

**EXAMINATION OF
SPECIFIC FINANCIAL ACTIVITY OF
KENLAKE STATE RESORT PARK**



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CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS

Transmittal Letter

July 30, 2008

Tourism, Arts and Heritage Cabinet
Kentucky Department of Parks
Kenlake State Resort Park
Gerry van der Meer, Commissioner

The Department of Parks contacted the Office of Auditor of Public Accounts regarding the theft of funds from Kenlake State Resort Park. We were asked to perform an examination at the park to determine the amount of misappropriated funds, examine the internal control structure at the Park, and make recommendations that would reduce the risk that this type of fraud could occur in the future.

Examination procedures to determine the amount of missing funds included analyzing daily business reports, deposit information, and other supporting documentation for the period September 1, 2005, through February 29, 2008. We also examined records prior to September 2005 on a test basis.

In addition, we conducted interviews with the Kenlake State Resort Park personnel, as well as the Department of Parks personnel. Detailed examination findings regarding these issues and recommendations to strengthen the Kenlake State Resort Park's internal control structure are presented in this report.

We have referred this report to the Kentucky State Police for further consideration and any further action that they may deem necessary.

Respectfully submitted,

A handwritten signature in cursive script that reads "Crit Luallen".

Crit Luallen
Auditor of Public Accounts



Tourism, Arts and Heritage Cabinet
Kentucky Department of Parks
Kenlake State Resort Park

Introduction

The Department of Parks contacted the Office of Auditor of Public Accounts regarding the theft of funds from Kenlake State Resort Park (Park). We were asked to perform an examination at the Park to determine the amount of misappropriated funds. Also, we were requested to examine the internal control structure at the Park, and make recommendations that would reduce the risk that this type of fraud could occur in the future.

Background Information

In February 2008, the business office manager and front desk supervisor at the Park discovered accounts receivable checks that were not posted properly to customer accounts. After further investigation, they became highly suspicious that fraud was being committed at Kenlake State Resort Park. At that point, the Department of Parks was contacted and their internal audit staff was brought in to investigate. After limited procedures were performed, the internal audit staff uncovered a lapping scheme of accounts receivable that was being committed by a business office employee with \$53,000 – \$55,000 in accounting inconsistencies being noted. The Kentucky State Police was promptly notified.

Based on information obtained from the Audit Reviewer/Specialist for the Department of Parks, funds were misappropriated by lapping of accounts receivables. Accounts receivable checks that were received through the mail were being inserted into the daily business transactions without being posted to customer accounts. As checks were inserted into the daily business activity, the same amount of cash was withheld from the daily deposits in order to balance that day's deposit with the Daily Business Report. Eventually other accounts receivable checks were used to cover the accounts of those customers whose checks had been misappropriated, or in some cases, the account was satisfied with a credit posted to the customer's account.

Summary of Procedures

At the request of the Department of Parks, representatives from the Auditor of Public Accounts performed examination procedures, which included examining and analyzing daily business reports, deposit information, and other supporting documentation for the period September 1, 2005 through February 29, 2008. We also examined records prior to September 2005 on a test basis.

In order to determine the amount of misappropriated funds, we performed a recap of each day's cash intake and compared that amount to the amount of cash that was actually deposited. Any variances noted in these comparisons were further investigated. Also, as part of obtaining assurance regarding our findings, we examined the accounts receivable aging report as of February 27, 2008. The findings relating to these procedures are summarized on page 3.

In order to obtain an understanding of the internal control structure, we conducted interviews of park employees. Inquiries were made regarding employees' responsibilities, standard park procedures, and also management's oversight of daily operations. The findings of these procedures are detailed and discussed beginning on page 4.

Tourism, Arts and Heritage Cabinet
Kentucky Department of Parks
Kenlake State Resort Park
(Continued)

Misappropriated Funds

Based on the available records, we have documented \$74,803 of misappropriated funds from September 2005 through February 2008. The amount of misappropriated funds may be greater than the amount we have documented due to weaknesses noted in the internal control system and the overall openness of the system. One way, the misappropriated funds went undetected, was the falsification of vendor account receivable balances. We examined the accounts receivable aging report as of February 27, 2008 and we were able to verify that \$61,555 had already been paid or adjusted. The amounts due from specific vendors were overstated.

The monthly totals of misappropriated funds are summarized in the following table:

<u>Monthly Totals</u>	<u>Misappropriated Funds</u>
September 2005	\$ 1,250
October 2005	519
November 2005	2,244
December 2005	1,018
January 2006	2,226
February 2006	400
March 2006	1,550
April 2006	1,791
May 2006	2,894
June 2006	3,166
July 2006	4,726
August 2006	1,957
September 2006	3,678
October 2006	6,070
November 2006	1,708
December 2006	1,467
January 2007	901
February 2007	1,664
March 2007	2,257
April 2007	3,294
May 2007	5,612
June 2007	1,075
July 2007	627
August 2007	4,525
September 2007	4,191
October 2007	6,559
November 2007	5,334
December 2007	1,350
January 2008	218
February 2008	532
Total Misappropriated Funds	<u>\$ 74,803</u>

Kenlake State Resort Park Should Strengthen Internal Controls Over Its Business Operations

During our review of internal controls as a result of a loss of funds through apparent theft at Kenlake State Resort Park (Park), we noted the following issues:

1. Inadequate segregation of duties;
2. Lack of independent reconciliations of financial information and lack of adequate supervisory review;
3. Failure to conduct internal audits;
4. Lack of routine performance reporting; and
5. Improper accounting of certain transactions.

Each of these weaknesses is discussed below.

1. Inadequate Segregation of Duties.

The situation at the Park is a classic example of failure to adequately separate duties among different employees so that the risk of theft or loss is minimized. The alleged fraud occurred as a result of one employee having the “keys to the kingdom”. This employee, who was an accountant, handled all money, created bank deposits, had access to all accounts, posted information to all accounting records, prepared bills, paid bills, and opened the mail, all with little or no management oversight. Thus, the accountant had complete control of all of the functions of the accounting system and deposits of funds.

The objective of segregation of duties, a key component of internal control, is to ensure that assigned duties are separated such that no one employee or group of employees is in a position both to commit and/or conceal errors or irregularities in the normal course of performing their assigned duties. In general, the principal incompatible duties to be segregated are:

- Authorization of transactions;
- Custody of assets; and
- Recording or reporting of transactions.

Adequate segregation of duties reduces the likelihood that errors, either intentional or unintentional, will remain undetected. This is carried out by providing for separate processing by different individuals at various stages of a transaction and for independent reviews of the work performed.

Staffing shortages attributed to the ability of one employee having the opportunity to get away with this fraudulent activity for over two years. Even with staffing issues, procedures should have been in place to address an appropriate level of segregated duties.

Tourism, Arts and Heritage Cabinet
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Examination of Internal Controls
(Continued)

Kenlake State Resort Park Should Strengthen Internal Controls Over Its Business Operations
(Continued)

1. Inadequate Segregation of Duties. (Continued)

Cross-training initiatives and job rotation among all functions are difficult to attain with staff shortages, but should be considered as a means to reduce the risk of fraud. Adequate segregation of duties assures the following:

- Fundamental controls over cash and receipt activity are in place;
- Appropriate authority levels are in place;
- Reconciliation of financial information is being performed;
- Independent supervisory review of the reconciliation process; and
- Adequate monitoring of operations and financial performance.

2. Lack of Independent Reconciliations of Financial Information and Lack of Adequate Supervisory Review.

During our review, we found almost no evidence that independent reconciliations of financial information were being performed or that financial activities were subject to sufficient supervisory reviews. Performing reconciliations and independent supervisory reviews are key components of proper internal controls.

The situation at the Park stemmed from the overall belief that everyone was trustworthy. Therefore, there was little or no management oversight into the day-to-day activities of the business office or any particular employee. As long as the accounting system balanced at the end of the day, no questions were asked.

Based on information provided to us, there were few if any reconciliations of accounting information. There were no reviews of accountant's work, or surprise audits of the business office operations. Daily Business Reports and Summary Revenue Reports are required daily; however, there is no reconciliation made between these reports.

The Department of Parks reconciles the bank statements against the Daily Business Reports, which, in this case, were balanced against the bank deposits, with both being prepared by the same person. The outcome, therefore, resulted in everything balancing and although the Park periodically performed surprise cash counts, the accountant conducted those, thus controlling the process to cover up any improprieties.

3. Failure to Conduct Internal Audits.

There has been no internal audit of the business operations at Kenlake State Resort Park since the late 1980s or early 1990s. The Department of Parks maintains an internal audit staff, but they currently do not perform any internal audits of the business operations of each of the state parks. The Daily Business Reports are vouched against the bank statements, but there is no formal audit to review other supporting information.

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Examination of Internal Controls
(Continued)

Kenlake State Resort Park Should Strengthen Internal Controls Over Its Business Operations
(Continued)

3. Failure to Conduct Audits (Continued)

There are no internal control reviews. We understand that the department is trying to implement audits in various areas; however, the current budget and personnel situation makes this a difficult task. Nonetheless, audits would greatly benefit the parks and significantly reduce the risk of loss or theft, as well as point out areas where improvements could be made, and establish good business practices where those are noted.

4. Lack of Routine Performance Reporting.

Neither the Department of Parks nor Kenlake State Resort Park uses any type of routine reporting for performance measures. They do not track room sales activity, deposit activity, cash on hand, accounts receivable aging reports, or other measures of business activity. Using analytical reports and analyzing activity at each park on a periodic basis may detect areas of concern and give management a clue that errors or problems may exist. Such analysis would also allow for park management and the Department of Parks to make better-informed decisions relating to business activities.

5. Improper Accounting of Certain Transactions.

We noted that some activities appear to be bartered for rather than accurately reflected in the accounting records. Expenses for “Froggy” radio advertisements were exchanged for the use of meeting rooms at the park. Thus, the revenue for the meeting room and the radio expense for this transaction, although the net result would be same, are not accurately reflected in the accounting records. Both accounts would be over/understated by the amount of the barter, thus, failing to accurately reflect actual activity.

Recommendations.

We recommend the following considerations be made:

- The agency should develop controls over the cash and receipt process that will adequately separate the duties of employees in order to reduce the risk of significant loss of assets or errors in the processing of accounting information. Specific recommendations for accounts receivables are:
 - Due to the fact that most accounts receivable payments are made by check and received through the mail, someone independent of the daily accounting function should open business office mail. This individual should prepare a schedule of receipts received through the mail. This schedule should be submitted to the park manager, with a copy being filed with the daily business packet. The park manager should periodically compare the schedule of receipts to accounts receivable postings. Any omissions should be investigated.

Tourism, Arts and Heritage Cabinet
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Examination of Internal Controls
(Continued)

Kenlake State Resort Park Should Strengthen Internal Controls Over Business Operations
(Continued)

Recommendations (Continued)

- Specific recommendations for accounts receivables are: (Continued)
 - Someone independent of the daily accounting function should prepare and make the bank deposit.
 - Someone independent of the daily accounting function should compare the amount of cash collected by the park and its departments to the amount on the bank deposit each day. Any variances, such as the payment of tips or refunds, should be explained and documented.
- Reconciliations of financial information should be documented and reviewed by management. We would suggest more involved oversight by management of the Parks' business operations. Specific recommendations for accounts receivables are:
 - The business office manager should review Daily Business Reports (DBR's) prepared by other business office employees. This review should include a comparison of the DBR to that day's deposit. If the business office manager prepares the DBR, the park manager or his designee should perform this review.
- Routine use of internal audits at all of the parks, either by the Department of Parks, or some other independent group.
- The use of performance reports and trend analysis of various park business activities should be considered as one measure of oversight to provide information for management to make a more educated business decision. Specific recommendations for accounts receivables are:
 - The Park Manager should review the accounts receivable aging report at the end of each month. Any accounts over 30 days old should be investigated. If necessary, the Park Manager should send delinquent notices to customers with old accounts. Also, he should receive any and all customer phone calls concerning accounts receivable notices.
- Follow standard accounting rules and accurately reflect each transaction in preparing the Parks' business activities.

TOURISM, ARTS AND HERITAGE CABINET
KENTUCKY DEPARTMENT OF PARKS

RESPONSE TO EXAMINATION OF SPECIFIC
FINANCIAL ACTIVITY OF KENLAKE STATE RESORT PARK



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July 8, 2008

VIA HAND DELIVERY

Ms. Crit Luallen
Auditor of Public Accounts
105 Sea Hero Road
Suite 2
Frankfort, Kentucky 40601-5404

Re: Response to Examination of Specific Financial Activity of Kenlake State Resort Park

Dear Ms. Luallen:

Attached to this letter is the Kentucky Department of Parks ("Parks") response to the recent Examination of Specific Financial Activity of Kenlake State Resort Park. On behalf of the Cabinet and Parks, I would like to extend our appreciation to your staff for their hard work and professionalism in conducting the audit.

If I can be of further assistance, please don't hesitate to contact me.

Sincerely,

Jamie Link
Deputy Secretary

cc: Gerry van der Meer
Sally Hamilton
Jeff Fryman

The Kentucky Department of Parks ("Parks") would like to thank the Auditor of Public Accounts, Crit Luallen, and her staff for their recent audit of Kenlake State Resort Park ("Kenlake"). Following Parks' own discovery of inconsistencies with accounts receivable at Kenlake, Parks conducted an internal audit to investigate the possibility of fraud. Parks' initial investigation revealed misappropriation by an employee in excess of \$50,000. Immediately thereafter, Parks contacted the Auditor of Public Accounts for assistance in determining the amount of misappropriated funds, to examine the internal control structure at Kenlake, and to make recommendations that would prevent similar fraud in the future. Parks also immediately contacted the Kentucky State Police for assistance and additional investigation.

Parks has reviewed the preliminary audit report detailing specific financial activity at Kenlake. Parks acknowledges the findings and recommendations for strengthening Kenlake's internal control structure. Parks intends to implement the recommendations set forth in the report system-wide, and notes that some of the recommendations are already in place. Those steps include implementation of an improved tracking system for checks received by parks, more effective use of internal audits and greater management oversight of the accounting process, especially when limited personnel resources prevent optimum segregation of duties.

In response to the specific findings contained in the audit report, Parks responds as follows:

1. Inadequate Separation of Duties

Personnel complement reductions in recent years have reduced the number of employees at Kenlake as well as at other parks. Other than the Park Manager and Business Manager, the Kenlake Business Office was staffed with one permanent employee (the Accountant II position) and one interim employee (working no more than 8.5 months in any year) for much of the audit period (a second permanent full-time position was established in March 2008, replacing the interim position). This diminished staffing level lessened the ability for adequate segregation of duties, thus requiring both strong internal processes and procedures and direct involvement by management personnel. This event brought to light inadequacies in both of these areas.

- Office staffing levels will be reviewed for all parks. While we do not anticipate being able to add many additional employees, if any, a review of personnel resource allocation is highly warranted.
- Management personnel have access to all internal accounting processes as well as "presence" during the daily processes of counting and reconciling cash, preparing daily business reports, creating invoices and paying accounts receivable. They will be expected to review these processes more closely and on a regular basis.
- Some internal processes have already been altered and others are being reviewed. A field review of current accounts receivable practices is also planned to acquire a thorough working knowledge of this process.

2. Lack of Independent Reconciliations of Financial Information and Lack of Adequate Supervisory Review

The vast majority of the financial documentation at each park is created and filed on site with very little documentation being received directly in Central Office. Financial and operational details are entered into various electronic systems at the park level and accessed in Frankfort. The hard copy originals of the Daily Business Report, including deposit slips, are mailed to Central Office. The opportunities for independent reconciliations by Central Office are minimal. Supervisory review must occur on site and in the Frankfort Central Office and both will be required to improve oversight in all areas.

- The Cash Percentage Report previously suggested is being used.
- Accounts Receivable Aging Reports, a report already available, is being reviewed more diligently in Central Office with explanations of aged accounts being required from the parks.
- Random requests for the new Cash/Charge Summaries and the source deposit envelopes are being made.

3. Failure to Conduct Internal Audits

In past years, the staffing level in the Department of Parks Internal Audit Branch has varied widely in number, qualifications, and responsibilities. The result has been inconsistent reviews in both the number of audits conducted as well as the scope and focus of work. Parks' internal auditors now report directly to the Commissioner which ideally allows them to independently evaluate financial and operational processes, identify potential weaknesses and make recommendations for improvements. Further, Internal Audit staff will determine the most critical financial areas and focus their work appropriately.

4. Lack of Routine Performance Reporting

Parks respectfully disagrees that routine performance measurement is not conducted. Daily sales are recorded to the minor revenue code level and counts are made on everything including meals served, golf rounds played and the number of spectators attending recreational activities. The electronic property management and campground reservation systems count every room and campsite sold in a variety of ways. The Division of Financial Operations produces abundant reports based upon eMARS data available to all parks and management personnel monthly. Parks agrees that there are numerous ways to analyze this information and has implemented at least one of the methods recommended by the Auditor's Office. The recent Department of Parks Performance Audit has provided further impetus to examine operational numbers with a renewed perspective.

5. Improper Accounting of Certain Transactions

"Trade-outs" are common practices in advertising and a lack of advertising dollars creates a need for Parks to occasionally utilize this practice. Parks agrees, however, that proper accounting of such value-in-kind transactions, both before an arrangement is approved and after execution of the agreement, provides essential documentation of such transactions.

Regarding the Recommendations:

- The overall separation of duties pertaining to receipt handling procedures will be reviewed and enhanced to include mandatory participation and documentation by park management personnel. Field evaluations will be conducted to provide first-hand knowledge that accounts receivable processes are being adequately followed.
- Parks respectfully disagrees that someone outside the Business Office should open the daily mail. There are many potentially sensitive and confidential items, including payroll and personnel documents, which arrive at the park via USPS mail, and should only be opened by management personnel. Parks agrees that a schedule of checks received be created and maintained as a reference to track the payment through the park's accounting system.
- Parks respectfully disagrees that someone independent of the daily accounting function should prepare and make the bank deposit. Counting cash and preparing daily reports is a key function in all Business Office personnel position descriptions. Business offices at the parks are located such that isolated counting of cash can be accomplished away from daily park activities, other park employees and guests.
- Park management is the best resource for the review of daily deposit slips and the associated supporting documentation.
- Department of Parks procedures require that one employee count the daily receipts, and prepare the bank deposit, while another employee prepares the Daily Business Report. It is not possible to reconcile the cash/checks/charges submitted from the various departments without preparing the deposit total. These procedures also require that these duties be alternated. At some locations the Business Manager enters the information on-line, thus providing another review.
- The need for internal audits has been addressed previously. Parks agrees with the need.
- The renewed diligence in managing accounts receivable has been addressed. The process of issuing invoices, both the original issuance and 30-day reminders, has been reinforced.

It should be noted that while this audit focused on Kenlake, the aforementioned measures will be adopted by all parks. It should further be noted that appropriate disciplinary actions have been taken with employees involved in the scope of the Kenlake audit, including the resignation and subsequent criminal indictment of the perpetrator of the identified theft of funds.

