan:

A. The APA recommends that the City should consider hiring a separate IT Administrator who reports directly to the City Manager. This function should not be under the control of the City's Finance Director.

   1. Actions taken concerning IT Administration. The City has identified this deficiency as well, and on February 4, 2014, the City Commission approved a Job Description for an Information Technology and Data Manager who will report directly to the City Manager. The new position is being advertised regionally and some interviews have already been scheduled with prospective candidates.

B. The APA recommends that the City should consider hiring a consultant to evaluate the appropriate level of access for each employee within the city.

   1. The City will assess this need, along with the Information Technology and Data Manager, once the position is filled.

C. The APA recommends that the Finance Department segregate duties so that employees with non-compatible job duties do not have unauthorized access to key accounting functions.

   1. This segregation of duties will be better assessed and implemented with new key staff in place. See Finding 2 above.

D. The APA recommends that the Finance Department implement procedures for documenting and maintaining information related to all vendor file changes.

   1. The Finance Department has started to work on upgrading its software. In addition to the new features that are mentioned throughout this Response, the accounting software will be programmed to provide a transaction history for records and any events including changes that occur in vendor files.

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Finding 4: Numerous Weaknesses Related to Purchasing and Payables were Identified.

Auditor's Recommendations: We recommend the City: update purchasing policies and procedures manual; develop a policy to address checks processed between check runs and determine what circumstances would necessitate a special check run; reevaluate the dual signature system for checks, and implement policies and procedures to insure the control is working as intended; account for all checks in numerical sequence by maintaining a check register or other check log system; limit vendor creation and vendor file changes to authorized personnel; improve system security to prevent users from accessing another user's identification; segregate the IT Administrator from the Finance Department; ensure procedures exist to maintain sufficient, accurate, supporting, approved documentation.

Recommendations and the City's Response and Corrective Action Plan:

A. The City should update purchasing and policies and procedures manual.

   1. The Finance Director has begun the process of drafting a manual of purchasing policies and procedures for the Department.

B. The APA recommends that the City should develop a policy to address checks processed between check runs and determine what circumstances would necessitate a special check run.

   1. As the current policy states, checks are run once a week. Special check runs would be rare and necessary in only emergency situations.

C. The APA recommends that the City should reevaluate the dual signature system for checks, and implement policies and procedures to insure the control is working as intended.

   1. The Finance Director reviews all supporting documentation for all check runs and initials all original checks. The City Manager reviews all check registers prior to release of checks. No checks are released from the Finance Department, unless they are approved by both the Finance Director and City Manager.

D. The APA recommends that the City should account for all checks in numerical sequence by maintaining a check register or other check log system.

   1. The Finance Department has already implemented steps to account for all checks. Before a check is printed, the number of the first check to be printed is reconciled with the last number of the previous check run to ensure that the check sequence is maintained. The check register accounts for each series of checks that are printed is then recorded on the paper and scanned as a "check log." The Finance Director maintains an independent check log detailing the number of the checks used for each check run.

E. The APA recommends that the City should limit vendor creation and vendor file changes to authorized personnel.

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1. Under the current policy, Purchasing is the only division of the Finance Department that can create new vendors.

F. The APA recommends that the City should improve system security to prevent users from accessing another user's ID. All City staff members have been advised not to share user ID's or passwords.

1. Passwords are required to be changed every ninety (90) days.

G. The APA recommends that the City should segregate the IT Administrator from the Finance Department.

1. The City has developed a job description for an Information Technology and Data Manager who reports directly to the City Manager. At the February 4, 2014 Commission meeting, the Mayor and Commission approved this position. Interviews are scheduled for the placement of this individual.

H. The APA recommends that the City should ensure procedures exist to maintain sufficient, accurate, supporting, approved documentation.

1. The Interim Finance Director issued a Procurement Memo on October 16, 2013, establishing the following process for procurement policies:

   a. All purchases over $100 must be entered and approved by the Finance Department before anything is purchased over $100.

   b. All requisitions approved over $5,000 but less than $20,000. Any department originating a transaction over $5,000 but less than $20,000 must attach three written quotes to the voucher/invoice that must submitted to Finance before payment will be issued.

   c. Departments cannot enter into a legal contract without approval by the Legal Department or without sending a copy of the contract to Finance.

   d. Requisitions entered over $20,000 must have the Order/Resolution number on the requisition denoting approval by the City Commission

   e. All items entered on a requisition must be detailed on the detail screen.

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Finding 5: The City should improve revenue and collections procedures.

Auditor's Recommendations: We recommend: all mail addressed to the City should be opened by designated staff in each Department, with all checks removed and processed in the regular daily deposit process; the Revenue/Collections Manager should determine the source of unknown revenue and provide accurate accounting coding to staff to ensure that all revenue received by the City is properly recorded and deposited; all revenue should be processed by designated revenue/receipts staff and be included in the daily deposit. All revenue should be posted to consistent account codes approved by the Revenue/Collections Manager; all checks should be stamped with a restrictive endorsement as soon as they are processed; appropriate segregation of duties should be implemented in regards to bank receipts and deposits; the City should develop a formal process for any Department that collects funds from the public; the City should determine whether the accounting system can be modified to include the needed components to identify and track delinquent taxpayers, or if a stand-alone system to handle the process is feasible. Effort should be made to get delinquent tax collections up-to-date.

City's Response and Corrective Action Plan:

A. The APA recommends that all mail addressed to the City should be opened by designated staff in each Department with all checks removed and processed in the regular daily deposit process.

   1. The Finance Director, within the first several days of her employment, distributed a memo to all departments stating in relevant part that: "All checks received by any Department will be stamped for restrictive endorsement for deposit only and logged. They should then be immediately transferred to the Finance Department in a clearly marked inter-office mail envelope." A check logging system has been established that accounts for any and all monies that do not go through the Collections window in the Finance Department. Finance Department staff that is responsible for opening mail must log checks the same day in a check log against which deposits are cross-referenced. As an added safeguard, the person logging the checks is separate from the person preparing and making deposits. The log is then included with all deposit details to ensure that all checks received in the Finance Department are deposited timely.

B. The APA recommends that the Revenue/ Collections Manger should determine the source of unknown revenue and provide accurate accounting coding to staff to ensure that all revenue received by the City is properly recorded and deposited.

   1. The City is implementing a new Finance Department staffing structure that accounts for a Revenue Manager who will be responsible for and in charge of all accounting coding and for providing guidance to all Finance Department staff regarding the appropriate code to use when recording transactions. The Finance Department will also develop a revenue manual for staff to reference.

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C. The APA recommends that all revenue should be processed by designated revenue/receipts staff and be included in the daily deposit. All revenue should be posted to consistent account codes approved by the Revenue/Collections Manager. All checks should be stamped with a restrictive endorsement as soon as they are processed. Appropriate segregation of duties should be implemented in regards to bank receipts and deposits.

1. As described in Finding 5, (a) above, the City has implemented measures to improve the revenue collection and daily deposit processes. The individual preparing the deposit slip is cross checked by a separate individual and total receipts are included with deposit support. Moreover, all receipts for the Finance Department are processed in the same batch. Separate trips to the bank with deposits should be rare, at best.

D. The APA recommends that the City develop a formal process for any Department that collects funds from the public.

1. The Memo described in Finding 5 (a) above states that all receipts from the public need to be directed to Finance immediately. Staff should not be collecting cash from the public. All cash should run through the Finance Department. If the occasion arises for staff to collect funds from the public, then pre-numbered receipts will be made available for staff to use. The individual will receive a receipt for the money they remitted to the City.

E. The APA recommends that the City determine whether the accounting system can be modified to include the needed components to identify and track delinquent taxpayers, or if a stand-alone system to handle the process is feasible. Efforts should be made to get delinquent tax collections up-to-date.

1. As part of the City's plans for the overhaul the Finance Department, the City intends to implement industry standard tax tracking technologies to facilitate the timely collection of delinquent accounts. The City Finance Director is in the process of obtaining quotes from providers of specialized tax collection modules, which could be integrated into and facilitate the operations of the Finance Department. The City plans to modernize and reorganize the Tax Department. The plan will utilize more efficient technologies, and the use of a lock box for depositing revenue.

2. The Legal Department is working with the Finance Department to implement modernized collection procedures. An additional Assistant City Solicitor position has been created in part to assist both departments with collections generally, including the collection of delinquent tax accounts.

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Finding 6: Internal Controls over bank accounts, bank reconciliations, and adjusting journal entries need improvement.

Auditor's Recommendations: We recommend: an accurate list of bank accounts be maintained; bank reconciliations should be prepared for all accounts on a monthly basis upon receiving the bank statements, and should be reviewed for completeness and accuracy by a supervisor. Procedures should exist to properly investigate and correct reconciling differences; adjustments that result from bank reconciliations should be posted by someone other than the person performing bank reconciliations, and should be reviewed and approved by a supervisor before they are posted. Journal entries should be prepared promptly and accurately, and they should have accurate descriptions and sufficient reporting documentation to justify the entry.

City's Response and Corrective Action Plan:

A. The APA recommends that an accurate list of bank accounts should be maintained.

   1. The City has a complete list of all bank accounts. All bank accounts with the City's primary bank are listed and accessed online and monitored on a daily basis by the Finance Director. The City Manager also has online access for only reviewing the bank accounts.

B. The APA recommends that bank reconciliations should be prepared for all accounts on a monthly basis upon receiving the bank statements, and should be reviewed for completeness and accuracy by a supervisor. Procedures should exist to properly investigate and correct reconciling differences.

   1. Online banking allows for bank statements to be available within a day of month's end. Procedures will be implemented to ensure that all account activity is recorded daily by either receipt module procedures or disbursement modules. Journalizing bank activity will be limited. A separate bank account already has been established for emergency ambulance services' billing receipts. This activity will then be removed from the main general account to further limit the number of transactions needed to be accounted for daily in the main checking account. Bank reconciliations are currently reconciled within the month.

C. The APA recommends that adjustments which result from bank reconciliations should be posted by someone other than the person performing the bank reconciliations, and should be reviewed and approved by a supervisor before they are posted. Journal entries should be prepared promptly and accurately and should have accurate descriptions and sufficient supporting documentation to justify the entry.

   1. Steps are being taken to ensure that all journal entries will be posted in a timely manner and reviewed by the Finance Director. In the future, they will also be reviewed by the Assistant Finance Director.

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Finding 7: The City should improve internal controls and oversight for pension funds.

Auditor's Recommendations: We recommend the City review the Actuarial Valuation Report provided by Fund Evaluation Group and implement the board's recommended annual contributions for each fund. When funding is not sufficient to meet its annual required contributions, the minutes of the City Commission should clearly identify its funding decision. Also, the Finance Department should ensure accurate financial reports are provided to the pension board of trustees and City Commission. In addition, the City should establish procedures for sound internal controls and sufficient oversight to ensure the accounts are being managed as intended.

City's Response and Corrective Action Plan:

A) The City Commission has not made contributions to the Pension Plan in recent years by choice. In the FY 13/14 budget proposed by the City Manager and adopted by the City Commission, an annual contribution as calculated by the Fund Evaluation Group to satisfy the current unfunded liability in twenty years was included. While not a required contribution, the City approved $384,806 for the Police and Fireman's Pension Fund and $148,843 for the City Employees' Pension Fund. The City Manager will continue to propose an appropriate level of annual contributions in future City budgets.

B) The composition and operation of the Police and Fire Board is defined by KRS Chapter 95, which also designates the Finance Director as the custodian of all cash and securities of the fund. The composition and operation of the City Employee (non-uniformed) is defined in Chapter 34 of the City Code of Ordinances and mirrors that of the Police and Fire Board except for a difference in board trustees.

C) Monthly benefits are paid from the City General Fund and repaid by the Pension Funds with periodic withdrawals from the Pension Fund investments.

D) While not individually responsible for the management of the Pension Plans, the Mayor and City Manager attend all meetings of the two Boards and were instrumental in gaining approval of the additional funding for the Pension Plans by the City Commission in the current year budget adopted June, 2013.

E) Monthly reports are provided to the Pension Board of Trustees on payment of benefits, investment earnings and fund totals as well as minutes of the prior month minutes. The Board is also provided copies of the investment report

<u>Footnote:</u> The information in this finding is inaccurate and not a reflection of the real and statutory requirement for operations of the Pension Plans. The Pension Plans are operated by a board of Trustees, not the City Commission, nor the City Manager.

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Finding 8: The City should improve accounting and accountability for the Devou Park Funds

Auditor's Recommendations: We recommend: the City should implement policies and procedures to ensure that all revenue and expenditures related to projects at Devou Park are coded accurately; the new Finance Director should meet regularly with the Programs and Strategic Projects Division Manager to compare actual expenditures to budgeted expenditures. Because the funds are received from a third party and are restricted for a specific use, an effort should be made to ensure the funds are only expended on approved projects; when reimbursement or fund distribution requests are made, the City should provide a report of expenditures and progress on approved projects to the oversight boards; the City should ensure that control of these funds is not limited to a single person without oversight or review.

City's Response and Corrective Action Plan:

A. The APA recommends that the City should implement policies and procedures to ensure that all revenue and expenditures related to projects at Devou Park are coded accurately.

   1. The City's new Finance Director and City Manager will work with the Devou Properties, Inc. Board to determine policies and procedures for these funds.

B. The APA recommends that the new Finance Director should meet regularly with the Programs and Strategic Projects Division Manager to compare actual expenditures to budgeted expenditures. Because the funds are received from a third-party and are restricted for a specific use, an effort should be made to ensure the funds are only expended on approved projects.

   1. The City's new Finance Director and City Manager have already scheduled meetings with this Division Manager and members of the Devou Properties, Inc. Board.

C. The APA recommends when reimbursement or fund distributions requests are made, the City should provide a report of expenditures and progress on approved projects to the oversight boards.

   1. The Finance Director and City Manager will work with the Devou Properties Inc. Board in the future to determine current report processes and delegation of tasks.

D. The APA recommends the City should ensure that control of these funds is not limited to a single person without oversight or review.

   1. The City's Finance Department is currently implementing staff reorganization in order to establish a better segregation of duties that will be realized over time with the addition of new key staff. No one person will have full control over any aspect of Devou Park funds.

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Finding 9: The City did not have a credit card policy and did not properly track issued cards.

Auditor's Recommendations: We recommend the City adopt a credit card policy that includes specific identification of unallowable expenses, detailed listing of any expenses requiring management approval prior to use, requirements that the credit card receipt be signed and reviewed by the employee's supervisor, requirement for Finance staff to reconcile credit card receipts to the statements, and requirements that employees are responsible for reimbursing the City for any unsupported expenditures; we also recommend the City implement procedures to obtain and maintain a list of all credit cards issued to employees, and also identify and maintain a list of all approved users and supervisors.

City's Response and Corrective Action Plan.

A. The APA recommends that the City adopt a credit card policy that includes specific identification of unallowable expenses, detailed listing of any expenses requiring management approval prior to use, requirements that the credit card receipt be signed and reviewed by the employee's supervisor, requirement for Finance staff to reconcile credit card receipts to the statements, and requirements that employees are responsible for reimbursing the City for any unsupported expenditures.

    1. The City has a master list of all credit cards, credit limits and authorized users. There are five credit cards issued to the City of Covington. Elected officials and City management do not have credit cards. Credit cards are issued to certain staff for the purpose of ordering departmental supplies and booking of travel. Credit card purchases follow the policies of the Procurement Memo outlined in Finding 4 (h). All transactions are supported by the original, itemized receipt. The Finance Director and the City Manager review all transactions before a check is issued paying off the credit card balance at the end of every month. The City does not have any credit card debt extending beyond the applicable month of the transactions.

B. The APA also recommends that the City implement procedures to obtain and maintain a list of all credit cards issued to employees, and also identify and maintain a list of all approved users and supervisors.

    1. The City retains a master list of all credit cards, approved users and limits.

Finding 10: Payroll duties were not adequately segregated and personal information related to payroll was not maintained in a secure manner.

Auditor's Recommendations: We recommend the City take the following actions: Duties should be segregated so that payroll employees do not have the ability to add new employees to the payroll module or change pay rates. Also, adequate supervisory review should be implemented, and the review should be documented and maintained. Computer access should be restricted so that only necessary personnel can add new employees and change pay rates; payroll reports and personnel files contain secure information that should be restricted to only those

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involved in the payroll and human resources process. Personnel files should be maintained by Human Resources, but access should also be restricted to only those who work in that area.

City's Response and Corrective Action Plan:

A. The APA recommends that duties should be segregated so that payroll employees do not have the ability to add new employees to the payroll module or change pay rates. Also, adequate supervisory review should be implemented, and the review should be documented and maintained. Computer access should be restricted so that only necessary personnel can add new employees and change pay rates.

   1. The new Finance Director is developing alternative solutions for payroll processing for the City. Quotes are being obtained for outside payroll processing service companies. If software is utilized from a third party it is planned that the Human Resources Department would enter new employee information upon hire as approved by Commission or City Ordinance. Human Resources would enter all payroll pay rate increases. The bi-weekly adjustments will be supported by approval documentation from the City Manager, entered by the Finance Department payroll specialist and submitted to the Finance Director for review and approval before processing. The Accounting Manager uploads the files for distribution to the banking solution, and the Finance Director approves the Automatic Clearing House transfers. If payroll stays in house processed by the Finance Department, new software will be utilized that will allow for Human Resources to enter new employee data and track and setup all human resource data electronically. Decisions regarding this move are being reviewed and will follow the procurement procedures of the City.

   2. In addition, the new Finance Director immediately after hired conducted a cross check of payroll records with Human Resources Department records.

B. Payroll reports and personnel files contain secure information that should be restricted to only those involved in the payroll and human resources process. Personnel files should be maintained by Human Resources Department but access should also be restricted to only those who work in that area.

   1. The City moved into the new City Hall in November of 2013. The electronic security of the new building allows for only approved access into the Finance Department and also records the names, dates and times of all who enter. Very few individuals are given access to the Finance Department. "Employee Only" signs have been installed on all entrances to the Department. All payroll registers are filed in lockable file cabinets in an office that has a lockable door. All old payroll data is filed in lockable cabinets or boxes in a Finance Department storage room with limited access. At previous City Hall, non-employee access to Finance Department offices was eliminated by order of the City Manager the next business day after arrest of the former Finance Director.

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Finding 11: Accounting Procedures are unclear, increasing the risk of undetected errors.

Auditor's Recommendations: We recommend the City update accounting policies and procedures to address these weaknesses, including the following: the use of "Due to/Due from" entries should be eliminated as routine transactions in favor of a more direct, transparent approach to posting cash deposits. "Due to/Due from" entries should be used sparingly, and transfers should be documented and reviewed/approved by a supervisor before the entry is made; checks should only be written from disbursement accounts, with the exception of instances permitted by accounting principles; policies and procedures should identify the circumstances that would necessitate the use of adjusting journal entries. Entries should only be created and posted by authorized personnel, only after supervisory review and approval.

City's Response and Corrective Action Plan:

A. The APA recommends that the use of "Due to/Due from" entries should be eliminated as routine transactions in favor of a more direct, transparent approach to posting cash deposits. "Due to/Due from" entries should be used sparingly, and transfers should be documented and reviewed/approved by a supervisor before the entry is made.

   1. The City's use of "Due to/Due from" entries has been the complexity of many issues in the Finance Department. The new Finance Director will find ways to minimize the use of these transfer entries. If an entry is made, it will be based on review and approval by the Finance Director.

B. The APA recommends that checks should only be written from disbursement accounts, with the exception of instances permitted by accounting principles.

   1. The City should only write checks from disbursement accounts. The new Finance Director will review past practice and make sure that the exceptions are only as permitted by accounting principles.

C. Policies and Procedures should identify the circumstances that would necessitate the use of adjusting journal entries. Entries should only be created and posted by authorized personnel, only after supervisory review and approval.

   1. As the City develops its new accounting manual, the policies and procedures surrounding the necessity for the use of adjusting journal entries will be clarified. Journal entries will only be created and posted by authorized personnel after supervisory review and approval.

Finding 12: The City should improve oversight of processes outsourced to third party organizations.

Auditor's Recommendations: We recommend the City improve oversight of third party organizations by implementing internal controls to ensure a sufficient review of documentation and reconciliation to actual cash received or paid.

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City's Response and Corrective Action Plan:

A. APA recommends the City improve oversight of third party organizations by implementing internal controls to ensure a sufficient review of documentation and reconciliation to actual cash received or paid.

1. The City requires its parking management contractor to report all revenues and expenditures. The City plans to utilize the newly established position of Internal Auditor to assess the procedures that the City's parking management contractor is using by including it in the current citywide risk management analysis being performed by the Internal Auditor.

2. The City utilizes Intermedix for emergency ambulance services' billing and collections. The City will request an independent auditor's report for review. The monthly transactions will all go through one newly created depository account for easier accounting and review practices.

3. The City utilizes MedBen for its self-insured health insurance claims processing. The Finance Director meets with representatives and Human Resources on a quarterly basis to help monitor the City's claim history and risk assessments. Every draw on the City's medical benefits account for claims is supportable by MedBen.

We are pleased that in many of the management responses above, changes have already occurred, and others are in the process. In addition to what has been noted above, the Board of Commissioners adopted in its current budget the funding for a new position, Internal Auditor, two months before Bob Due's embezzlement was detected. The Internal Auditor position was filled as of December 30, 2013, with an experienced Internal Auditor and Certified Fraud Examiner from Louisville Metro government. This new position will help to ensure that new accounting policies and procedures adopted by the Finance Department and all other City Departments are observed. Further, a hotline is being established by the City for employees to report fraud. The Task Force was already discussing such a tool, and their support was affirmed after hearing speakers at your Good Government Summit in the fall of 2013 who attested to the importance of such a tool for employees to anonymously report theft and fraud in the workplace. Also, the City solicited new bids for an external auditor for our FY 13 annual audit, at the recommendation of the Task Force, and contracted with a public auditing firm that had no previous relationship with the City.

The City and its citizens have experienced a serious and damaging breach of trust by its former Finance Director. There is perhaps no more serious offense than that of public officials betraying the public trust. This breach began in 2001 long before any of the City's current management staff or elected officials were in office. The quick actions of City staff and management when the breach of trust was uncovered are commendable. This breach was uncovered solely due to the courage of the Finance Department staff who came forward to report on the illicit activities of their Director, a Director who kept the Finance Department in the dark ages of accounting

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processes in order to perpetrate a fraudulent scheme to steal money, for his own personal gain. This money was stolen from the hard working citizens of Covington.

The City of Covington's Finance Department needs a complete and total overhaul. This is evident by the long list of internal control issues that the State's auditors have documented. As noted within by the City, that process is already well under way.

In addition to the embezzlement by our former Finance Director, Covington, like other communities has endured a difficult national and local economy. The Board of Commissioners has made difficult changes in the past two years in the City's organizational structure and budget to adjust to economic changes and to position itself for future growth, and is now on the move upward again with renewed emphasis on investment in community infrastructure, neighborhood revitalization, riverfront development, and economic development. In its almost 200 year history, Covington has survived floods, tornadoes, civil war and martial law. It will survive the embezzlement by our former Finance Director, and be better for it in the long term.

Our new Finance Director for the City of Covington has made it her mission to work with City Management and the Board of Commissioners to reform completely the City's financial operations. The Board of Commissioners has already demonstrated their total commitment to reform by appointing the new Director, and supporting new positions of Assistant Finance Director and Information Technology and Data Manager. The City's Finance Department needs new direction to accomplish the many tasks at hand. The addition of an experienced auditor as the Assistant Finance Director, a new Revenue Manager, a city-wide Information Technology and Data Manager, and a procurement manager will all work together to develop a strong financial operation for the City. The goal is nothing less than to have a City Finance Department that will be viewed in the future as one of the most credible in the Commonwealth of Kentucky and one to whom other municipalities look to for best practices.

The Mayor, City Commissioners, City Manager, and Finance Director want to thank the APA and your staff again for your efforts in conducting this examination, and we appreciate the professionalism of your office in handling this matter. Please let us know if you have any additional questions or would like more supporting information.

Sincerely

Sherry Carran Larry Klein Lisa A. Goetz

Sherry Carran Mayor City of Covington, Kentucky	Larry Klein City Manager City of Covington, Kentucky	Lisa A. Goetz, CPA Finance Director City of Covington, Kentucky

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AUDITOR'S REPLY TO EXAMINATION RESPONSE

FROM THE CITY OF COVINGTON

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In its response to Finding 7, the City included a footnote stating, "The information in this finding is inaccurate and not a reflection of the real and statutory requirement for operations of the Pension Plans. The Pension Plans are operated by a board of trustees, not the City Commission, nor the City Manager." The detail in Finding 7 reflects the creation of the board of trustees for both pension funds, and therefore the assumption is the language the City took exception to is the statement that the City currently manages the pension funds. Although we acknowledge that the direction of the plans is provided by the boards of trustees, funding decisions are made by the Commission, as noted in the City's response. We understand those funding decisions are at the discretion of the Commision; however, auditors were unable to tell by minutes of Commission meetings or other information available whether the lack of funding was the City's decision or an act of the former finance director regarding funding matters. This highlights the impairment created by the lack of segregated duties, as well as weaknesses in documentation.

Furthermore, the former finance director was responsible for accounting for the pension funds on behalf of the boards of trustees. This duty could not be segregated from his role as finance director. It is not reasonable to assume that the former finance director was tasked with the role as "custodian of all cash and securities" of the pension funds, but that the City Manager who oversees the finance director is not involved. Also, there likely was an assumption by the boards of trustees that the work of the former finance director on their behalf was not unsupervised. A belief that the activity was being managed correctly with appropriate supervision may explain why the boards did not insist on regular reporting.

This is further evidenced in guidance the City received from the Internal Revenue Service (IRS) for tax year 2009. In its examination of the City's employment tax responsibilities, the IRS identified certain individuals receiving both forms W-2 (for employees) and 1099-Misc (nonemployee compensation) due to compensation the employees were receiving for other duties. The IRS clarified that unless at a minimum an employee performed additional duties as part of a bona fide self-employment activity and the services would have absolutely no connection to the existing employer-employee relationship, the wages received for those duties are still employee wages. The former finance director was tasked with responsibilities related to the pension funds primarily because of his role as finance director, and did not constitute a self-employment activity or activity having no connection to his employer. Even though the IRS examination was related to wage reporting, this same logic should apply to supervision and oversight of employee activities.

Therefore, we reiterate that the accounting for pension funds performed by the finance director or any other employee of the City should adhere to internal controls established for all other activities of the employee, including adequate monitoring and supervision.