



Johnson County Auditor
Johnson County, Kansas
PERFORMANCE AUDIT

January 31, 2008

Library Management Transition

“Operational changes could achieve resource savings”



Johnson County Audit Services

January 31, 2008

To: The Johnson County Board of County Commissioners
The Johnson County Library Board
Donna Lauffer, Johnson County Librarian

In accordance with the approved audit plan, we performed an audit of the Johnson County Library. We conducted the audit with a view toward evaluating operating practices and, where applicable, identifying alternatives that would help the Librarian in program management. In some instances, we identified opportunities for collaborating with the County to use available resources, thus saving library resources, while at the same time maintaining the independence of the Library decision-makers.

Our results show the Library could improve:

- Management of the Gift Fund,
- Management of available resources in some areas, and
- Compliance with some Library administrative regulations, policies, and procedures to strengthen internal controls.

Of particular note, was the successful automated library collection management system used for book purchases, and cash management functions. Additionally, the Library started an initiative to integrate their collection management system with the County's Oracle system which is in discussion phases now.

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards, except that Peer Review has not been performed. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence that provides a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

I appreciate the cooperation of the Director and her staff throughout the audit process.

William D. Miller, CIA, CGFM
County Auditor

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Library Management Transition

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RESULTS AND RECOMMENDATIONS

1. The Library Can Improve Management of the Gift Fund

There are weaknesses in internal controls and lack of safeguards over library assets that can be corrected with enhancements to the accounting and management practices. Examples of matters noted include:

- Internal controls, such as a budget and separation of duties for accounting, were not adequate.
- Library staff used Quicken, a personal checkbook management program, to record transactions for the Gift Fund. This product is not sufficient to provide adequate accounting or internal controls.
- Gift fund financial transactions were reported late and complete information, including accrual amounts, was not included in the County financial reports, and the report did not include accrual information.
- Audits conducted by external auditors hired by the Library were not effective.
- Comprehensive policies for the management of the Gift Fund which consider its unique situation were not established.

The Library Board has chosen to keep the Gift Fund separate from the Johnson County accounting management as permitted by statute. As a result of this decision, the Library Board needed to establish a system of management, financial, and accounting controls which are comparable to the controls established by the County for The Library Operating Fund and other government funds. These controls also need to ensure the Gift Fund remains in compliance with applicable laws, rules, regulations, and County policy, to the extent required by statute. This has not been done. As a result, the Gift Fund lacks adequate management and accounting controls.

Recommendations

We recommend the County Librarian and the Library Board:

Internal Controls

- 1.1 Establish a system of internal controls for the Gift Fund which has the following minimum components:
- Segregation of duties for accounting, bank transactions, bank reconciliations, purchasing, P-Card use, investment management, and accounts payable.
 - Limit the maximum discretionary purchases for Library staff to \$750 which is commensurate with the size of the fund. All expenditures exceeding that amount should be approved by the Library Board prior to the expenditure.
 - Use of an accounting system which is sufficiently robust to handle the complexity of transactions in the fund including grants and restricted contributions. (See Recommendation 1.2)

- Detailed review of transactions by the Library Board if the Gift Fund is not maintained in the Oracle system.
 - Budget for the Fund which includes estimated receipts and expenditures and provides guidance to staff on the type and amount of expected expenditures. Because of the nature of the receipts in the fund this budget should be revised as necessary by the Library Board.
- 1.2 Set up accounting for the Gift Fund within the County's Oracle system with workflows designed to ensure the Library Board has final authority to approve transactions.
 - 1.3 Establish a reporting system which will provide full accounting information, including accrual information, to the County accounting staff within the time frames established by the Office of Financial Management (OFM) for year end accounting.

Budget

- 1.4 Budget the non-gift portions of the Gift Fund as required by statute including approval by the Board of County Commissioners.

Transaction Accounting

- 1.5 Establish accounting rules for the Gift Fund which will ensure compliance with applicable laws, rules, regulations, and applicable County policies.
- 1.6 Establish an on-going total of restricted assets held by the Gift Fund to ensure restricted money is spent in accordance with the wishes of the donors and that general expenditures are made out of unrestricted money.

Gift Fund Audit

- 1.7 Determine whether the external audit of the Gift Fund provides sufficient additional information to be cost effective.
- 1.8 Work with County, or other individuals with accounting and auditing experience, to determine whether audit procedures can be developed which would provide the Library Board with more useful information and convert the financial audit to an agreed-upon-procedures engagement.
- 1.9 Withdraw the Gift Fund financial statements for the year ended December 31, 2006, and re-issue the statements in full compliance with GASB standards.

Investments

- 1.10 Use the County pooled investment service to maximize the return on the Gift Fund assets, and improve internal control by having the investments managed by someone without access to cash and accounting records.

Management Comments

- 1.1 *We certainly will consider the recommendations for improving financial management of the fund in the future as staff and the Board work through the elements presented in the report.*
- 1.2 *We are evaluating alternatives to the Oracle system and will certainly consider the recommendation.*
- 1.3 *We have worked closely with OFM for end of year information and have not been asked for this information. We will do what is necessary to provide information and work closely with OFM.*
- 1.4 *The requirement was unknown to staff. The non-gift portions would apply to the sale of books that are weeded from library collections and donated material. The library owns these materials 50/50 with Friends of the JCL. We will investigate methods for complying with this requirement in the future.*
- 1.5 *I respectfully disagree with this general statement. The Library Board has procedures and policies in place. In some instances, we follow County policies that might apply. Meticulous records are prepared. The Library Board will consider their current process and explore improvements but to imply that the Board has not provided appropriate oversight is a misrepresentation. Qualified external auditors have regularly reviewed the fund and have found only one instance of concern which was addressed promptly. We will explore improvements.*
- 1.6 *Reports of this nature are prepared regularly and available to the Library Board. Monthly detailed reports are provided. We will review the process for improvements but our record of appropriate use of restricted funds is clean. This has not been an issue.*
- 1.7 & 1.8 *Audit Services is indicating that our external auditor did not provide an appropriate audit for the Library Board. We provide information to the external auditor on our procedures and our accounting practices as anyone would do with an audit process but certainly do not tell him what to do. Our external auditor is a certified CPA. We will consider the financial management suggestions but are in no way able to evaluate one auditor's opinion over another equally qualified auditor.*
- 1.9 *We will consider the auditor's recommendation for future audits but will not be reissuing past audits.*

1.10 We will consider this recommendation and explore the process for improving investment management with OFM and the Treasurer.

Additional Comment:

The separate management of the Gift Fund is permitted by statute which also clearly states the Library Board has authority for the fund. Although regular external audits are performed and have verified the proper reporting of the fund and detailed reports are provided regularly to the Board enabling the Board to provide the necessary oversight, there is an inherent risk factor present due to the limited number of staff the library has in the financial management unit. Our limited staff is as efficient as possible and accomplishes a tremendous amount of work with very few resources.

The Gift Fund is a relatively small fund that has been managed through the software, Quicken. This software has served us well in flexibility of reporting and accuracy of accounting and has not been a management issue in past external audits.

Actual segregation of duties differs somewhat from the report in that other administrative staff are involved in data entry and purchases. However due to the limited staff, many of the functions of reconciliation, reports and deposit preparation are done by the Finance Manager. We have fewer financial management staff than most Johnson County departments our size. The County Librarian approves purchases and the Library Board Chair signs the checks along with the County Librarian. There have been no problems with the Quicken software. We understand the inherent challenges that this software has but converting to the Oracle system will require more staff and there may be other options to explore. Our experience with the Oracle system has not been without difficulties. We will consider the recommendation carefully and work with OFM to assess the feasibility.

External audits of the account are provided annually and we have altered our procedures when necessary.

Limit maximum discretionary purchases. It is true the fund is much smaller (\$150,000) than the Library Operating Fund (\$24,000,000). However, the Library Board of Directors has delegated authority to the County Librarian in compliance with County Operating Fund parameters. The Library Board has ultimate authority for these thresholds but must balance the need and impact of the recommended changes.

The Library Board currently reviews transactions of the Gift Fund in depth. We keep meticulous records of donor restrictions which are honored and reports are available to the Library Board for review at any time.

The requirement of budgeting non-gift portions of the Gift Fund is the result of new GASB rulings and is being implemented countywide in the near future. We intend to comply and will work with county OFM staff as the procedures are released.

Audit Comment:

The financial audit prepared for the Gift Fund has not “verified proper reporting of the fund....” As discussed in the report, restricted assets and accounts receivable were not disclosed in the financial statements and the entity was described as a component unit.

Quicken has no built-in internal controls and does not have the capability to provide internal control, therefore it is inadequate. It is not a correct statement that Quicken has served them well when, in fact, every potential fraud indicator exists in their current system. Part of the standard for developing internal controls requires that the controls be cost effective in the situation. When the number of people available is too small to provide adequate controls, alternate procedures need to be developed to compensate for the risk of fraud and theft. The County’s Oracle system, used for the Library’s Operating fund could also be used for the Gift Fund. That system has substantial internal controls built in.

Limiting the maximum discretionary authority of the County Librarian is an additional internal control based specifically on the smaller size of the Gift Fund.

The Library Board transaction review is currently done after the transactions have been completed. Our recommendation would require the Board to pre-approve some transactions which we currently estimate at 40 per year. Our point on the donor restrictions regards reporting them in the financial statements.

The budget requirement, and the related exemption from budgeting for gifts and bequests, has been part of Kansas law since 1933, therefore, it is not a new requirement. The Library failed to take into account that book sale proceeds were not gifts or bequests when they began posting these transactions to the Gift Fund.

Discussion

Gift Fund Background

K.S.A. 12-1225 gives the Library Board the power:

(h) to receive and accept any gift or donation to the library and administer the same in accordance with any provisions thereof. If no provisions are specified, the board shall have the power to hold, invest or reinvest the gift and any dividends, interest, rent or income derived from the gift in the manner the board deems will best serve the interests of the library;

and

(j) as to money received from sources other than a tax levy for library purposes,¹ in its discretion, to place such money in a separate fund or funds, or to place the money in the fund

¹ Such as a donation or gift but not including federal and State grants which must be handled in the Library Operating Fund in compliance with K.S.A 12-1225a. [footnote added]

to which the tax levy money is credited unless the grantor or donor directs how and for what purpose the money shall be handled and spent.

The Johnson County Library Board has elected to place gifts and other non-tax revenues in the Gift Fund and maintain the accounting records for this fund outside the County's fiscal and accounting systems. In addition to placing the money in a separate fund, the Library Board has elected to place the money in separate bank accounts. As a result of separate accounting and creating separate bank accounts, the services and related internal controls, provided by the County for management of public money such as accounting, money management, checking, purchasing, and accounts payable are not used for the Gift Fund.

Having made the choice to operate the Fund in this manner, the Library Board is accountable to the public for the management of the Fund and should provide adequate management and internal controls sufficient to ensure the Fund is safe and efficiently managed.

Policies, procedures and improved practices would enhance stewardship

In reviewing the operations of the Library Gift Fund we found:

- 1) The Library Board has not established adequate policies or procedures specifically for managing the Gift Fund.
- 2) Duties were not properly segregated. One employee is responsible for Gift Fund accounting, check writing, investment management, purchasing, accounts payable, and bank reconciliations.
- 3) A greater return on investments can be achieved.
- 4) Records were kept of restricted donations and the resolution of the restrictions but these records were not used in preparing public reports.
- 5) A budget was not adopted for the Gift Fund although non-tax revenue other than gifts and bequests have been commingled in the Fund.
- 6) The Library Board contracted for an outside audit of the Gift Fund but the reported financial statements had short-comings in complying with Governmental Accounting Standards Board (GASB) requirements and Kansas law.

Delegated spending authority in the Gift Fund is high compared to annual expenditures

The Library Board has delegated Gift Fund expenditure authority of \$99,999 to the County Librarian. This is based on the delegation of expenditure authority for the Library Operating Fund and Special Use funds. However, the Library Operating Fund and Special Use funds have a budget of over \$24 million dollars annually and have a full set of internal controls. The Gift Fund has annual expenditures of less than \$150,000 and is not subject to any of the internal controls inherent in the management of the Operating Fund.

Based on the comparative activity in the two funds, we believe the delegated expenditure authority in the Gift Fund should not exceed \$750 (which is the same ratio of authority to expenses as the expenditure authority for the Operating fund). Any expenditure in the Gift Fund

exceeding that amount should be approved by a member of the Library Board prior to committing to the related purchase.

Gift Fund investment management

The Gift Fund money was invested in an interest-bearing checking account and a money market account. As noted above, K.S.A. 12-1225 (h) and (j) give the Library Board the authority to handle the money separately from the County money or other library money. The statute does not preclude the Library Board from investing the money in the manner that will bring the best return on investment.

Library can increase return on investments

A comparison of the investment return achieved by the Gift Fund and that received from the County investment manager showed the Library could have earned an additional \$1,700 each year by including their investments with the County's, an improvement of 20 percent in return on investment. This analysis shows the Library has an opportunity to maximize return on their investment if they collaborate with the County investment manager. The current accounting system used by the County can easily identify parts of the pooled investment by fund, thus ensuring separate identity of Gift Fund money in the same way the Library Operating Fund money is separately identified as required by statute. There is no risk that the money, so invested, would be spent against the wishes of the Library Board or that the money would not be available when needed.

Revise the financial statements issued for 2006

Our review of the financial transactions showed bookkeeping for the transactions on a cash basis was well done. Staff responsible for the bookkeeping does not have in-depth accounting training.

The Gift Fund financial statements for the year ended December 31, 2006, issued by the Library, do not comply with Governmental Accounting and Financial Reporting Standards as published by the Governmental Accounting Standards Board (GASB) in the following ways:

- 1) The Gift Fund is designated as a component unit of the Library. The Gift Fund can not be a component unit unless it is a separate legal entity. It is not. (GASB Codification 2100.119)
- 2) The Library has posted non-gift funds in the Gift Fund (primarily book sale proceeds) and those were not budgeted as required by K.S.A. 79-2927. This statute requires that all government funds be budgeted. K.S.A. 79-2925 exempts gifts and bequests from the budget requirement but not other revenue and related expenditures such as book sales.

GASB requirements and the Kansas Municipal Audit Guide require government financial statements to include a cash basis financial statement showing compliance with the Kansas budgetary law along with accrual basis statements to be in compliance with generally accepted accounting principles.

3) Book sale revenues were understated in the 2006 financial statements by approximately \$30,000.² The related account receivable was understated in 2006 by that amount plus additional amounts from prior years. Book sales have not been handled in accordance with Library Board Regulation 50-20-55.

Library Regulation 50-20-55 codifies a verbal agreement between the Library and FOL. This regulation requires book sale proceeds to be deposited in the Library bank account. The Library Treasurer is then to disburse 50 percent of the proceeds to FOL. This process was not followed. FOL deposited the proceeds in its bank account, deducted expenses, and then sent half of the remainder to the Library. The Library received approximately \$30,000 less than it was entitled to. These transactions, including the \$30,000 receivable from FOL, were not included in the financial statements. A similar process was followed in 2006 and the amounts were not reported in that year. In 2005, the underreported revenue was approximately \$120,000.

4) The Gift Fund included both restricted and unrestricted net assets at the end of the year. The financial statements did not show the restricted portion of the net assets. GASB Codification 2200.119 requires that net assets should be reported as restricted when external constraints are placed on the use of the funds and provides a definition of restricted net assets.

The Gift Fund receives donations from sources outside the Library. Donations which have restrictions placed on them by the donor have to be expended in accordance with the donor's wishes³ and, if unexpended at the end of the year, must be reported in the year-end financial reports as restricted assets. Library staff maintained very good records of the donations that had restrictions placed on them. However, the restricted portion of net assets were not reported in the separate audit of the Gift Fund nor were the amounts of those restrictions reported to the County for inclusion in the County's financial statements.

The amount of restricted assets was material to the balance in the Gift Fund in each year that we examined. We believe these amounts should be reported on a timely basis, and the related expenditures should be reviewed to ensure compliance with the restrictions.

These conditions amount to a material misstatement and may be misleading to the users of these financial statements.

In addition, there was a serious internal control violation in the operation of the Gift Fund. One staff member of the library performs all of the following functions: Check writing, deposit preparation, bank reconciliation, bookkeeping, investment management, purchasing, purchasing card use, and approval for all purchasing card users. This is a significant deficiency and a material weakness under GAGAS and should be reported to the Library Board as part of a financial audit process.

² The amounts are approximate because, as of time this report was prepared, the Library was unable to obtain specific amounts from FOL for either 2005 or 2006.

³ K.S.A. 12-1225(h)

In the 2006 external audit, the auditor commented that the Library staff member who did the accounting also made occasional deposits. Based on the audit comment, the Library contracted with a courier service to deliver the deposits to the bank. However, the staff member performing the incompatible duties listed above continues to prepare the deposit. No comments were made about the same staff person performing the other incompatible duties.

External audit could be more focused to Library needs

The audit of the Gift Fund duplicates the audit performed by the County’s external auditor. The County’s published financial statements provide assurance the Gift Fund financial statements are presented without material misstatement provided proper disclosure of financial information to OFM. Changing the nature of the audit engagement for the Gift Fund would provide the Library Board with more useful information. Generally accepted auditing standards allow for an Agreed-Upon-Procedures engagement which is designed to allow the responsible officials to have the auditor answer specific questions. The auditor then designs audit procedures to answer those questions. If the Library Board wanted to know whether all expenditures were made in accordance with the gift restrictions or whether all expenditures over \$1,000 were made in accordance with Library regulations, the auditor would design applicable procedures and obtain agreement from the Board that the procedures would answer the questions. The auditor then performs those procedures and reports those results to the Board.

External audit
could provide
better information

2. The Library Can Improve Management of Available Resources

The Library has an opportunity to use their resources more effectively and efficiently and achieve dollar savings. We identified potential annual savings of \$365,118 by changing management practices and taking advantage of alternatives to current practices. The bulk of the savings is associated with the Library support for private tax-exempt, non-profit corporations; corporations that should be self sustaining without reliance on taxpayer funds.

Additional savings which we could not quantify can be achieved by interfacing SIRSI, the Library's book management system to the County's Oracle financial system and integrating the Library's Purchase Card (P-Card) system for the Gift Fund with the County's P-Card system.

Each of these areas provides the opportunity for the Library to improve the management of scarce resources.

Recommendations

We recommend the County Librarian and the Library Board:

- 2.1 Improve the process for disposing surplus books to ensure the minimum amount of current tax money is expended.
- 2.2 Use the space currently allotted to FOL to house the computer inventory saving the lease cost of the warehouse space.
- 2.3 Discontinue the use of tax money to support the activities of non-profit corporations which are intended to provide support for library activities.
- 2.4 Work with Oracle Support to develop an interface between the Library's SIRSI system and the County's Oracle system.
- 2.5 Use the County's P-Card system rather than a separate P-Card system for the Gift Fund.

Management Comments

2.1, 2.2 and 2.3 I vehemently object to the implications presented by Audit Services as to the loss of revenue from the Friends of Johnson County Library regarding the sale of surplus books and donations. The Friends assist the library in the disposal of surplus library materials that no longer meet the requirements of library collections. The public have a special connection to books and library materials. Public sale of public library materials is very popular with families, individual, and other non-profits. Serious consideration of any alternative short of a public sale would not bode well and should be cautiously investigated regardless of the modest revenue gains.

JCL has benefited from the support and hard work of the Friends of JCL for more than 50 years. Their efforts not only fund the purchase of library materials but also make possible the summer

reading program, adult programming, staff development opportunities and library events for the public are invaluable to the community. The revenue generated by the book sales also meets BOCC goals of pursuing non-tax revenues. The Friends are conscientious and dedicated to supporting and advocating for library services in the community. Their management of the book sale process is well known in library circles. By developing the process for internet sales, FOL have exhibited great innovation in using new online tools. As a result 2007 internet sales are increasing significantly.

Audit Services looked only at the dollars and not at the volunteer hours which are equally important. If we did not have the Friends volunteers to assist with the book sales, JCL would require 5.97 FTE to perform this function for an estimated cost of \$143,000. The Friends also support the library with other activities in the library year and provide volunteer hours and support such as volunteer recognition, patron appreciation events, 50th anniversary of the library, author visits, receptions and other events. Not only does Audit Services suggest losses but also encourages the Library to no longer provide space for the book sale sorting. This negates the efficiency of sorting and collecting donations and weeds in one place reducing courier runs to another leased location. The discussion of space in the Audit Services report is inaccurate. The space used by the Friends for book sorting is not equivalent to the warehouse space we currently lease. Nearly 4,700 sf of warehouse space is needed for the ebb and flow of furniture, equipment and fixtures received and removed from the system over the course of a year. The Friends occupy approximately 3,900 sf of the Antioch facility. The space at Antioch would not meet the library's storage needs and would not eliminate the warehouse contract.

In 2005 FOL reported \$178,754 in revenue which includes bookstore/booksale revenue and other revenue such as membership dues, tote bags and other miscellaneous sale items. \$94,421 was returned to JCL or 53% of the total revenue. Without FOL volunteers for booksales, the library would need 5.97 FTE to achieve the same work. This is a cost equivalent of \$143,000. If volunteer hours are factored into the equation, you can see that we are not losing money.

Total Friends Support 2005

FOL Revenue	FOL Library Support	JCL FOL Support
\$178,754	\$64,389-Book sales	\$46,665-Salaries
	17,750-Summer Reading	15,561-Benefits
	2,000-Vol Recognition	10,650-Health Benefits
	5,000-Adult Programs	730-Misc. Support
	8,282-Staff Development	63,696 Donated Space
	143,000-FTE Avoidance	12,980-Mtnc/ Support
	237,421 Total	295-Courier
	155,076 Library Support	399-LIT Support
	58,535	\$155,076 Total Support

Audit Services did find a discrepancy between the Library Board's policy for book sale revenue versus the actual practice. We will work to bring the practice into compliance with the policy but will need to evaluate the policy and practices.

Audit Services states that the Friends split the book sale proceeds 50/50 after deducting costs. That is partially true. All proceeds from the annual book sale held in June of each year are split 50/50. Only the proceeds from the continuous bookstores in the Antioch and Blue Valley Libraries and the internet book sales are split 50/50 after expenses which primarily cover the cost of bookstore manager staff. If the proceeds were split 50/50 before expenses the increased revenue would be offset by overall decline in revenue provided by the Friends for other activities resulting in no increase. Regardless of this situation, the deposit process does not adhere to Library Board policy and will need to be reviewed and aligned.

Library Foundation – JCL Foundation has been in existence for several years but has not been significantly active until the last five years. We consider their efforts as still in the start-up stage. However, the JCL Foundation Board recently adopted a strategic plan which calls for the organization to assume responsibility for the employment of an executive director in the future. We will continue to work closely with the board as they develop and strive to assume this function.

2.4 We welcome the development of an interface between the Library SIRSI Acquisition system and the County Oracle accounting system as it will save us redundant data entry. It will have no impact on ensuring budgetary and other controls as all expenditure transactions are already ultimately processed in Oracle and according to County policy. We have requested an interface be developed between the Library SIRSI Acquisitions system and the JC Oracle system for several years but resources are limited everywhere and to-date we have been a low priority. We will work with the Oracle staff to develop an interface.

2.5 The Library uses a separate P-card for the Gift Fund. In the past, both County and Gift Fund P-cards were managed by County Purchasing staff. When the County transitioned to the new P-card processing software, Library staff inquired as to how we should process Gift Fund P-card purchases in this software. County OFM staff responded that they would no longer manage Gift Fund P-cards and we could not process Gift Fund purchases within this system. The Library Board subsequently applied for its own P-card account for the Gift Fund. Going to one P-card for both Operating and Gift Fund as recommended by Audit Services will not save staff time or resource, it will simply divert staff from one process to another. However, we will investigate the process and evaluate the improvements that may result.

Audit Comment:

The fact remains that booksales revenues do not equal or exceed the costs to conduct the booksales. This should be cause for review of the practice. The Library's rebuttal costs are not relevant to the issue. The cost avoidance achieved by using volunteers does not reduce the actual loss occurring. Rather, it prevents the loss from being greater. While we have proposed other ways to handle the books, if book sales are a priority for the Library it could be done more

effectively. Instead of the Library taking ownership of the books, they could be donated directly to the Friends of the Library. FOL could obtain space, conduct the sale and donate whatever amount they wanted to the Library after the sale. The Library would not have to take possession and account for the donated books in their accounting records, or provide free space for the book sale activity.

The difference in space mentioned in the response is miniscule (800 square feet) and is more than offset by better management of the inventory.

Discussion

Our audit focused on policies and procedures employed by the Library in conducting their business. We tracked staff practices to required procedures, and we analyzed business practices to determine rationale for these practices and to study alternatives where applicable. This analysis led us to conclude annual dollar savings amounting to at least \$365,118 are achievable. Some of these potential savings would require major changes in approach to long-standing practices, particularly with non-profit organizations. Our analysis identifies the cost of doing the business the way they have been doing it and does not take into account non-financial reasons for the practices employed. We believe such other reasons would have to be weighed in terms of the cost to continue such practices.

The savings we identified are summarized as follows:

Table 2.1: Areas of Potential Savings

Modify Resource Use	Potential Savings
Reduce Surplus Book Sale Costs	\$ 68,523
Eliminate Leased Storage	\$ 24,750
Eliminate Tax Support for Foundation	\$ 116,769
Eliminate Tax Support for FOL	\$ 155,076
Total Potential Savings	\$ 365,118

Further discussion and the business rationale for these potential savings follow.

Disposal of Surplus Books

The Library removes books and other materials from its collection on a regular basis. In 2006, the Library identified and removed 126,509 items with an original cost of \$2,723,455. These books are disposed of by making them available for sale to the public. Any items not sold are donated to other government agencies.

Book sales are managed by FOL for the Library. FOL reported sales revenue of \$178,754 and related expenses of \$73,476 in 2005. In accordance with an agreement, FOL and the Library were to share proceeds 50-50. Prior to turning over the proceeds, FOL deducted its expenses and only paid the Library 50 percent of the net proceeds.

FOL book sales are not cost effective

An analysis of the book sales operated by the FOL shows consistent financial losses and unnecessary costs to conduct this business. During 2006, the Library spent \$155,076 in current year tax money to support the operation of FOL as follows:

Costs exceed revenues

- \$90,650 for Library staff salaries and related overhead for 7 employees who spent part of their work time supporting FOL plus additional support activities from Library Facilities and IT,
- \$63,696 for the 3,961 square feet of office space provided to FOL in the Antioch Library, and
- \$730 spent for software and refreshments for FOL Board meetings.

FOL paid the Library \$86,553 for a loss of \$68,523 (\$155,076-\$86,553) in 2006 and similar amounts in other years. Additionally, the Library leased storage space for equipment at an annual cost of \$24,750 which would not have to be incurred if the space provided for FOL was made available for the storage use. Considering these costs, the net loss is \$93,273.

There are other less costly alternatives for disposing surplus books such as bundling the books for auction in large quantities, selling the books for scrap, or even destroying the books, many of which, according to a FOL representative, are damaged.

Library management told us there were other considerations besides cost in the decision to hold book sales. Mentioned specifically was the community involvement these sales bring to the County. Our analysis has put a price tag on these other considerations and gives the Library Board the opportunity to evaluate the value of these considerations in light of the cost.

The Library uses tax money to support unrelated, charitable organizations

FOL and the Johnson County Library Foundation (Foundation) are tax-exempt corporations which were established to provide support for the Library. As described above, the Library spent \$155,076 to support FOL and an additional \$116,770 to support the Foundation.

The purpose of both of these organizations is to raise money and provide support for library activities. Using tax money to support these organizations does not accomplish that purpose.

The Foundation reported \$244,246 in 2006 expenses.⁴ Tax money paid for 38.4 percent of the Foundation's operating expenses. The Foundation has been in existence for over 19 years and should be self-supporting.

High percentage of expenses are subsidized

FOL reported \$21,495 in expenses paid in 2005⁵ (The most recent year

⁴ 2006 Federal Form 990, Part II. Total functional expenses of \$383,523 less Grants of \$139,277 = net expenses of \$244,246 plus unreported tax support of \$59,466 = total expense of \$303,712. \$116,770/\$303,712 = 38.4%

available to us.). Tax money paid for 87.8 percent of FOL's operating expenses.

The Library's collection management system can be integrated with Oracle

Library management recognized a way to improve their collection management system by interfacing their system with the newly implemented County Oracle system several years ago. To that end, they asked for assistance to accomplish the interface. At that time, the Oracle Support Center (OSC) staff was not able to provide the assistance needed.

SIRSI is the Library's comprehensive collection management system. The system includes all of the management systems for the Library collections and encompasses inventory, cataloging, and purchasing. It is not integrated with the County's Oracle financial system. Entries made in the SIRSI system need to be reentered in the Oracle system resulting in duplication of effort and increasing the possibility the two systems will not contain the same data.

Library seeks aid from County Oracle system

We asked staff from the County's Office of Financial Management (OFM) and OSC whether the situation had changed in the past 18 months. OFM was very supportive of having an interface between the two systems. The Director, OSC told us they had changed structure and hired additional qualified staff since the original inquiry. Based on current staffing levels and expertise, OSC is willing, and perhaps eager, to develop an interface between the two systems.

Accordingly, we suggested Library staff and OSC develop a plan to create an interface between SIRSI and the Oracle system as quickly as possible. This will lead to overall savings of time at OFM and the Library, improve the quality of information in the Oracle system, and ensure the budgetary and other controls in Oracle are used in the collection management process.

The Library uses two P-Card systems

The County implemented a P-Card system which the Library uses for Operating Fund purchases. The Library also uses a separate version of the same system for purchases in the Gift Fund. Library management established the Gift Fund P-Card system for two main reasons:

- The system the County uses could not distinguish between the Gift Fund and Operating Fund purchases.
- Using the Operating Fund P-Cards and then having the Gift Fund reimburse the Operating Fund for the appropriate charges generated "substantial additional paperwork."

⁵ 2005 Federal Form 990, Part II. (The most recent report available.) Total functional expenses of \$133,480 less Grants of \$111,985 = net expenses of \$21,495 plus unreported tax support of \$155,076 = Total expense of \$176,571. \$155,076/\$176,571 = 87.8%

We examined these two reasons and concluded that, while the County system could not differentiate between the two funds, the amount of additional paperwork is minimal. The only documents required are an invoice from the Operating Fund to the Gift Fund and a payment from the Gift Fund to the Operating Fund.

Two P-Card systems could be integrated

This process could be simplified even further if the Gift Fund were fully implemented in the Oracle system. In that case, an interfund transfer would be the only requirement.

Eliminating the Gift Fund P-Card would eliminate 26 P-Cards and improve internal control.

3. The Library Should Improve Internal Controls

Although Administrative Regulations and procedures were established, staff did not always adhere to them. In those instances, basic internal controls were breached as follows:

- Book sales were managed by an unrelated charitable organization resulting in a loss of control of deposits, loss of revenue (estimated at \$30,000 for 2006), and oversight of a verbal sales-sharing agreement
- Safe combinations were not changed in compliance with Library Cash Deposit procedures
- Computer inventory was not tracked in compliance with Library Asset and Inventory Management Policy, including:
 - Date of purchase and warranty date were not included in inventory records
 - New inventory was not formatted and deployed on a timely basis
 - Surplus computer equipment was not disposed of timely
 - A physical inventory of assets has not been performed since February 2006

The Administrative Regulations and procedural documents maintain basic internal controls for the Library's physical and financial assets. Library management said these regulations were not followed due to ease of business and lack of staff. Staff said they were not aware of the regulations or thought other controls were practiced instead.

Recommendations

We recommend the County Librarian and the Library Board:

- 3.1 Ensure the Treasurer of the Johnson County Library Board of Directors receives and disburses all book sales proceeds as defined in Library Administrative Regulation 50-20-55.
- 3.2 Recover amounts underpaid by FOL.
- 3.3 Ensure that book sales revenues are accurately accounted for in the Gift Fund.
- 3.4 Formalize the arrangement between the Library and the FOL through written agreement establishing the Library's right to audit the sales records, books owned by the Library in the hands of FOL, and the amount and timing of commission payments.
- 3.5 Ensure branch managers change safe combinations on a regular basis or when an employee who has had access to the safe terminates employment.
- 3.6 Include the date of purchase, warranty date, and location information in the asset inventory records as defined in the Library Asset Inventory and Management Policy 3.6.

- 3.7 Ensure Library Information Technology (LIT) staff format and deploy new inventory items in a timely manner.
- 3.8 Ensure LIT staff clean surplus computers and turn them over to OFM for disposal in a timely manner.
- 3.9 Ensure LIT staff perform the annual physical inventory of assets.

Management Comments

3.1, 3.2, 3.2 & 3.4

There is a discrepancy between board policy and practice in regards to the control of deposits with the book sales. We will begin work to remedy this oversight and realign policy and practices.

The variance in revenue is the cost of hiring book store managers at the Antioch and Blue Valley Library locations where ongoing bookstores sell primarily donated materials. These stores were started in the late 1990's. Very few weeded items are actually sold at these locations. See response in section 2.0.

Book Sale revenues are accurately accounted for in the Gift Fund. There has been close working relationship between the Friends and the Library staff. We have not seen any discrepancy and we have reviewed these accounting records. For the annual book sale and the internet sales, approximately 30% of the books sold are library weeds. Approximately 70% are donations from the community. The bookstores sell primarily donations not library weeded materials. We will review this process and align the procedures.

Again, the Library's relationship with the FOL has worked well for many years. FOL are an important partner to the Library. We will consider these suggestions and work through the process.

- 3.5 *We will work to assure that branch managers change safe combinations on a regular basis or when an employee who has had access to the safe terminates employment as prescribed in procedures.*

3.6, 3.7, 3.8 & 3.9

The asset inventory and computer inventory has had multiple challenges over the past two years. JCL staff have maintained the information but in a different manner than the Fixed Asset Policy. The difficulties with the records were due primarily to staff vacancies and inadequate resources coupled with changes in County Surplus support and additional requirements to remove data from computer hard drives. Staff did their best to "triage" the many tasks they needed to perform with limited staff.

In 2005 a new requirement was added to remove data from the hard drives of computers being sent to surplus. The process requires computers to run a program that takes 6-8 hours per unit. At the same time County Purchasing asked us to hold our surplus equipment temporarily while they moved to another location. Up to that time a firm retrieved the computers at our warehouse and removed to a county facility storage for sale. The temporary hold is still the situation two years later.

We requested that monitors and other peripherals be posted to the online surplus website for sale while we worked with the hard drive data removal. We experienced several weeks of delay before Purchasing posted the units to the online surplus list. Hopefully these interdepartmental miscommunications have been resolved.

Again in a triage situation with insufficient time to complete all of the detail in the fixed asset inventory, staff used the vendor tracking reports for much of this information. We do have the required data, we do not have all of it entered into the county fixed asset inventory.

We prefer to receive the total 2007 computer order at one time so we can plan for the “cloning” of all units and to take advantage of discounts. Some of the discounts are unique to the library because it is considered an “educational” entity which is not available to the rest of the county.

Generally the process of deployment takes only two months. Unfortunately in 2007, with significant staff turnover, and loss of 3 weeks to gather data for the audit, we have a backup in the warehouse and have not been able to complete the fixed asset inventory for computers. We are working on solutions and have already consulted with County department that may be of assistance.

It is not our intent to not comply with these requirements but we have experienced great difficulty hiring and retaining IT staff due to salary issues and a low supply of skilled workers competing with private industry salaries. When Audit Services arrived in July, we were struggling and continue to be challenged but we will look for better solutions.

Audit Comment:

The lack of a contract and agreed upon procedures between the Library and FOL is detrimental to sound business practices. Transactions between these two organizations should be at “arms length.” This includes accounting for revenues appropriately. This is not being done since FOL is taking possession of the gross revenues and distributing them.

The educational discount for computer purchases is available to all educational members of the Western States Alliance. There is a volume discount for purchases of 200 or more, but there is no requirement to receive them all at one time. A blanket purchase order with delivery schedules can be used. Receiving less at one time and managing the activity will reduce the rental space need and make the use of the Antioch space for this process viable. The backlog in the new computer inventory was created by the unnecessary volume purchases which have had a detrimental effect on the ability of the IT staff to keep current.

The time involved to respond to audit requests was primarily due to the inability of the Library staff to locate specific inventory items in the warehouse. The warehouse was disorganized and Library staff was unable to reconcile prepared inventories to items on hand and hasn't yet been able to reconcile the inventory. The implication that the audit contributed to the delay is not accurate. Audit asked the appropriate question that led to disclosure of a major problem that had not been addressed by Library management.

Discussion

Administrative Regulation 50-20-55

Administrative Regulation (ARM) 50-20-55 is the Library Board's authorization for the Library to operate a Friends of the Library (FOL) book sale and used bookstores. ARM 50-20-55 describes the distribution and use of the book sales earnings should be as follows:

All funds generated by provisions of this regulation will be received and disbursed by the Treasurer of the Johnson County Library Board of Directors. One-half of the funds received shall be disbursed to the Friends of the Johnson County Library, and one-half shall be disbursed to the Johnson County Library Gift Fund.

This regulation ensures the Library has control of its own funds generated by its book sales and provides the Library Board with the knowledge the funds are accounted for accurately.

Sales revenues need to be collected and recorded properly in accounting records

Library management sells books that no longer meet the needs of the Library. The books are sold through bookstores at library locations, several large book sales off library premises, and through E-Bay. The sales operations are supported and manned by volunteers from the Friends of the Johnson County Library (FOL), a non-profit organization established to support library activities.

FOL sells the books and deposits the proceeds in its own bank account. Under a verbal agreement, FOL is supposed to remit 50 percent of the proceeds of the sale to the Library. The remaining 50 percent is retained by FOL as a commission and is used in its non-profit operations, most of which consists of providing donations and support to the Library. The Library has regularly posted the payments from FOL for book sale proceeds to the Gift Fund.

There is no written agreement between the Library and FOL formalizing this process.

Library Regulation 50-20-55 requires the proceeds of book sales to be received by the Library Board Treasurer and subsequently deposited in accordance with the Regulation. This Regulation is not being followed. FOL deposits all book sale proceeds into its own bank account and then remits the Library's share of proceeds to the Library Board Treasurer net of some related expenses. The Library staff should review the sales, deposits, and cash register tapes to verify the sales, make the deposit as required by the Board adopted Regulation, and

Library should control sales distribution

allocate the proceeds appropriately and pay the sales commission to FOL. We estimate FOL underpaid the Library for book sale proceeds by \$30,000 in 2006.

The FOL arrangement should be formalized with a written agreement establishing the Library's right to audit the sales records, books owned by the Library in the hands of FOL, and the amount and timing of commission payments.

Library safes are vulnerable to inappropriate access

The Library branches were not in full compliance with the Library's cash deposit procedures. We visited the Central Resource Library and three branch libraries to review their cash deposit procedures. Branch managers and staff interviewed could not remember the last time the safe combinations were changed.

For security measures, the Library's Cash Deposit procedures PS 40-80-35 states:

Keep safe combination/keys secure and limit access to as few staff as possible. Change safe combinations several times throughout the year, if possible.

Branch managers and supervisory staff we interviewed provided the following explanations for not changing safe combinations:

- Didn't know the combinations were supposed to be changed,
- Safe was too old for the combination to be changed,
- Since the locks on the doors and the key card codes were changed whenever an employee was terminated, the safe combinations did not need to be changed.

Several clerks and staff have access to the safes and know the combinations. Additionally, employees with knowledge and access to the safes have terminated employment since the combinations were last changed. Failure to comply with the Library procedures is a weakness in internal controls and creates risk to the Library's cash assets.

Computer equipment inventory

The Library's Asset Inventory and Management policy ensures "all IT assets are inventoried, tracked, and managed throughout each IT asset's lifecycle. The LIT Department is responsible for the management of these resources."

A few of the specific responsibilities described in this policy are:

- To track information on each asset, inventory records will be created. At a minimum, asset information will include:
 - Asset tag # or unique identifier
 - Equipment type (see document, Types of Equipment in LIT Asset Inventory)
 - Manufacture

- Model
 - Serial number
 - Purchase date
 - Warranty date (if applicable)
 - Current location record
- Ongoing updates of the inventory include equipment additions, moves, changes and disposals. Inventory records will be updated in a timely manner when changes occur.
 - LIT will conduct a physical inventory to reconcile IT asset inventory information at least annually. Physical inventory means physical verification of all items listed on the LIT inventory records.

The Library's policy contains internal controls that protect the Library's physical assets.

The Library's policy states the LIT staff would manage the Library's IT assets throughout their lifecycle. When the IT assets have reached the end of their useful lifecycle for the Library's purposes they become "surplus" and should be disposed of through OFM's surplus and the County's ITS Asset Disposal Procedures. The County's ITS Asset Disposal Procedures require all surplus computers to be cleaned of all information before they are picked up for disposal.

The LIT has not complied with the Asset Inventory and Management policy in the following ways:

- The purchase date and warranty date are not included with the asset information on the inventory list.
- LIT has not performed a physical inventory of computer equipment since February 2006.
- LIT staff did not deploy new computer equipment on a timely basis and stored them in a warehouse while the warranty depletes.
- LIT staff have not cleaned surplus computers for disposal or disposed of surplus equipment that does not require cleaning.

The purchase date and warranty date of the computers and equipment were not included in the asset inventory list and the locations of the assets were not updated as needed. The LIT director said they replace the computers every 3 years. Replacement is done on a continuous basis replacing 1/3 of the Library's computers each year. She said the computers are replaced based on the model of the computer, older models being replaced first. When we found new computers stored in a leased warehouse, LIT staff could not tell us when the Library purchased them or how long they were there because the purchase date was not included on the asset inventory list.

There were delays in deploying computer equipment purchases and surplus equipment

Library staff stored 426 new IT equipment items including; 134 computers, 188 monitors, 51 printers, and 53 miscellaneous IT items in leased warehouse space and has not deployed them for at least 5 months as of September 21, 2007. The last invoice from the contractor for computers and equipment was April 29, 2007. LIT staff said they have staff shortages and did not have time

to format the new computers and deploy them to library branches. They also said they purchased the computers in large quantities to get better prices.

The Library purchases all computers on a County contract which is based on the State of Kansas contract. The price for these computers is established in the contract negotiation. There is an additional discount for volume purchases but the delivery dates for parts of the order can be scheduled over long periods of time. Technology improvements occur rapidly with improvements generally made every 6 months. Waiting until the computers are needed insures the best available technology. The warranty on these computers and equipment began the day of shipment from the contractor. Delayed deployment reduces the value of the manufacturer's warranty. Scheduling deliveries of the computers when needed leads to improved technology, better use of warranties, better management of staff time, and reduced cost for storage space.

In addition to the new computers, 1,030 surplus computer items were located in the warehouse. This included 373 monitors, 75 printers, and 58 miscellaneous IT items LIT determined were surplus and should have submitted to OFM for disposal. Additionally, 524 surplus computers were stored that have not been cleaned for disposal. LIT staff again said they had not had the time to clean the computers for disposal. The County IT Director provided all departments with a data cleaning application which, when used properly complies with County policy. This application can be used to clean the hard drives with minimal time and effort. OFM requires departments to clean all surplus computers according to the County's ITS Asset Disposal Procedures before the computers are picked up for disposal.

Surplus computers are building up in the warehouse

Over 1/3 of the Library's computer assets are stored in a warehouse

There was a total of 1,456 out of 3,766 computer equipment items listed on the inventory stored in the warehouse. During testing of the inventory list, LIT staff were unable to locate 14 of 254 (6%) of the items in the test. LIT had not performed a physical inventory of the asset inventory list since February 2006. During the audit, LIT staff organized the computer equipment in the warehouse and assigned the items to pallets. LIT staff said they might be able to locate the remaining items after they had performed a physical inventory. The 1,456 new and surplus computer equipment items in the warehouse account for 39 percent of the total library asset inventory list.

The Library's non-compliance with its asset inventory and management policy has weakened internal controls and put the physical assets at risk for theft.

4. The Library Has Not Reported \$2.5 Million in Accounts Receivable

The Library has an accounts receivable balance of at least \$2,533,494 as of December 31, 2006. Accounts receivable are not recorded when they occur nor has the balance been recorded or reconciled at any time. Library staff stated they did not have sufficient resources to track accounts receivable. They also believe patron information, connected with the accounts receivable, is protected by statute and may not be reported in this way. Not reporting this asset understates the Library income statement and balance sheet.

In addition, the Library does not make substantial efforts to collect the accounts receivable balances which are not recovered by an attempt to recover unreturned library materials. The Library contracts with a service to attempt to recover unreturned library materials. If that service is unsuccessful, no library materials are involved, or the materials are returned without paying the related fines and fees, the Library makes no attempt to collect the amounts due. This results in a loss of cash and results in library patrons who are conscientious subsidizing those who fail to return library materials.

Recommendations

- 4.1 Record accounts receivable when the amounts become due and manage the receivables by regular reconciliations.
- 4.2 Report the accounts receivable amount for inclusion in the County's GAAP basis financial statements along with a suitable allowance for uncollectible amounts.
- 4.3 Modify internal control procedures to ensure that all accounting matters are subject to review by staff that are familiar with generally accepted accounting principles.
- 4.4 Attempt to recover unpaid fines and fees by referring non-payers to collections.

Management Comments

4.1, 4.2, 4.3, & 4.4 Here is another example of interdepartmental communication. These amounts have not been reported in the past because the bulk of accounts receivable are small amounts from individuals that do not fall within the Office of Financial Management (OFM) parameters for reporting at the end of the year. The parameter is specified reporting accounts greater than \$2,000. In response to inquiries with OFM concerning this issue, they have agreed that a lump sum amount is acceptable. Staff will work with OFM to determine uncollectible allowances. However, OFM has subsequently requested patron information that conflicts with the Library Board confidentiality policy. Library staff and counsel are working with OFM to find a workable solution so the library does not violate its own policy. We will work with OFM to determine the process for meeting this requirement and may need to request additional resources to accomplish.

The \$2,525,220 accounts receivable at the end of 2006 represents borrowed library materials that are past due and the resulting fines and fees. The amount reflects \$1,848,543.85 sent to

Unique Management Services (UMS) for recovery. The remainder of the accounts are less than \$25 so they were not sent to UMS. This is an accumulated value going back to 1998.

Nine years ago the Library Board contracted with a semi-collection agency process designed to encourage delinquent patrons to return borrowed library materials and to pay fines or fees. Patron accounts delinquent over 55 days and larger than \$25 are submitted to the agency. A series of letters and phone calls are placed. This service has significantly reduced the overall outstanding debt and has also proven to be as non evasive as possible. Unresolved accounts are then credit reported. In 2006, the agency secured return of \$138,445.88 in materials, \$73,072.43 in fines and fees while charging the library approximately \$32,000+ for the service. The agency has been consistently effective in reducing outstanding debt.

The library uses a software vendor, SIRSI, to manage the circulation and management of 6,200,000+ transactions of patrons checking out library materials. This software is not designed with an accounts receivable element but rather a tool for the management of the circulation of library inventory. Currently we do not “write off” old fines, fees or lost materials charges. We would welcome some assistance in determining how to do this as it would seem to be good practice to remove old debt from the system.

The suggestion that we then need to send these unresolved accounts to a collection agency poses significant challenges to the role of public libraries in a community. We must balance the service we are providing with the extent the Library Board wants to pursue debts against the good will and relationship the library has with its patrons. Also nearly 50% of our business is with juveniles. Our most significant concern is that the filing of collection lawsuits will generate far more costly litigation. This does not make sense in light of the very small sums that are owed. There are many factors to consider and we will study the issue.

Auditor Comment:

OFM asked for gross accounts receivable exceeding \$2,000. The Library staff stated they interpreted that to mean individual accounts of more than \$2,000. When we asked for a balance of accounts receivable during the audit, Library staff had not run a receivable report ever. They estimated the balance was less than \$1M. The actual balance exceeded \$2.5M. No aged accounts receivable or receivable reconciliation has ever been prepared.

The \$1.1M amount is the balance on hand at UMS. The balance in SIRSI is \$2.5M which does not include additional receivables from prior to the SIRSI implementation. Because no aged accounts receivable was available and no receivable reconciliation had been done, our balance in the report is an estimate. It will need to be refined based on additional accounting work. It is the responsibility of the Library staff to determine the amount and viability of the accounts receivable and report accurately on the aging of the accounts.

Other than “credit reporting” no additional attempts are made to collect these receivables. The taxpayers of Johnson County are paying for the actions of those few who fail to return library materials. We suggest the patrons who fail to pay fines and fees should be held accountable for those actions. “Credit reporting” may be inconvenient for some of the people at some point in the

future, but we believe much better results can be obtained by actively pursuing the amounts due to the Library. Additionally, before “old” debt can be written off as suggested by the Library there should be a determination whether the “old debt” is collectible.

The Library has a fiduciary responsibility for ensuring accountability for funds owed them. Arguments regarding the age of the patrons or the impact on the goodwill and relationship the Library wants to have with patrons, pale in the reality that they are not collecting debts owed and had no plans for collecting debts. The taxpayers, patrons or not, expect sound fiscal management from the entities their taxes are supporting.

Discussion

Accounts receivable balance

On December 31, 2006, the Library had an accounts receivable balance of at least \$2,533,494 arising from fines, fees, and unreturned library materials. The accounts receivable are recorded by the Library’s SIRSI system but those amounts are not transferred to Oracle, the Library’s accounting system. Until requested during the audit, Library staff had not printed a listing of accounts receivable from the SIRSI system.

The Library also contracts with a material recovery service (MRS) to recover library materials along with the related fines and fees. In those cases where library materials have not been returned, the amount due exceeds \$25, and the balance has been outstanding over 55 days, the Library refers the patron account to the MRS. The MRS contacts the patron and requests return of the overdue materials and payment of the fines and fees. If the patron still does not respond MRS reports the patron to a credit reporting agency.

The MRS has had substantial success in recovering materials and collecting fines and fees. Over 9 years, the MRS has recovered \$1.8 million (61% of the receivables referred) for the Library.⁶ As of December 31, 2006, accounts valued at \$1.2 million were in the possession of the MRS and recovery efforts were ongoing. During 2006, the firm recovered \$211,518 in unpaid fines, fees, and Library materials that had not been returned leaving a total outstanding at MRS of \$1,173,525. The cost for the recovery service was \$30,448. This cost was added to overdue accounts as a service fee. The Library has made no attempt to recover fines and fees owed to them where the library materials had been returned.

The balance in the SIRSI system differs from the balance at MRS because some accounts were referred to MRS prior to the inception of SIRSI and because the SIRSI system includes those amounts that do not meet the criteria for referral to MRS. Library staff was unable to reconcile the difference between those reported amounts. Accordingly, we cannot accurately determine the true balance of accounts receivable.

In our opinion, after making an allowance for uncollectible accounts, the accounts receivable balance as of December 31, 2006 exceeds \$1.9 million.

⁶ These amounts are based on the vendor’s report and have not been verified as part of the audit process.

Accounts receivable and the related allowance for uncollectible accounts need to be recorded in Oracle as they occur. This requires a regular reconciliation of the accounts referred to MRS with the SIRSI system. This also requires that a basis for the allowance for uncollectible accounts be determined and used to determine the related allowance entries. While this can be done annually along with other year-end entries, it seems more reasonable to prepare the reconciliations more often because of the complexity of the issues and to aid management in evaluating any developing trends and developing methods of reducing the losses involved.

Failure to record and report receivables also indicates an internal control deficiency in the operation of the accounting system.

Accounts receivable collections

Amounts that are uncollected after the efforts of MRS have proved unsuccessful can be referred to a traditional collection agency. This has not been done. While collections of this type may not result in recovery of library materials, we believe additional cost recoveries are possible and would result in additional revenue to the Library. This referral would not entail transmitting any patron information in addition to the information already provided to MRS.

The County has recently initiated a collection service which could be used for this effort.

5. Johnson County Library Foundation Director an Employee of the Library

The Library employs an individual to perform the duties of the Executive Director (ED) of the Johnson County Library Foundation. The ED reports directly to the County Librarian. The ED also reports to the Board of Directors of the Foundation. The Library and, ultimately, Johnson County, is legally responsible for the actions of the ED and also legally responsible for supervision of the ED although his or her work is controlled by the Foundation. This situation can lead to conflicts of interest and uncontrolled liability for the Library and the County.

Recommendation

We recommend the Library Board:

- 5.1 Remove the ED from the Library payroll and allow the Foundation to hire and pay its Executive Director.

Management Comments

5.1 We respectfully disagree with this recommendation. The Library will continue to employ the Foundation Executive Director. The Johnson County Library Foundation provides overwhelming public benefit to the Library and to county government. It provides volunteer support, promotion of the institution's programs, extensive good will for the library and for county government, and additional funding. It makes sense for the Executive Director to be a Library employee.

The Library is not alone in utilizing such an arrangement. The Johnson County Community College employs the executive director and the staff for the extraordinarily successful Johnson County Community College Foundation. That foundation is a separate tax-exempt organization pursuant to section 501(c)(3) of the Internal Revenue Code. A number of public entities in Johnson County have adopted the Johnson County Community College model because of the tremendous public benefits that have been generated by the arrangement.

*There is no question that the expenditure of county funds for these purposes is appropriate pursuant to the state's public purpose doctrine. Kansas courts and the state attorney general have repeatedly interpreted the doctrine to confer very broad authority on county commissions to make expenditures to private entities so long as those entities are serving a public purpose. See *Ulrich v. Board of Thomas County Commissioners*, 234 Kan. 782 (1984); *Kan. Atty. Gen. Op. No. 87-52*; *Kan. Atty. Gen. Op. No. 92-17*; *Duckworth v. City of Kansas City*, 243 Kan. 386, 785 P.2d 201 (1988); *Kan. Atty. Gen. Op. No. 2004-30*. It is clear that the public purpose doctrine does not require a strictly dollar-for-dollar calculation. The entire transaction is to be taken as a whole and the consideration for a transfer of property by the state to a private entity may consist, at least in part, of the public benefit that flows from the transfer. *State ex rel. Tomasic v. City of Kansas City, Kansas*, 237 Kan. 572, 595 (1985).*

The Library's employment of the Foundation Executive Director has provided overwhelming public benefit for the Library and county government. For that reason, the Johnson County Library Foundation Executive Director will continue to be a Library employee.

Auditor's Comment:

Our recommendations do not dispute the potential public benefit but reflect the Library's inability to adequately monitor and control one of its employees or control risk of loss from law suits caused by the Executive Director's actions. To be clear, the Library Board by this action has placed an unnecessary legal liability on the Johnson County Board of County Commissioners. The risk of loss to the County and the taxpayers of Johnson County is not even mitigated by a contract between the Library and the Foundation that clearly defines the responsibilities and liabilities of the parties for the actions of the Foundation Executive Director whether those actions are personal or directed by the Foundation Board. Since the Library cannot be sued other than as Johnson County, the County would ultimately be liable for the Foundation Director's actions.

Citing other entities that practice the same business model is not relevant to the Library. The issue remains that the BOCC is subjected to a liability they do not need to be. This liability appropriately should rest with the Foundation which cannot be done with the current Executive Director arrangement.

Additionally, the comment "the Johnson County Library Foundation Executive Director will continue to be a Library employee" contradicts the discussion on page 12 which discusses the Foundation's strategic plan which includes assuming the salary of the Director at some point. This comment also sends a mixed signal to the Foundation.

Discussion

The Foundation as discussed above is a separate legal entity from the Library. For many years the Library has hired and paid for an Executive Director for the Foundation. Currently, the ED reports directly to the County Librarian but the County Librarian does not control the activities of job duties of the ED. These activities are controlled by the Board of the Foundation.

The dual relationship can cause a conflict of interest for the ED. If instructed to take action which is in the best interest of the Foundation but not in the best interest of the Library, it is not clear which instruction would be followed. Additionally, what happens if the Foundation wants the director removed? We understand the interests of the two parties generally coincide but there is no guarantee.

In addition, any personal misconduct on the part of the ED would be the responsibility of the Library and the County.

We believe the relationship of the Library to the Foundation ED needs to be severed to preserve the separate status of the two organizations and to reduce the liability.

6. Patron Records Should be Retained in Accordance with the County Policy

The Library deletes many of the patron records and related information after 30 days. Johnson County policy provides for retention of public records for various periods. The patron records created by the Library are public records. K.S.A. 45-221 specifically exempts patron records from disclosure under the Open Records Act but does not exempt them from document retention. Good business practices require information which is useful in managing the Library should be retained for 2 years as prescribed in the Johnson County Records and Retention Policy.

Recommendation

We recommend the Library Board:

- 6.1 Retain patron records and related information for the period prescribed by statute.

Management Comments

6.1 The Library will adopt new procedures that allow for the deletion of lists of materials read or checked out by a patron but that call for the retention of all other patron records, including those pertaining to fees and fines, for a period of at least two years.

There is considerable merit in a recommendation to retain relevant Library patron records for a period of at least two years. The Library for many years has had in place a policy to protect the confidentiality of patron records. It enforces that policy in a rigorous and consistent way. In protecting the confidentiality of the materials that a patron reads or checks out, the Library has adopted procedures that cause a general purging of patron records. This is clearly not necessary. It would be helpful for the Library to have access to records relating to fines and fees, for example, for at least two years.

Discussion

The Library deletes patron transaction information after 30 days. Library staff said this was because patron information is protected by law and they did not want the information to “be used against them.” In the course of our audit, we attempted to determine what fines and fees had been forgiven and whether the items forgiven were done uniformly by all employees or if some employees or locations were more liberal than others. We were unable to make this test because this information had been deleted along with the patron record.

K.S.A. 45-221 does provide protection for Library patron records for disclosure under the Open Records Act. However, because these records are created by the Library in the course of the normal operations, the records must be treated as public records and maintained accordingly especially when the information can be used for management analysis and control.

The Johnson County Records and Retention Policy states individual circulation records should be retained for 2 years.

7. Conflicting Position Held by the County Librarian

The County Librarian holds a position on the Board of Foundation. The Foundation is a separate 501(c)(3) corporation. An inherent, direct conflict of interest arises when the County Librarian proposes Library regulations that may conflict with the interests of the Foundation. The County Ethics policy precludes County employees from operating in situations where a direct, or perceived, conflict of interest may arise.

Recommendation

We recommend the Library Board:

7.1 Remove the County Librarian from the Board of Directors of the Foundation.

Management Comments

7.1 We respectfully disagree with this recommendation. The Library and the Foundation work together for the benefit of the public. The County Librarian's position as a director on the Foundation's very large Board of Directors is a substantial benefit to both the Library and the Foundation. It is a powerful signal to Foundation directors and donors that the Library and its chief executive are fully committed to the Foundation's mission.

It is again instructive to look at the arrangement adopted by the very successful Johnson County Community College Foundation. The president of the college sits on, and serves as secretary for, that Foundation's board of directors. He also serves as a member of the board's executive committee. We respectfully disagree that the County Librarian's service on the Library Foundation's Board of Directors represents a conflict of interest. We anticipate that the Library Board will want the County Librarian to continue to serve on the Foundation Board.

The Foundation Executive Director reports to the County Librarian who, as supervisors, evaluates his/her performance annually and sets the performance plan. This is done by working closely with the Foundation officers and frequent communication.

Auditor's Comment

The issue is conflict of interest and this situation is truly a conflict of interest. The Librarian cannot serve two masters. As with the Executive Director of the Foundation, this situation unnecessarily places liability on the Board of County Commissioners and subjects them to defending actions brought against the Foundation. The objectivity of the Librarian in decision making regarding activities of the Foundation will never be clear as long as the Librarian has a vote or is an officer of the Foundation Board. Citing what others do does not mitigate the issue at Johnson County. Interaction with the Foundation Board can be done through means other than participating as a Board member or officer, and such interaction would display the same support for the Foundation's mission as long as it coincided with the Library's mission.

Discussion

The County Librarian is also on the Board of the Foundation. She is involved in setting Library policy which will directly impact the interest of the Foundation.

The Johnson County Ethics Policy states, in part:

Standard 1101: Never allow his judgment to be compromised by any personal, family or business interest not a part of his government service and never act upon any matter in which he, his family, or business has or may have any financial or beneficial interest; and should always declare and disclose the full nature and extent of any personal, family, or business interest in any matter related to governmental actions or duties.

This requires all County employees to act on behalf of the County to the exclusion of any other personal business interests. Additionally, as an ethics matter, employees should not be in a position that even gives the appearance of a conflict of interest – which the current arrangement between the Library and Foundation does at a minimum.

8. Contract Management Can Be Improved

The small sample of service contracts entered into by the Library showed improvements could be made in the contract structure and the review process. The contracts reviewed were missing certain elements that County legal staff recommends. The elements missing were:

- Identification of the parties including contact information
- Responsibilities of the parties
- Performance standards minimally referring to compliance with laws, rules and regulations
- Term or duration
- Default and remedy considerations
- Liability issues including indemnity and insurance requirements
- Standard operative provisions such as notifications, governing law, independent contractor status, non-discrimination, etc.
- Execution by authorized individuals

Recommendations

We recommend the County Librarian and the Library Board:

- 8.1 Consult with counsel to establish minimum contract content and form.
- 8.2 Request that contract review by counsel include verification that those minimum requirements are included in every contract.
- 8.3 Review all current contracts and renegotiate terms to include the elements that are identified as missing.
- 8.4 Before renewing existing contracts, review to determine if provisions need to be updated and to determine if contracting the service is still appropriate.

Management Comments:

- 8.1 *This recommendation is accepted. Library counsel has already consulted with members of the county legal staff and is working on revisions to the Library's regulation on contracts to address additional contract standards.*
- 8.2 *This recommendation is accepted. Counsel will revise his standard verification that he has completed his review and that the contract "may be approved and executed in accordance with Library policy" to include language that the minimum contract requirements have been included.*
- 8.3 *This recommendation is accepted. However, a cost-benefit and risk analysis will be applied before any contracts are opened for discussion. This is particularly appropriate in light of the fact that all Library contracts expire after one year.*

8.4 *This recommendation is accepted.*

The Library has in place a rigorous system of contract review and management. Pursuant to Library board regulation, all Library contracts are reviewed by both staff and Library counsel. No contracts are executed without that review. In addition, no contract is executed until Library counsel states in writing that he has completed his review and that the contract “may be approved and executed in accordance with Library policy.”

The Library’s system of contract review and management is designed to minimize the risk of litigation for the Library and county government. The effectiveness of the system is demonstrated by the fact that (1) no lawsuit has been brought against the Library or the county under any of the Library’s contracts in the past twenty-five years; (2) no vendor has asserted a claim of any kind against the Library under any of its contracts in the past twenty-five years; (3) since 1982, Library staff and Library counsel have reviewed, and members of the Library staff have then managed, architectural services and construction contracts on projects totaling more than \$100 million in value, without any litigation; and (4) the Library has entered into and managed contracts on its computer systems and software licensing and online information services without any litigation or any claims of copyright violation for more than twenty-five years.

We have concluded as a result of this audit, however, that the Library can improve its inventorying and tracking of its executed contracts. It will adopt appropriate procedures to ensure that multiple copies of executed Library contracts are electronically stored at several locations. This will assure ready access to Library contracts and associated documents.

In addition, we have concluded that the system of contract review and management can always be improved.

Discussion

Our review of contracts was not comprehensive. The contracts we reviewed were missing most if not all of the contract elements noted above. Establishing minimum requirements would provide better control of liability and provide a more uniform approach to the contracting process.

One example of this was the MRS contract, discussed above, that showed none of the key requirements listed above have been included in the contract, the contract was silent on the vendor’s compliance with applicable law pertaining to debt collection activity, and also silent on the issues regarding protection of patron information.

OBJECTIVES, SCOPE AND METHODOLOGY

Objectives

The audit objective was to review the Library's related internal and management controls to determine if the Library is managed (1) effectively and efficiently and (2) in compliance with applicable policies, procedures and statutes.

Scope and Methodology

In order to accomplish these objectives we reviewed:

- 1) Applicable county-wide and Library policies and procedures,
- 2) A random sample of Gift Fund expenditures which included Gift Fund Visa purchases,
- 3) A random sample of LIT equipment inventory,
- 4) Contributions made to the Gift Fund,
- 5) Library contributions to the FOL and the Foundation,
- 6) Cash handling practices,
- 7) Purchasing practices,
- 8) Book and computer surplus practices, and
- 9) Applicable Kansas statutes.

Our period of audit included transactions from January 1, 2004, through October 31, 2006. We interviewed management and staff members to obtain an understanding of management and internal controls.

Our audit included gaining an understanding of the Library and FOL book sales and reviewing its associated costs to Johnson County. To accomplish this, we conducted interviews with appropriate department staff members and calculated space usage and personnel costs. We also consulted with County Counsel, the Office of Financial Management, and Oracle Support.

Additional written suggestions were communicated to the County Librarian during the course of the audit.

We selected inventory items, using statistical sampling methodology, to test Library inventory procedures and conducted physical inventories.

Scope Impairment

In the course of our audit, we attempted to determine what fines and fees had been forgiven and whether the items forgiven were done uniformly by all employees or if some employees or locations were more liberal than others. We were unable to make this test because this information had been deleted along with the patron record.

ADDITIONAL COMMENTS FROM THE LIBRARIAN

Overall the Transition Audit has provided valuable insight for the new County Librarian into the practices and financial procedures throughout the Library. Staff made every effort to provide the information and data requested by Audit Services as quickly as possible. The report provides a wealth of suggestions for financial management that can be considered in determining ways to improve financial management in the library. In many instances county cross department communication and coordination problems were discovered and can now be remedied. This will take time to evaluate and to discuss by both staff and the Library Board.

There are other areas of the report that do not provide the full picture of library relationships and practices. Audit Services approaches the report as a strict assessment of financial controls and good management practices according to a business perspective not necessarily a government perspective. In managing a vibrant civic institution such as a library where a strong history of community support and volunteerism has manifested over the years, the picture is more than just numbers. My response should clarify my concerns.

During the four-month audit multiple library employees were involved in the process for a total of 47 work days or 376 hours.