

**EXAMINATION OF CERTAIN
PROCESSES, PROCEDURES, CONTROLS,
AND FINANCIAL ACTIVITY
OF THE CITY OF FRANKFORT**



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CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS

October 15, 2007

The Honorable William May, Jr., Mayor
City of Frankfort
315 West Second Street, Box 697
Frankfort, Kentucky 40602

RE: City of Frankfort Examination

Dear Mayor May:

We have completed our examination of certain processes, procedures, controls, and financial activity of the City of Frankfort (City). This examination was conducted as a result of concerns received by this office regarding certain practices and processes followed by the City.

Examination procedures included interviews with the City Manager, City Finance Director and other City employees, the former Certified Public Accountant engaged by the City, and an employee of the U.S. Department of Labor. Various documents examined and analyzed include City Commission meeting minutes, City policies, City inventory and surplus property listings, contracts, timesheets and payroll records, and previous City financial statement audit reports.

Findings in this report include:

- the City had not formally adopted a fixed asset inventory policy;
- additional procedures could improve the City's surplus property sales control process;
- IRS 1099 tax forms were not issued to golf course volunteers for years 2004 through 2006;
- required approval signatures were not consistently applied; and,
- the failure to pay overtime to part-time Parks employees.

Detailed examination findings regarding these issues are presented in this report. This office made 19 recommendations to strengthen the City's control procedures related to findings above.



Mayor May
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Due to certain findings resulting from this examination, we have referred this report to the U.S. Internal Revenue Service, the Kentucky Department of Revenue, and the U.S. Department of Labor, Employment Standards Administration Wage and Hour Division, for consideration and any further action deemed appropriate.

We thank you, the City Manager, the City Finance Director, and other City employees for the cooperation and assistance received throughout this examination.

Very truly yours,

A handwritten signature in cursive script, appearing to read "Crit Luallen".

Crit Luallen
Auditor of Public Accounts

**Findings and
Recommendations**

**The City had not
formally adopted a fixed
asset inventory policy.**

The City of Frankfort (City) maintains a perpetual fixed asset inventory for assets with a value of \$1,000 or above. The Finance Director stated that an annual physical inventory is taken to verify the existence of fixed asset inventory items described on the inventory listing. Upon request, the City provided documentation to support that an annual physical inventory was taken for the 2005 fiscal year; however, documentation was not provided for the 2006 fiscal year. The City did not have a formal written policy regarding the value of fixed assets that will be inventoried. While discussing this with the City's Finance Director, we discovered certain City financial related policies and procedures have been in place for years, although the policies were not written and formally adopted.

According to the current City Finance Director, many informal City policies and procedures were established in the years prior to his employment with the City. For approximately the last 18 months, since accepting the position of City Finance Director, he has initiated a process to document all City policies and procedures in a formal written format.

*Proposed policies
developed subsequent to
discussion with auditor.*

The Finance Director provided this office with a City Finance Department Account Classification-Descriptions administrative policy, adopted in approximately December 2006, and a Vehicle Surplus Sale for In-State/Out-Of-State administrative policy, adopted in March or April 2007. After discussions with the Finance Director, two proposed written administrative policies were provided to the auditor. The first proposed policy was titled Inventory/Asset Management and the second was titled Surplus and Obsolete Property.

The City's proposed inventory policy states:

[i]n addition to the \$1,500 inventory limits, all computers will be inventoried annually. All furniture will also be inventoried annually.

To ensure asset control for these items valued below \$1,500, all Department Heads will review and implement lock down procedures for tools, and all other items. It is the Department Head's responsibility to assign the supervision of the lock down policy.

Establishing formal written policies and procedures will assist the City in providing guidance to its employees and will ensure the proper management of certain City financial activities.

Recommendations

We recommend the City ensure an annual physical inventory of City fixed assets is taken and that the City maintain written documentation to confirm the performance of a physical inventory and to document any adjustments made to the fixed assets inventory.

We recommend the City formally document in written form its financial policies and procedures. As the City completes and adopts written policies and procedures, the policies should be disseminated to all personnel responsible to implement or oversee these procedures.

We further recommend the City implement procedures to record significant items of inventory such as computers, furnishings, artwork, or other valuable items that are easily portable that may be valued under the fixed asset inventory threshold established by the City.

Additional procedures could improve the City's surplus property sales' control process.

Surplus property listing is advertised and available to citizens.

Although an informal process exists to declare and sell City surplus property, the City could strengthen its control over the disposition and proper accounting for all surplus property.

In preparation for the City's surplus property auction, City departments annually evaluate property and equipment inventory and list items to be included in the City's surplus property sale. The surplus property listing is reported by the departments to the City's finance department where the lists are consolidated and presented to the City Commission with a motion to declare the items surplus property.

Under certain circumstances items may be removed from a surplus property sale.

Upon approval by the City Commission, the surplus property auction along with a listing of the surplus property items is then advertised in the local newspaper. According to one City employee partially responsible for the oversight of the City's surplus property sales, after the surplus property is advertised in the local newspaper, citizens can request from the City a full copy of the listing any time prior to the auction.

The employee also stated that surplus property may be removed from the listing prior to auction if another City department decided to use the surplus property item. If an item is removed from surplus property, the City documents the removal of the item and ensures that the auctioneer makes an announcement at the beginning of the auction that the specified item(s) are no longer included in the surplus property sale.

City accounts for larger items sold at surplus property sale.

The City employee interviewed stated that she was present at City surplus property auctions for the last six years. At these auctions, the employee attempts to record the sale amount of the larger surplus items such as vehicles so a reasonable estimate of the total auction sales receipts can be made after the auction. Based on the receipts estimate, the employee estimates the amount the City can expect to receive from the auction house and reports this amount to the City Finance Director, who then provides the estimate to the City Manager. Upon receipt of the Final Settlement document and check from the auction house, the City then compares its receipt estimate to the actual sales proceeds reported by the auction house. According to this City employee, if a significant variance is found as a result of comparing actual sales proceeds to the estimated sales proceeds the variance is investigated by reviewing the detailed auction sales receipts.

A total reconciliation of surplus property items sold to sales receipts is not typically performed.

The City provided our office with surplus property records related to the 2007 Sanitation surplus sale held on April 28, 2007, and the 2007 General surplus sale held on May 19, 2007. Subsequent to the auditor's discussion with the City Manager and the Finance Director, a reconciliation was done by the City that is not routinely performed as part of the surplus property process. The City reconciled the April and May 2007 surplus property listings to the auctioneer's sales tickets and buyer registration. The City then reconciled the checks received from the auction house to the total amount collected for items sold. As previously noted, the employee explained that the auction sales receipts are reviewed if a significant variance is noted between the City's estimate of surplus property sales receipts and the actual sales receipts.

While the City currently has a process to account for its surplus property and the receipts from the sale of the property, additional controls could strengthen the City's oversight of surplus property prior to auction and its accounting for receipts from the sales.

Upon review of the documentation provided by the City, we identified what originally appeared to be discrepancies between the City's surplus listing and the auctioneer's sales tickets. While investigating these discrepancies, we found the City had reconciled several surplus property items to one auctioneer sales ticket recording the sale of items listed as "All of Computer." The employee and the Finance Director explained that some surplus property is sold in batches; therefore, the auctioneer sales ticket did not include a listing of individual items included in the sale of those specific items.

Like items grouped together for surplus property sale.

As it was explained, surplus property is moved from the individual City departments to the auction house the day prior to the surplus property sale. According to the employee, the surplus property is categorized by type and placed on trailers with similar items. One example given by the City employee was that computers and office equipment may be grouped together while tables and chairs may be grouped together. According to the employee, the auctioneer will attempt to sell the items in batches to expedite the auction. If individuals want to purchase a few items and not the entire batch, the auctioneer will take bids on those individual requests first and then auction off the remaining items on a trailer in one batch.

By following this process, the City is not accounting for surplus property once it is taken to the auction house; therefore, although the City attempts to track the sale of larger surplus property during the auction, the City is not accounting for other items, which could be diverted prior to the auction.

City policy ensures surplus vehicles are removed from City inventory and City insurance policy upon sale.

The City created a Vehicle Surplus Sale Policy and Procedures document in the Spring of 2007, prior to the City's surplus property sale held on April 28, 2007. The new Policy and Procedures document was created to ensure that City owned vehicles are removed from the City's inventory listing and insurance policy once the surplus items are sold. The Finance Director stated that the City is considering implementing a process to ensure all surplus property items are immediately removed from the City's inventory listing.

Recommendations

We recommend the City adopt a written policy to formalize the process followed to control the accounting for items sold at surplus property auctions.

We recommend the City consider reconciling the revised surplus property listing to the surplus property items after items are transferred to the auction house, prior to the start of the auction. This will ensure that all items included in the City's declared surplus were accounted for prior to sale.

We further recommend the City determine a method to tag individual surplus property prior to transferring items to the auction house, indicating on the revised surplus property listing the associated tag number for each surplus item. The City should then account for the tag numbers the day of the sale.

We also recommend that the City reconcile the receipts received to the receipts listing prepared by the auction house on the day of the sale.

Finally, we recommend the City implement a process to remove all surplus property from the City inventory listing and insurance policy upon sale of the inventory items.

The City failed to ensure that IRS 1099 forms were issued to City golf course volunteers in 2004 through 2006.

During tax years 2004, 2005, and 2006, the City did not ensure IRS 1099 tax forms were issued to volunteers that were compensated the amount equivalent to the value of a season pass to the City's golf course. According to City records presented to this office, the last year 1099 tax forms were issued to golf course volunteers was in 2003, by a former Golf Pro the City contracted with to operate and maintain the City's golf course.

City contracts stated that the City Golf Pro was responsible for issuing 1099 tax forms to golf course volunteers.

According to the Finance Director, City Manager, and the City Attorney, issuing the IRS 1099 tax forms to the golf course volunteers is the responsibility of the City's Golf Pro. In 2004, the City contracted with another Golf Pro. The responsibility to issue IRS 1099 tax forms to these individuals was overlooked. The City entered into a contract with its current Golf Pro on May 1, 2004. This contract includes as part of the Golf Pro's remuneration "35 free memberships to distribute as he sees fit as further part of his remuneration" and establishes as part of the Golf Pro's duties to provide each volunteer "with a 1099 Tax Form, which reports the rate and number of hours that is equivalent to the value of the season pass or other compensation received by said volunteers." The same terms were included in the Golf Pro contract for 2005, 2006 and 2007.

IRS 1099 tax forms were not issued to approximately 30 individuals in each of the 2004, 2005, and 2006 tax periods.

Although the City had a contract in place with a Golf Pro during 2004, 2005 and 2006, and the contracts included this requirement, the IRS 1099 tax forms were not issued to volunteers at the City's golf course. Documentation maintained by the Golf Pro reveals that the City had over 30 individuals, in each of the three years, who received memberships in exchange for volunteer hours at the City golf course. During this three-year period, the value of the pass appears to be approximately \$1,000.

The City Manager believes that the Golf Pro simply forgot to issue the required tax forms. Although the City has placed the responsibility on the Golf Pro, it is ultimately the City's responsibility to ensure that the Golf Pro is performing the duties as documented in the contract.

We are referring this matter to the Internal Revenue Service (IRS) and the Kentucky Department of Revenue (DOR) for further consideration or any action deemed appropriate.

Recommendations

We recommend the City develop a process to provide proper oversight of its contracts to ensure that contractors are fulfilling the terms of the agreement.

We further recommend that the City consult with the IRS and DOR to determine how to best address not appropriately issuing 1099 tax forms and take action to resolve this issue as recommended by the IRS and DOR.

Required approval signatures on timesheets are not consistently applied.

Through testing of certain timesheets for City Parks Department part-time employees, we found signatures for both employees and their direct line supervisors were not consistently applied.

The City Parks Department employs part-time personnel in three separate areas: (1) Maintenance, (2) Athletics, and (3) Swimming Pools. Timekeeping for the Maintenance and Athletics personnel follows a similar process as employees are required to sign in and out each day on a timesheet maintained by their supervisor. The employee is to initial next to the time recorded on the timesheet to certify that the employee worked the hours as documented on the timesheet. At the end of the two-week pay period, the supervisors are required to sign the individual employee's timesheet to certify that the time

reported is an accurate reflection of the time worked by the employee. Upon completion, the timesheets are submitted to the Parks Department office at Juniper Hills Park, reviewed for mathematical accuracy by the Administrative Aide (Aide) in the Parks Department and then entered into an automated payroll spreadsheet, which summarizes and consolidates the employee timesheets by area worked. The spreadsheet is signed by the Aide to certify that it is correct and then it is examined and approved by the Parks Director before being sent to the City's Personnel Department for processing.

City process to record and approve employee work hours is not consistent.

The employee time recording process followed by employees of the Swimming Pools varies from Maintenance and Athletics areas as all Swimming Pool employees sign in and out daily on a consolidated sheet posted at the pools rather than individual timesheets completed by Maintenance and Athletics employees. Supervisors at the Swimming Pools are required to initial next to each individual's time each day, certifying that the time reported is an accurate reflection of the time worked by each employee. Employee time for Swimming Pools employees is then transferred by two part-time employees working in the pool office at Juniper Hills Park into an automated payroll spreadsheet, similar to the one used by the Aide in the main Park's office to record Maintenance and Athletics employees work hours. The spreadsheets for Swimming Pools and Maintenance and Athletics employees then follow the same process and are printed out and signed by the Aide and Parks Director then submitted to the City's Personnel Department for processing.

A sample of 15 part-time employees for the pay periods ending June 10, 2007, July 8, 2007, and July 22, 2007, was selected for testing. Of those tested, we found two instances where employees did not apply the proper initials to their individualized timesheets and four instances where supervisor signatures were not applied to indicate review and certification of the hours worked by the employee. Finally, we identified five instances where the time recorded on the timesheet or in/out form did not agree with the payroll summary for that pay period. Four out of these five instances where the time reports did not agree were for employees who worked at the Swimming Pools and during the previous pay period ending June 10, 2007.

Initially while discussing these findings with the Park's Aide, an explanation for the variances between time reports could not be determined; however, we noted that the discrepancies occurred during the first week of the pay period. After expanding testing of part-time employees working at the Swimming Pools for the pay period ending June 10, 2007, additional timekeeping issues were identified requiring further examination. Ultimately, we examined the time recorded for each part-time Swimming Pool employee during the first week of the June 10, 2007, pay period and it appeared that employees were receiving on average an additional two hours of work for the first day of that pay period. In some cases, the hours appeared significantly overstated and employees received credit for hours worked when they had not signed in on the pools in/out sheet.

Employee hours worked were allocated to an incorrect pay period.

After further examination, we found that the City carried hours worked forward from the previous pay period and applied these hours indiscriminately to days in the first week of the following pay period. These hours were earned during the pay period ending May 27, 2007, but were not processed in the City's payroll until the next pay period, ending June 10, 2007.

In addition, according to the City's Pool Manager, some of the discrepancies are due to training hours applicable to the first week of the two-week pay period. The City required lifeguards, pool attendants, and pool supervisors to attend two-hour training sessions. In most of these cases, the employees were required to attend one training session for two hours; however, there were a few employees who received four hours of time credited because they had attended the supervisor's training and an additional training session for either the lifeguards or pool attendants. We found that the training hours, as with the hours worked during the previous pay period, were applied indiscriminately to days in the following pay period making it difficult to ensure that the employees received the proper credit.

Employee work hours were applied to an incorrect pay period due to the untimely receipt and entry of information into the payroll system.

According to the City Pools Manager, the hours associated with work performed on May 26, 2007 and May 27, 2007, along with the employee orientation training hours were not reported in the payroll processed for the pay period ending May 27, 2007, because the employees' information had not been entered into the payroll system at that time. He stated that the employees did not receive payroll documents to

complete until the orientation meetings held on May 21, 2007 and May 22, 2007. Employees unable to attend the orientation meetings did not obtain their required paperwork until a later date. Furthermore, employees were required to direct deposit paychecks into their personal accounts, which required the employees to obtain routing information from their banks. In some cases, the employees had to establish an account at local banking institutions because they did not already have an established account.

Employees did not properly sign in and out to reflect hours worked.

After factoring in the training sessions and hours worked over the previous weekend, significant variances still existed. To address these variances a meeting was held on August 30, 2007, with the Park's Director, Assistant Director, Administrative Aide, and Pools Manager. During this meeting, the Pools Manager stated that he believed the individuals had worked the hours, but that they failed to properly sign in and out for the day. Furthermore, he stated that one of the pools had been closed for several days during the summer and that some of the employees assigned to that pool were reassigned temporarily to another City pool and that those employees may not have been familiar with the location of the in/out log or may have simply forgotten to sign in since they were not working in a familiar location.

On occasion employees were allowed to verbally report hours worked.

According to the City Parks Department Rules for employment distributed to all Swimming Pool employees, employees are responsible for their own time and "if the time is not on the timesheet, you will not get paid for that time." Although this statement is presented to pool employees upon employment with the City, it was explained by the Park's Administrative Aide and Pools Manager that on occasion verbal reporting of hours worked would be accepted by the two part-time employees as they recorded employees' time into the payroll summary. If a verbal reporting was made, they stated that the supervisor on shift would be contacted to get verbal approval of the hours reported to them. Other than the payroll summaries printed out at the end of the payroll period, no documentation exists to indicate the instances when time was reported or approved verbally rather than using the in/out log. Without formal documentation of the hours worked by the employee or the approvals applied to certify by a supervisor that an employee worked the hours they claimed to have worked, the City has no support for those hours paid to employees in such instances.

We also were informed by the Administrative Aide that the City Parks Department does not pay its part-time employees overtime and as such if an employee works over 40 hours in one week, the hours over 40 are applied to the employees time for the following week. This occurrence would account for some of the remaining discrepancies and resulted in difficulty in determining whether employees received proper pay for the hours worked. The following finding provides further detail related to this issue.

Recommendations

We recommend the City review timesheets and in/out logs for completeness and ensure that all appropriate signatures are applied.

We recommend the City provide additional oversight of the time recording process at the pools, particularly at the start of the summer season when part-time employees, many working their first job, are beginning employment with the City.

We recommend the City design a time reporting process to ensure that verbal reporting and approval of hours worked by an employee are not accepted. Employee hours worked and managerial approvals should be documented in writing. This documentation should be maintained in the City Park's office payroll records along with other existing payroll documentation for the corresponding pay period.

We further recommend the City explore the possibility of standardizing the City employee time recording process.

We finally recommend that the City review the Fair Labor Standards Act (Act) regarding payment for overtime hours worked and ensure compliance with this Act.

The City did not pay overtime to part-time Parks employees.

As documented in the preceding finding, the City does not pay overtime to its part-time Parks employees. We identified at least two employees who were not compensated for overtime worked.

According to the City Parks Director, overtime was not allowed for part-time Parks employees because it had a negative impact on the morale of full time Parks Department employees. The Director stated that the Parks Department attempted to limit the overtime worked by its full time personnel and found it difficult to limit this overtime if part-time employees were allowed to work overtime.

However, according to the Fair Labor Standards Act, covered, nonexempt employees who work more than 40 hours in a work week must receive at least one and one-half times their regular rate of pay for the hours worked over 40 in a work week. A workweek can begin on any day of the week and run for seven consecutive 24-hour periods. The workweek for City seasonal employees begins Monday and ends on Sunday. Full time City employees' workweek starts on Tuesday ending on Monday.

Employees were not paid overtime for hours worked in excess of a 40-hour workweek.

We identified two employees for the pay period June 10, 2007, who clearly worked in excess of the 40-hour threshold for the week but did not receive overtime for that period. We also identified other employees whose hours exceeded the 40 hours; however, included in these hours were hours worked for orientation training and hours worked the weekend before the pay period began.

We examined one pay period for one area of the Parks Department at this level of detail. Instances of employees working in excess of 40 hours in a workweek may have occurred in other pay periods.

We will refer this matter to the U.S. Department of Labor, Employment Standards Administration Wage and Hour Division (Department of Labor) for further consideration and any action it deems appropriate.

Recommendations

We recommend the City ensure compliance with the Fair Labor Standards Act. We further recommend the City comply with any determination made by the Department of Labor regarding the City's method of compensating certain City employees for overtime worked in excess of a 40-hour workweek.

In addition, we recommend the City establish and monitor the compliance with a policy to strengthen the controls over the City employees time reporting process to accurately reflect the number of hours worked on a specific date.

CITY OF FRANKFORT RESPONSE

City of Frankfort
Capital of Kentucky

315 West Second Street, P.O. Box 697
Frankfort, Kentucky 40602
(502) 875-8500

Mayor

William I. May, Jr.

Commissioners

Lynn Bowers
Kathy Carter
Douglas C. Howard
Rodney S. Williams

Date: 10/9/07

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

Regarding: City of Frankfort Examination Findings

Dear Ms. Luallen:

The City of Frankfort has received and reviewed the State Audit findings and provides the following response to the findings. As indicated below, the City has been proactive in addressing and remediating the issues raised in the audit.

State Audit Finding #1: The City had not formally adopted a fixed asset policy- The City Commission approved an order on 9/24/07 that established a written inventory policy. The policy states that all Fixed Asset Inventory of \$1,500 or more will be inventoried. Additionally all computers, office furniture, and other office valuables will be tagged. Finally, each Department Director will review their lock down procedures for tools and other items.

State Audit Finding #2: Additional procedures could improve the City's surplus property sales control process- The Finance Department currently verifies that all large approved surplus equipment are included at the sale. Furthermore, we verify that those items are included on the final sales ticket.

Future Control:

Each asset or batch of supply items to be auctioned will be tagged prior to the sale. The tagged items will be agreed to the Commission approved list and the final sales ticket to further strengthen controls. This control measure will be implemented at the fall surplus sale on 11/17/07.

State Audit Finding #3: IRS 1099 tax forms were not issued to City golf course volunteers for years 2004 to 2006- The City Golf Pro made the Commission aware of this oversight at a recent Commission meeting. 1099 tax forms for 2004 to 2006 are currently being prepared for the golf course volunteers and will be completed by 10/31/07.



EQUAL OPPORTUNITY EMPLOYER M/F/H
EQUAL HOUSING OPPORTUNITY 

Future Control:

In order to confirm 1099 tax form filings, the golf pro will provide a copy of the 1099 tax forms to be kept on file by the Human Resources Department.

State Audit Finding # 4: Required approval signatures were not consistently applied- The State Auditor found instances where part-time employee's time sheets were not properly signed and approved. Payroll procedures were reviewed and communicated to the all Park's personnel immediately after the finding was received to ensure consistency and compliance.

Findings # 5: Failure to pay overtime to part-time Park employees- The State Auditor found a small number of exceptions where part-time employees were not paid overtime. The oversight was corrected immediately after this discovery. An internal audit was performed by the City Finance Department for the months of June, July, and August of 2007 to ensure the error was confined to the state's sample finding. No additional overtime payment exceptions were found.

Furthermore, the Human Resource Director is very knowledgeable of the Labor Department's overtime standards and is continuously instructing all Department Director's to fully comply with those standards.

Summary:

The City of Frankfort is always striving to improve its internal controls. The State Audit examination has provided the City an additional opportunity to continue with this effort.

We would like to thank Brian Lykins and Tiffany Welch of the State Auditor's office for their efforts with the City of Frankfort.

Sincerely,


Tony Massey
City Manager


Steve Dawson
Finance Director

