

*Kentucky Cities Financial Manual*

*Office of Financial Management  
and Administration*



TM

*Kentucky*  
UNBRIDLED SPIRIT™  
Governor's Office for Local Development

Dear City Official:

The Governor's Office for Local Development (GOLD) recognizes the tremendous effort put forth by Kentucky's locally-elected officials in making the Commonwealth of Kentucky such a wonderful place to live and work.

GOLD's primary mission is to help local leaders fulfill their statutory duties. To that end, it is with extreme pleasure that I present to you a city finance handbook to direct you as you carry out those duties.

This handbook delivers a comprehensive guide in preparing a municipal budget, including additional resources that may be of help to you. Of course, GOLD staff from the Office of Financial Management and Administration stands ready to answer your questions.

Sincerely,

Ellen Williams  
Commissioner

# Cities Financial Manual

## Preface

Budgeting and financial management are basic functions for city officials. No expenditures should be incurred without a legally adopted budget to guide the city's operations. Even in the smallest city, financial management plays a critical role in the city's ability to provide public services. The importance of budgeting cannot be overstated.

The Governor's Office for Local Development has prepared this manual to provide a convenient handbook for budgeting, accounting, and reporting requirements for Kentucky cities. Cross-references to technical resources and Kentucky Revised Statutes are included to provide additional sources of guidance for municipal financial management. This manual is written in laymen's terms for those municipal employees who are unfamiliar with the technical language of accounting and outlines the application of generally accepted governmental accounting principles within the framework provided by Kentucky Revised Statutes.

This manual also discusses the relationship of GAAP with legal restrictions for governmental entities. Kentucky Revised Statutes provide a specific structure for financial management, budgeting, revenue sources and expenditure of public funds, and the KRS are based upon GAAP. Additional accounting and reporting provisions may be imposed by statutes, therefore, cities should be aware of these. Each section in this manual will highlight both the Kentucky statutory provisions and the standards outlined in the GASB Codification.

One objective of this manual is to assist city financial managers in areas such as accounting policies and procedures, and to support cities in achieving compliance with KRS 91A.020:

- (1) Each city should keep accounting records and financial reports in such a way as to:
  - (a) Determine compliance with statutory provisions;
  - (b) Determine fairly and with full disclosure the financial operations of constituent funds and account groups of the city in conformity with generally accepted governmental accounting principles; and
  - (c) Readily provide financial data as may be required by federal grant programs.
- (2) Municipal accounting systems should be organized and operated on a fund basis.

The Governor's Office for Local Development is providing technical resources to assist Kentucky cities to demonstrate accountability for public dollars. This manual is intended to serve as a building block for a city's financial reference library and should be used in conjunction with the publications listed below. References to these publications will be included in each of the chapters to provide additional technical resources for city financial management.

- Governmental Accounting Standards Board (GASB) Codification establishes financial accounting and reporting guidance for state and local governmental entities.
- Selected statutes for financial management of Kentucky cities are included in manual as Appendix 1 Kentucky Revised Statutes (KRS).
- Government Finance Officer's Association (GFOA), *Governmental Accounting, Auditing and Financial Reporting*, (the Blue Book) provides practical guidance on governmental accounting, auditing, and financial reporting.
- GFOA Small Government Series is a series of publications providing practical guidance for specific areas of governmental finance.

Cities are not required to purchase these publications, but they are useful reference publications to supplement this manual.

GOLD is dedicated to supporting Kentucky cities. Please contact our office anytime you need assistance.

Governor's Office for Local Development  
Office of Financial Management and Administration  
Cities and Special Districts Branch  
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Frankfort, Kentucky 40601-8204

Email: [Glenn.Oldham@ky.gov](mailto:Glenn.Oldham@ky.gov)

Toll Free: 800-346-5606

Office: 502-573-2382

Fax: 502-573-3712

<http://www.gold.ky.gov>

The Kentucky Revised Statutes and Kentucky Administrative Regulations are all available online at <http://www.lrc.state.ky.us/legresou/legres2.htm>.

If you are not able to access this information via the Internet, please call us at GOLD and we will be happy to research the KRS and send you the sections you need.

## **ADDITIONAL RESOURCES FOR TECHNICAL ASSISTANCE**

### ***The Kentucky Area Development Districts***

#### ***BARREN RIVER AREA DEVELOPMENT DISTRICT***

177 Graham Avenue  
P. O. Box 90005  
Bowling Green, KY 42102-9005

<http://www.bradd.org/>

(800) 598-2381  
(270) 781-2381  
(270) 842-0768 Fax

#### ***BIG SANDY AREA DEVELOPMENT DISTRICT***

110 Resource Court  
Prestonsburg, KY 41653

<http://www.bigsandy.org/>

(606) 886-2374  
(606) 886-3382 Fax

**BLUEGRASS AREA DEVELOPMENT DISTRICT**

699 Perimeter Drive  
Lexington, KY 40517

<http://www.bgadd.org/>

(859) 269-8021  
(859) 269-7917 Fax

**BUFFALO TRACE AREA DEVELOPMENT DISTRICT**

Kenton Commonwealth Center  
201 Government Street, Suite 300  
P.O. Box 460  
Maysville, KY 41056

<http://www.state.ky.us/agencies/btrc/>

(606) 564-6894  
(606) 564-0955 Fax

**CUMBERLAND VALLEY AREA DEVELOPMENT DISTRICT**

P O Box 1740  
342 Old Whitley Road  
London, KY 40743-1740

<http://www.cvadd.org/>

(606) 864-7391  
(606) 878-7361 Fax

**FIVCO AREA DEVELOPMENT DISTRICT**

P O Box 636  
3000 Louisa Street  
Catlettsburg, KY 41129-0636

<http://www.fivco.org/>

(606) 739-5191  
(606) 739-8533 Fax

**GATEWAY AREA DEVELOPMENT DISTRICT**

P O Box 1070  
19 East Main Street  
Owingsville, KY 40360

<http://www.gwadd.org/>

(606) 674-6355  
(606) 674-6658 Fax

**GREEN RIVER AREA DEVELOPMENT DISTRICT**

3860 U S Highway 60 West  
Owensboro, KY 42301-0200

<http://www.gradd.com/>

(270) 926-4433  
(270) 684-0714

**KENTUCKIANA REGIONAL PLANNING AND DEVELOPMENT AGENCY**

11520 Commonwealth Drive  
Louisville, KY 40299

<http://www.kipda.org>

(502) 266-6084  
(502) 266-5047 Fax

**KENTUCKY RIVER AREA DEVELOPMENT DISTRICT**

917 Perry Park Road  
Hazard, KY 41701

<http://kradd.org/>

(606) 436-3158  
(606) 436-2144 Fax

**LAKE CUMBERLAND AREA DEVELOPMENT DISTRICT**

2384 Lakeway Drive  
P O Box 1570  
Russell Springs, KY 42642

<http://www.lcadd.org/>

(270) 866-4200  
(270) 866-2044 Fax

**LINCOLN TRAIL AREA DEVELOPMENT DISTRICT**

P O Box 604  
613 College Street  
Elizabethtown, KY 42701

<http://www.ltadd.org/>

(270) 769-2393  
(270) 769-2993 Fax

## ***NORTHERN KENTUCKY AREA DEVELOPMENT DISTRICT***

22 Spiral Drive  
Florence, KY 41042

<http://www.nkadd.org/>

(859) 283-1885  
(859) 282-2707 Fax

## ***PENNYRILE AREA DEVELOPMENT DISTRICT***

300 Hammond Avenue  
Hopkinsville, KY 42240

<http://www.peadd.org/>

(270) 886-9484  
(270) 886-3211 Fax

## ***PURCHASE AREA DEVELOPMENT DISTRICT***

P O Box 588  
1002 Medical Drive  
Mayfield, KY 42066

<http://www.purchaseadd.org/>

(270) 247-7171  
(270) 251-6110 Fax

## ***THE KENTUCKY LEAGUE OF CITIES***

101 East Vine Street, Suite 600  
Lexington, KY 40507-3700

<http://www.klc.org>

(859) 323-3700  
(800) 876-4552  
(859) 323-3703 Fax

The Kentucky League of Cities (KLC) is a voluntary association of cities created in 1927, to assist municipal officials in representing the interests of cities and to provide services to members which will foster improved municipal government in Kentucky. The League provides a comprehensive service program to members which assists city officials in carrying out the important and challenging task of local governance.

### **AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTS (AICPA)**

1211 Avenue of the Americas  
New York, NY 10036-8775  
(212) 596-6200

1455 Pennsylvania Avenue, NW  
Washington, DC 20004-1007  
(202) 737-6600

<http://www.aicpa.org>

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### **FINANCIAL ACCOUNTING STANDARDS BOARD (FASB)**

401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116  
(203) 847-0700, Telephone Orders Ext. 10

<http://www.fasb.org>

FASB Organization. Formed in 1973 as the successor organization to the AICPA's Accounting Principles Board, FASB operates under the auspices of the Financial Accounting Foundation and under a 1984 jurisdictional agreement with GASB, which was reaffirmed in 1989, has GAAP standards-setting authority over all entities except those specifically assigned to GASB.

### **GENERAL ACCOUNTING OFFICE (GAO)**

441 G Street, NW  
Washington, DC 20548  
(202) 512-6000  
Fax (202) 512-6061

<http://www.gao.gov>

GAO publication copy requests should be sent to the U.S. General Accounting Office, P.O. Box 37050, Washington, DC 20013; phone (202) 512-6000. Orders may also be placed by using the fax number (202) 512-6061. Certain publications can also be obtained from GAO's home page.

### **GOVERNMENT FINANCE OFFICERS ASSOCIATION OF THE UNITED STATES AND CANADA (GFOA)**

Headquarters Office  
180 N. Michigan Avenue, Suite 800  
Chicago, IL 60601-7476  
(312) 977-9700  
Fax (312) 977-4806

Washington, DC Office  
1750 K Street, NW, Suite 350  
Washington, DC 20006  
(202) 429-2750  
Fax (202) 429-2755

<http://www.gfoa.org>

GFOA Organization. Founded in 1906, the GFOA is a professional association dedicated to serving the interests of government finance practitioners. GFOA offers a variety of services and programs designed to improve the knowledge and practice of government finance and enhance the skills and performance of those responsible for government finance policy and management.

GFOA publications include books, manuals, guidelines, and periodicals covering a wide range of financial management topics such as: accounting, auditing and financial reporting, budgeting, capital finance and debt administration, cash management, financial management, public employee retirement administration, etc. Contact GFOA's order department for a free catalog describing all currently available products and services.

### **GOVERNMENTAL ACCOUNTING STANDARDS BOARD (GASB)**

401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116  
(203) 847-0700

<http://www.gasb.org>

GASB Order Department, P.O. Box 30784, Hartford, CT 06150 (Prepaid orders only); or phone (203) 847-0700 ext 10

GASB Organization. Formed in 1984 as the successor organization to the National Council on Governmental Accounting (NCGA); GASB operates under the auspices of the Financial Accounting Foundation and under a 1984 jurisdictional agreement with the FASB, which was reaffirmed in 1989, has GAAP standards-setting authority over all state and local governmental entities, including (1) cities, counties, school and other special districts, and (2) public benefit corporations and authorities, public employee retirement systems, governmental utilities, hospitals and other health care providers, colleges, and universities.

### **NATIONAL ASSOCIATION OF LOCAL GOVERNMENT AUDITORS (NALGA)**

6 Clouser Road  
Mechanicsburg, PA 17055  
(717) 795-7475  
Fax (717) 795-7473

<http://www.nalga.org>

The National Association of Local Government Auditors brings together audit professionals to share common experiences. NALGA is a forum of issues that concern local auditors and a voice for their interests. NALGA provides members an opportunity to discover new ideas and innovations, improve audit quality, and encourage professional standards and ethics. Established in Philadelphia in the summer of 1989, NALGA is open to everyone. Full members are auditors from local governments, school

districts, boards and authorities that conduct audits as a primary duty. Federal and state auditors, and others, may join as Associates, non-voting members. NALGA's annual conference, designed specifically for local government auditors, features recognized experts and practitioners as well as opportunities for peer interaction. The Board of Directors has also initiated projects to improve audit quality, such as a peer review system for local auditors interested in external quality control review, and an automated data base of audit reports, unique audit methodologies and innovative recommendations.

### ***NATIONAL INTERGOVERNMENTAL AUDIT FORUM (NIAF)***

Room 5Z231b  
441 G Street, NW  
Washington, DC 20548  
(314) 516-8359 or (202) 512-9355  
Fax (314) 241-9091 or (202) 512-9193

NIAF Organization. Congress formally recognized the need for an organized intergovernmental approach to auditing by passing the Intergovernmental Cooperation Act of 1968. The primary purpose of the NIAF is to improve coordination and cooperation in intergovernmental auditing. The NIAF is the umbrella organization for ten regional forums composed of representatives from federal, state and local audit organizations and independent certified public accountants who meet to exchange ideas for improving governmental auditing.

### ***OFFICE OF MANAGEMENT AND BUDGET (OMB)***

Executive Office of the President Publications Office  
New Executive Office Building  
725 17<sup>th</sup> Street, NW  
Washington, DC 20503  
(202) 395-7332  
Fax (202) 395-9068

<http://www.whitehouse.gov/OMB>

Many of the Office of Management and Budget's publications are available on OMB's home page on the Internet. The Office of Management and Budget also makes several of its circulars available through a fax-on-demand system. Fax requests may be placed by calling (202) 395-9068.

### ***PRESIDENT'S COUNCIL ON INTEGRITY AND EFFICIENCY (PCIE)***

The PCIE was established in March 1981 to coordinate and implement government-wide activities to combat fraud and waste in government programs and operations. The PCIE is chaired by the Deputy Director of the Office of Management and Budget. Its members include the Associate Attorney General, the Director of the Office of Personnel

Management, the Executive Assistant Director for Investigations of the Federal Bureau of Investigation, the Director of the Office of Government Ethics, the Special Counsel of the Merit Systems Protection Board, all statutory Inspectors General, and a designee of the Secretary of the Treasury.

The PCIE Audit Committee published supplemental, nonauthoritative guidance for federal officials addressing issue arising from the implementation of the Single Audit Act and related OMB Circulars.

Over the years, the PCIE Audit Committee (or its predecessors) has issued a total of six position statements. Most of these position statements were developed to address issues related to audits conducted under the Single Audit Act of 1984, Circular A-128, and the March 1990 version of Circular A-133. Only PCIE Statement No. 4, which establishes uniform procedures for referrals of substandard audits to state boards of accountancy and the AICPA, continues to be applicable to audits conducted under the Single Audit Act Amendments of 1996 or the June 1997 Circular A-133.

PCIE Statement No. 4 is available from the U.S. Department of Education, Office of the Inspector General, Technical and Non-Federal Audit Staff, 600 Independence Avenue, SW, Washington, DC 20202-1510; telefax (202) 205-8238. It is also available on IGnet, the Inspectors General Internet site, in the Single Audit Library.

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# Prudent Record Keeping

## INTRODUCTION

Governmental entities are subject to a wide variety of complex laws and regulations. These restrictions impose a significant burden on the management team for any governmental entity. The requirements are justified, however, because governments are entrusted with the collection and distribution of public tax dollars. City officials must adopt a fiduciary role when managing the resources for their city since the monies originate with the taxpayers within and without the jurisdiction.

City officials should carefully review these recommendations and adopt written policies and procedures that will ensure compliance with these minimum provisions. The Kentucky Constitution and Kentucky Revised Statutes provide legal authority for certain minimum requirements to provide appropriate accountability in Kentucky cities.

## BONDING

KRS 65.067 requires that all officials or employees who handle public funds be bonded for an amount covering the maximum amount they may have under their control at any given time. This statute applies to all officers, officials, and employees of all local governments who handle public funds in the execution of their duties. Elected officials who post bond as required by another statute, and employees covered by a blanket or umbrella bond, will be in compliance with this requirement.

At a minimum, anyone who takes receipt of funds, signs checks, or is responsible for the deposit and investment of city funds should be bonded. Deputy officials, such as a deputy finance director or deputy treasurer, should be included under the primary official's bond.

While financial managers are responsible for the entire city budget during the fiscal year, at any particular time they are only handling a small portion of this amount. The administrative policy for the amount of bonds should be based on cash and investment balances to ensure that these amounts are safeguarded at all times. For instance, if the average checking account balances total \$500,000 and the average investment balances are \$2.5 million, the treasurer's bond should cover a total of \$3 million to provide adequate security.

## PERSONAL FUNDS SEPARATE FROM PUBLIC FUNDS (KRS 64.850 AND 61.190)

KRS 64.850 applies directly to county officials, but the penalty provisions of KRS 61.190 apply to all public officials. Public funds should always be separate from any personal funds and safeguarded to prevent misuse for personal purposes.

## **BOOKS OF ORIGINAL ENTRY (KRS 91A.020)**

City accounting systems must be based on generally accepted accounting principles (GAAP) outlined in the GASB Codification.

Books of original entry must be organized and maintained so that financial reporting will comply with these provisions. There are several characteristics that are important to consider:

- Understandability - The accounting system must provide a clear trail from the original transactions to the final financial reports. Management and users of the financial statements must be able to evaluate the results of operations and the nature of all governmental transactions.
- Reliability - Accounting systems, manual or automated, must accurately record the transactions.
- Completeness - All transactions of the city must be recorded in the books of original entry. No transactions should be omitted, even if external parties manage the funds. The city's portion of pooled funds, joint ventures or cooperative agreements must be reported in the financial statements.
- Timeliness - Accounting records must be maintained in a timely fashion. Transactions occur daily and entries to record those transactions should be completed promptly to provide accurate and timely financial reporting.
- Consistency - GASB requires the application of GAAP consistently from one period to another.
- Comparability - Legislators, managers and the public are always checking to see "how are we doing?" This analysis can only be accomplished if the city uses uniform accounting policies and procedures that reflect normal practices in the governmental environment.

The books of original entry are the most critical component of the government's accounting system. Analysis of historical information is more efficient and effective if the accounting system is structured with the characteristics listed above. Financial statements are based on the books of original entry. The government can only demonstrate compliance with laws and regulations and accountability for public funds if the books of original entry are properly organized and maintained.

## **BASIS OF ACCOUNTING (KRS 91A.020)**

KRS 91A.020 require Kentucky cities to follow generally accepted accounting principles (GAAP) established by the Governmental Accounting Standards Board. One of the primary principles (GASB Codification Section 1100.101) in governmental GAAP requires the governmental accounting system to provide the following:

- Present the financial reports fairly, with full disclosure, and in conformity with GAAP
- Demonstrate compliance with finance-related legal and contractual provisions

These accounting principles require modified accrual basis of accounting for governmental funds and accrual basis of accounting for proprietary funds (business-type activities). Governmental funds include the general fund and other funds for general types of governmental services and programs. Proprietary funds include the resources and operations of governmental services that are similar to the commercial sector. For instance, water, gas and sewer utility funds are proprietary. Another example is the public properties corporations created pursuant to 58.180.

## **ANNUAL BUDGET (KRS 91A.030)**

The provisions of KRS 91A.030 provide the basic budgetary requirements and should be emphasized to highlight the importance of the legal authority of the budget.

### *91A.030. Annual budget.*

- 1) *Each city shall operate under an annual budget ordinance adopted and administered in accordance with the provisions of this section. Notwithstanding any other provision of law, no city shall expend any moneys from any governmental or proprietary fund, except in accordance with a budget ordinance adopted pursuant to this section.*
- 2) *Moneys held by a city as a trustee or agent for individuals, private organizations, or other governmental units need not be included in the budget ordinance.*
- 3) *If, in any fiscal year subsequent to a fiscal year in which a city has adopted a budget ordinance in accordance with this section, no budget ordinance is adopted, the budget ordinance of the previous fiscal year shall have full force and effect as if readopted.*
- 4) *The budget ordinance of a city shall cover one (1) fiscal year.*
- 5) *Preparation of the budget proposal shall be the responsibility of the executive authority of the city in cities operating pursuant to KRS Chapter 83, KRS 83A.130 or 83A.140 or the city manager in cities operating pursuant to KRS 83A.150.*
- 6) *The budget proposal shall be prepared in the form and detail as is prescribed by ordinance.*
- 7) *The budget proposal together with a budget message shall be submitted to the legislative body not later than thirty (30) days prior to the beginning of the fiscal year it covers. The budget message shall contain an explanation of the governmental goals fixed by the budget for the coming fiscal year; explain important features of the activities anticipated in the budget; set forth the reasons for stated changes from the previous year in program goals, programs, and appropriation levels; and explain any major changes in fiscal policy.*
- 8) (a) *The legislative body shall adopt a budget ordinance making appropriations for the fiscal year in such sums as the legislative body finds sufficient and proper, whether greater or less than the sums recommended in the budget proposal. The budget ordinance may be in any form that the legislative body finds most efficient in enabling it to make the necessary fiscal policy decisions.*
- 9) (b) *No budget ordinance shall be adopted which provides for appropriations to exceed revenues in any one (1) fiscal year in violation of Section 157 of the Kentucky Constitution.*
- 10) *The full amount estimated to be required for debt service during the budget year shall be appropriated for all governmental fund types.*
- 11) *The city legislative body may amend the budget ordinance after the ordinance's adoption, if the amended ordinance continues to satisfy the requirements of this section.*
- 12) *Administration and implementation of an adopted budget ordinance shall be the responsibility of the executive authority of the city. That responsibility shall include the preparation and submission to the legislative body of operating statements which shall include budgetary comparisons of each governmental fund for which an annual budget has been adopted. These reports shall be submitted not less than once every three (3) months in each fiscal year.*
- 13) *To the extent practical, the system utilized in the administration and implementation of the adopted budget ordinance shall be consistent in form with the accounting system called for in KRS 91A.020.*
- 14) *No city agency, or member, director, officer, or employee of a city agency, may bind the city in any way to any extent beyond the amount of money at that time appropriated for the purpose of the agency. All contracts, agreements, and obligations, express or*

*implied, beyond existing appropriations are void; nor shall any city officer issue any bond, certificate, or warrant for the payment of money by the city in any way to any extent beyond the unexpended balance of any appropriation made for the purpose.*

KRS 91A.030 provides very specific guidelines for budget adoption, but it does allow flexibility for development and administration. A simplified approach for accounting and financial reporting includes a budget format that reflects the GAAP reporting requirements. Neither the KRS or the GASB prescribe the basis of accounting for budgets, but it is much easier to use the same basis for accounting and budgeting.

#### **NOTIFICATION TO THE STATE LOCAL DEBT OFFICER FOR LONG TERM DEBT ISSUANCE. (KRS 65.7719 AND 66.045)**

Cities cannot borrow funds without first notifying the state local debt officer. KRS 65.7719 provides the guidance for short-term debt (loans that are due within one year) and KRS 66.045 provides the guidance for long-term debt. Long-term debt is usually issued as general obligation, revenue or special assessment bonds in the public sector.

Statutory provisions related to the issuance of municipal debt are very complex. Cities should utilize the services of an attorney with experience in structuring municipal debt issues to ensure compliance with these legal restrictions. The Legislative Research Commission publishes Informational Bulletin Number 145, *Kentucky Municipal Statutory Law*. Chapter VI of that publication includes condensed discussions about indebtedness for Kentucky cities and a table that summarizes the applicable statutes.

#### **RECEIPTS FOR ALL COLLECTIONS**

Receipts for all collections are an important feature of internal controls over revenue collection. Receipts serve two purposes. First, they provide documentation to the payor that amounts have been remitted to the city. Second, receipts provide documentation about where collections originated and when amounts were remitted to the city. Receipts often contain more information than can easily be entered into the cash journals or general ledger.

The receipt system will depend on the type of collections and whether the accounting system is manual or automated. Payments that are evidenced by checks or tax returns do not require receipts unless the payor requests one. Walk-in taxpayers generally do require a receipt. The audit trail for cash receipts is improved with a written receipt, and the automated systems provide a more efficient means of receipting high volume collections such as concession sales.

Automated systems allow the issuance of receipts as transactions are recorded in the general ledger system. Manual systems, on the other hand, rely on receipts to document collections to be recorded in the cash receipts journal and summarized in the general ledger. The most important concept is that collections should be recorded as they are received. The taxpayer should receive verification of payment. And the collection should be recorded in the proper accounts to reflect the nature of the transaction. Receipt systems should be designed to provide efficient, accurate record keeping in a cost-effective manner.

## **OFFICIAL DEPOSITORIES (KRS 91A.060)**

All checking and savings accounts must be federally insured or collateralized. All deposits in excess of the insurance provided by Federal Deposit Insurance Corporation (\$100,000) should be fully collateralized or secured by surety bonds in accordance with KRS 66.480.

KRS 91A.060(1) delegates the authority to the executive authority for determining which financial institutions the city utilizes as its official depositories. The executive authority may delegate the administrative duties to the finance officer or city clerk. If the statutory authority is delegated to other administrative staff, the city's cash and investment policies should designate the officials who have authorization to open checking and savings accounts and make transfers or disbursements from those accounts. Those authorizations should also be limited to management level positions such as the city manager (or administrator), finance director (or treasurer), mayor and/or mayor pro-tem.

In most cases, it is beneficial to designate three individuals with authorization to establish official depositories and require two of those three signatures to authorize disbursements or transfers. This system will allow smoother operations when key officials are not in the office and strong internal controls to minimize unauthorized activity.

Cities should also be careful to avoid conflicts of interest between elected officials and the financial institutions selected for official depositories.

Government deposits are generally significant balances for the local banks. These deposits generate funds for economic development within the community, as well as residential and consumer loans. These accounts are also high-volume accounts that are costly to maintain. City officials should work closely with banks to identify the most efficient alternatives for the city's depository accounts. In some cases, banks will require service fees to pay for account maintenance. In other cases, the government can agree to keep specified amounts (compensating balances) on hand that generate sufficient income for the bank to recover costs. City officials should request an "Account Analysis" from the bank to explain the costs of services and the income earned by amounts on deposit.

Daily deposits insure that cash, checks, and other payments are adequately safeguarded. An individual who did not handle the collections and will not be reconciling the bank account should make deposits. In smaller cities, this segregation of duties can be difficult. If there is only one person to manage all the financial records, An appropriate official should assist with the cash functions to improve internal controls.

## **INTEREST-BEARING ACCOUNTS**

There is no statutory requirement to use interest-bearing accounts for the official depositories. However, it only makes good business sense. Governments may have significant amounts of surplus cash at any given point in time, and these surpluses should be invested prudently. Restrictions for early withdrawals should not create problems for access to funds for timely payment of obligations.

City officials should carefully review grant documents to determine requirements (or restrictions) on investments of advances for grant projects. Contracts may provide that these funds must be segregated from other city accounts and interest earnings restricted to the grant program or returned to the grantor.

Most money managers strive to maximize the interest earnings on idle cash reserves. In the governmental environment, this objective must also be balanced with legal or contractual restrictions and the preservation of principal. Governmental entities must *minimize* the risk of losing principal and ensure that all deposits are adequately safeguarded. Earning interest on cash reserves is a prudent business practice, but governments must not take chances with public money.

## **INVESTMENTS (KRS 66.480)**

KRS 66.480 provides very specific guidance about investments of Kentucky cities. In addition, the statute requires cities to develop written investment policies for management of investments. A copy of a model investment policy developed by the Kentucky League of Cities is included in Appendix C. City officials should refer to the statute for the specific requirements. Highlights of the statute include:

- ❑ Investments are limited to the types of obligations and instruments specified in the statute.
- ❑ Investments should be diversified so that no more than 20% of the investment portfolio is placed in a single institution or invested in the same obligation, such as a single certificate of deposit or a single U S Treasury note or bond.
- ❑ Governments may not purchase investments on "margin" accounts.
- ❑ The written policies should include the following provisions:
  - ❑ A designation of the officer or officers of the local government or political subdivision who are authorized to invest and oversee the investment of funds;
  - ❑ A list of the permitted types of investments;
  - ❑ Procedures designed to secure the local government's or political subdivision's financial interest in the investments;
  - ❑ Standards for written agreements pursuant to which investments are to be made;
  - ❑ Procedures for the oversight, control, deposit, and retention of investments and collateral;
  - ❑ Standards for the diversification of investments, including diversification with respect to the types of investments and firms with whom the local government or political subdivision transacts business;
  - ❑ Standards for the qualification of investment agents which transact business with the local government, such as criteria covering creditworthiness, experience, capitalization, size, and any other factors that make a firm capable and qualified to transact business with the local government or political subdivision; and
  - ❑ Requirements for periodic reporting to the governing body on the status of invested funds.
- ❑ Investment requirements are not intended to contradict legal provisions for depository accounts.
- ❑ Investment authority can be delegated to appropriate officials who are authorized to handle public funds, such as the treasurer, finance director, or fiscal officer.
- ❑ The state local debt officer will provide technical assistance on investment management.
- ❑ The state local debt officer may create investment pools to provide investment alternatives for cities or cities and counties may create investment pools. (Note: The Kentucky League of Cities operates an investment pool for its member cities.)

City officials should carefully review the requirements of KRS 66.480 to ensure that investments of the city comply with legal mandates.

## DEPOSIT AND INVESTMENT SECURITY (KRS 66.480)

There are several issues that should be considered to provide adequate security for deposits and investment of public funds. Safety should be the primary concern with all investments. These considerations fall into two broad categories:

- Protection against loss of principal
- Safeguarding custody of investments and underlying securities

KRS 66.480 (1)(d) requires a pledge of securities to protect all public funds except direct federal obligations and funds protected by federal insurance. Most governmental deposits exceed the \$100,000 FDIC coverage. Therefore, the banks are required to set aside collateral with a market value equal to the amount of deposits that exceed the \$100,000. The Attorney General has issued an opinion, OAG 94-22, that interprets the provisions of KRS 66.480. This opinion emphasizes that the collateral must have a quoted market value equal to the balances that are uninsured.

Cities often have related agencies that also deposit funds in local banks. City officials should consult with their legal counsel to determine which accounts are combined to calculate the \$100,000 insured balance. The government, including its related entities, only has insurance for \$100,000 in *each* financial institution. Collateral for uninsured deposits should also cover uninsured deposits of related entities. For instance, if the city creates a Children's Museum that is owned and operated by the city, the account balances for the museum should be included in collateral requirements for other city deposits. This would also apply to accounts maintained by the city utilities board or the tourism commission. When in doubt about which balances are included -- require collateral.

Collateral requirements should also be adjusted when balances change significantly. For example, property tax collections or quarterly license fee payments generally create large balances in the checking account until transfers or investments are completed. Collateral should also be adjusted to reflect these increases. Collateral can be released after balances return to lower levels.

Repurchase agreements are a common investment for state and local governments. A repurchase agreement is a purchase of securities with a promise from the seller to buy those securities back (repurchase) at a specified price on a specified date. The risk in a repurchase agreement is that the seller will not be able to repurchase the securities as promised. The protection against this risk is the value of the underlying security. If the security has a market value equal to the agreed price in the repurchase agreement, the buyer has the option of selling the security to another entity to recover funds. Just like the requirements for collateralizing deposits, the city should be sure that the value of the underlying securities matches the value of the agreed sales price.

Another primary consideration is safeguarding the custody of collateral, securities and investments. In many cases, financial instruments are no longer issued in paper form. Banks and investment brokers often use "book entry" to transfer ownership and custody. However, safekeeping receipts are issued for these types of transactions. These safekeeping receipts should be safeguarded as if they were securities or investments. Written policies for investment management should require delivery of these receipts to the appropriate city official and advise banks and investment brokers that changes cannot be made without approval from designated officials.

The custodian for collateral and investment securities is also important. The bank should not hold the collateral set aside for the city's deposits. This collateral should be transferred to a third party custodian, usually another bank or a Federal Reserve Bank, and held in the name of the city. The city should insist on third party custodians to hold collateral securities.

City officials should periodically ask banks to provide a listing of collateral and the current market value. If balances change significantly each month, the collateral balances should be reviewed monthly. If the city maintains relatively steady account balances, quarterly reviews may be sufficient. The collateral report should indicate the type of security, maturity date, interest rate, face amount, and current market value and indicate the name of the third party custodian. An authorized bank official should sign the collateral report to verify that market values are accurate to the best of his/her knowledge. The city should reconcile the collateral report with the safekeeping receipts sent by the third party custodians.

### **MONTHLY BANK RECONCILIATION (GASB SECTION 1100)**

Governments usually have numerous transactions within any given month. Monthly bank reconciliations ensure that bank records and book records reflect the same transactions. The bank reconciliation will provide important information to verify the accuracy of book entries. Errors and irregularities will be much easier to correct if they are discovered quickly. In addition, banks usually require notification within a certain number of *days* to correct any errors on the bank statements.

It is also important for the bank reconciliations to be prepared by someone who did not write checks or make deposits. Internal control over cash and investments is much better if these functions are separated. Cash and investments are subject to the highest risk for misuse and misappropriation and should be closely safeguarded.

### **WRITTEN AUTHORIZATIONS FOR DISBURSEMENTS (KRS 91A.060)**

KRS 91A.060(2) requires a written authorization for all expenditures from public funds. The statute does not provide specific guidance about the use of cash and checks. The DLG recommends that cities only disburse funds with checks. Petty cash funds should be kept to minimum balances, such as \$100 to \$200 for smaller items. All other disbursements should be made by check.

Checks provide important documentation (audit trail) of the transaction and satisfy the requirements of KRS 91A.060. This statute specifies the following criteria for documentation of expenditures:

- Name of payee
- Purpose of expenditure
- Funds used to finance expenditure
- Numerical sequence
- Written record of transaction

Current technology is moving toward a paperless financial system. Many federal transactions are already restricted to electronic transfers. Banks are offering on-line services that allow customers to enter transactions via modem or telephone. The Internet offers numerous alternatives for electronic commerce for governmental entities. While the statutory language was written prior to the development of this technology, the basic concepts in the statute should also be applied to the government's electronic transactions. Authorizations for electronic transactions should include the same information required for authorization of disbursement by check.

In some cases, individuals will be granted authorization for recurring transactions that will be documented with a master document, such as a policy statement or memo. Documentation may also be a worksheet for calculating the amounts. There should also be documents that provide information to be recorded in the general ledger system if the system is not interfaced with the electronic transaction system. Very often, the electronic system will generate a confirmation of the transaction that includes the details required by KRS 91A.060.

### **PURCHASE ORDER SYSTEM (KRS91A.060 and GASB Sections 1600 and 1700)**

KRS 91A.060 only permits city disbursements with written authorization from the executive authority. Executive authority is the mayor in a mayor/council city, the city manager in a manager/commission city and the entire commission in a commission city. A sound purchase order system is the most effective way to accomplish this.

First, purchase orders provide authorization for the acquisition of goods and services prior to the actual purchase. Once a vendor has delivered goods or services as promised, the city has an obligation to pay for those items. The purchase order notifies the vendor that proper purchasing authority exists, and that sufficient resources have been appropriated for payment.

Second, a purchase order system is an inherent component of modified accrual and accrual basis of accounting and compliance with GAAP. These principles require recognition of expenditures (or expenses) when costs are incurred, not when payment is rendered. A purchase order system is really the only way to track expenditures (expenses) for the modified accrual (accrual) basis of accounting.

Third, the purchase order system improves budgetary compliance. Agreements with vendors to purchase goods and services create a commitment against budgetary appropriations. Purchase orders are the easiest way to monitor these commitments. Purchase orders should be recorded as reductions of available funds and reconciled to invoices to insure that budget resources are available for all purchases.

### **KRS 424.260. Bids for materials, supplies, equipment, or services.**

- (1) Except where a statute specifically fixes a larger sum as the minimum for a requirement of advertisement for bids, no city, county, or district, or board or commission of a city or county, or sheriff or county clerk, may make a contract, lease, or other agreement for materials, supplies except perishable meat, fish, and vegetables, equipment, or for contractual services other than professional, involving an expenditure of more than twenty thousand dollars (\$20,000) without first making newspaper advertisement for bids.*

Cities may also establish lower limits for other controls on purchasing. For instance, the city could require three written price quotes for purchases of \$1,000 to \$20,000. Large volume purchases of small items could be controlled with price contracts. If all departments use office supplies, for example, the city may advertise and negotiate a price contract with one or more vendors to establish the price for the entire fiscal year.

The statute allows an exception for emergency purchases. In some cases, such as natural disasters, or a major equipment failure that threatens public safety, there is not sufficient time to advertise for bids. The chief executive officer should provide a written certification to the financial officer that an emergency exists. This written certification should be retained with the expenditure records to document compliance with KRS 424.260. In some cases, these purchases will also require legislative approval or a budget amendment.

KRS 45A.345 - .460 allows cities to adopt the Model Procurement Code used by the Commonwealth of Kentucky. This section of 45A provides the specific requirements for local government procurement and the balance of Section 45A applies only to the Commonwealth. The Model Procurement Code is designed to achieve the following objectives:

- Simplify, clarify, and modernize the law governing purchasing
- Permit the continued development of purchasing policies and procedures
- Consistent purchasing laws among governmental entities
- Provide for increased public confidence in the procedures followed in public procurement
- Insure fair and equitable treatment of all persons who deal with the procurement system
- Provide increased economy in governmental procurement by fostering effective competition
- Provide safeguards for the maintenance of a procurement system of quality and integrity.

### **MODEL PROCUREMENT CODE (KRS 45A.343 - 460)**

Cities are not required to adopt the Model Procurement Code in KRS 45A.343 through 45A.460, but it provides excellent guidance for development of purchasing policies and procedures. The Code was specifically written for local governments. The statutes provide broad guidelines and flexibility for city officials to adopt specific policies that are in the best interests of the taxpayers.

The basic provisions in these statutes include:

- ❑ Requires all contractors and vendors to comply with applicable income tax, sales tax, workmen's compensation, wage and hour, occupational safety, and unemployment statutes.
- ❑ Outlines the elements for using energy savings contracts.
- ❑ Mandates written documentation of purchasing decisions and problem resolutions.
- ❑ Directs local governments to develop administrative regulations for purchasing functions.
- ❑ Discusses the requirements for competitive sealed bidding, competitive negotiation, and noncompetitive negotiation.
- ❑ Allows local governments to adopt their own policies for small purchases.
- ❑ Provides guidance for cancellation of invitation for bid, request for proposal or rejection of all bids or proposals.
- ❑ Describes how government officials should document whether a vendor has met the bid requirements.
- ❑ Establishes the criteria for pre-qualifying potential bidders.
- ❑ Restricts changes in cost estimates after bids are awarded.
- ❑ Allows local governments to inspect vendor sites to evaluate performance and compliance with relevant laws and regulations.
- ❑ Discusses the use of specifications in the invitation to bid or request for proposal and sets forth the requirements for using unique specifications.
- ❑ Provides guidance for the disposal of surplus property.
- ❑ Outlines the requirements for bonds to ensure compliance with submitted bids and performance for providing goods and services.
- ❑ Emphasizes the importance of maintaining public confidence, applying fair and impartial judgment, hiring and retaining competent staff, and protecting government integrity.
- ❑ Prohibits gratuities and kickbacks and restricts the use of confidential information.
- ❑ Allows local governments to develop cooperative purchasing agreements to maximize purchasing efficiency.
- ❑ Requires recovery of value for transfers or payment in breach of ethical standards.

Even if a city chooses not to adopt these provisions, these criteria can be incorporated into the purchasing policies and procedures adopted by ordinance.

## **FIXED ASSET INVENTORY (GASB SECTION 1400)**

Fixed asset inventories are based on GAAP requirements to account and report for fixed assets. Certain assets are recorded in the funds and others are segregated in the general fixed asset account group. Cities can only comply with the GAAP requirements for reporting fixed assets if adequate inventory records are maintained to track acquisitions and dispositions of fixed assets.

Fixed assets are an important resource for governmental entities. Many assets, such as park facilities, street equipment, fire trucks or police cars, are necessary to deliver public services. Accounting and reporting principles are structured to provide information about the availability of these resources and the potential to provide future services.

Fixed asset inventories also provide important controls to safeguard these assets from misuse or misappropriation. Inventory records are also important for coordinating adequate insurance coverage for public assets. Inventory records should originate with the purchase of fixed assets, but should also monitor the location and disposition of fixed assets. Periodic physical inspection of fixed assets should be conducted to insure that written inventory records are accurate. All fixed assets should be tagged and numbered to clearly identify public property. Inventory tags should be pre-numbered and controlled by the appropriate city official. Auditors should verify that inventory records support balances included in the annual financial statements.

Fixed asset inventories will also provide valuable information for the budgetary process. Many cities include a multi-year capital improvement plan in their annual budget. Inventory records can generate details about asset condition, age, and/or obsolescence to support recommendations for additional budget resources for capital projects.

## **BONUSES, PREPAYMENT, AND CONTRIBUTIONS (SECTION 3, KENTUCKY CONSTITUTION)**

The provisions of Section 3 of the Kentucky Constitution provide broad guidance for the use of public funds. There are numerous opinions from the Attorney General that provide additional guidance about how to apply these constitutional rules. Basically, the following opinions define that public funds cannot be expended for bonuses and no prepayments are permitted for goods or services. City officials should carefully review this section and the accompanying OAG references to clearly understand the limits for expenditure of public funds.

*A city is not legally authorized to grant a bonus or additional compensation to city employees out of public funds over and above that amount fixed according to law. OAG 62-1.*

*Governmental appropriations must be for a public purpose. When examining whether or not a purpose is a "public purpose" the "test is not who receives the money, but the character of the use for which it is expended." Public funding must also meet the "connection and control" test. Appropriations, which are earmarked and used for a public purpose, are a lawful use of public funds and are consistent with Section 179 of the Kentucky constitution. OAG 99-5 [This opinion was issued to provide guidance for appropriations made to nonprofit entities, which are earmarked and used for a public purpose]*

*The practice of making full or partial payments on state personal service contracts which reflect no services actually rendered is unconstitutional. OAG 79-448.*

*This section is unequivocal on the point that public emolument to any person must be based on the consideration of "public services," which means "public services actually rendered," not "public services to be rendered." OAG 79-448.*

### **ANNUAL FINANCIAL STATEMENT (KRS 424.220, GASB SECTION 1900 & 2200)**

As city officials design and implement any financial administration system, they should be aware of the requirements for preparing and publishing annual financial statements. Requirements for reporting will define how transactions in the books of original entry are summarized and consolidated to prepare financial reports. On the other hand, certain types of transactions require special reporting, so the accounting system should be designed to highlight these transactions.

GASB requires certain disclosures about long-term debt in the notes to the financial statements. Similar information must be included in the Uniform Financial Information Report required by KRS 65.900. The records for bonds and notes should clearly identify the type of debt issued, date funds were borrowed, interest rates, term, maturity, source of funds for repayment, and requirements for periodic payments to comply with these reporting requirements. Depending on the type of debt incurred, a city must first notify the state local debt officer prior to incurring long-term debt. Therefore, reporting related to debt occurs both before the funds are borrowed and at the end of each fiscal year. The financial management system should provide for all types of reporting.

KRS 424.220 also requires local governments to publish annual financial information in newspapers. There are provisions for publishing selected sections of the audit report in lieu of the detailed financial information.

### **ANNUAL AUDIT (KRS 91A.040)**

Audits are a critical component of any financial management system and the Kentucky Revised Statutes emphasize the significance of audits. Cities must demonstrate compliance with laws, regulations and contracts and provide accountability for the use of public funds. KRS 91A.040 requires audits to be conducted in accordance with generally accepted governmental auditing standards by an independent certified public accountant or the auditor of public accounts. The auditor's reports provides users of governmental financial reports with the results of their objective, independent analysis about the following:

- ❑ Whether the general purpose financial statements present fairly, in all material respects, with full disclosure, the financial position and results of financial operations of the funds and account groups of the governmental unit in conformity with generally accepted accounting principles,
- ❑ Results of tests of compliance with laws, regulations, contract and grants,
- ❑ Whether there are reportable conditions or material weakness in the internal controls over financial reporting,
- ❑ If applicable, the results of test of compliance with federal laws and regulations over federal financial assistance, and
- ❑ If applicable, whether there are reportable conditions or material weakness in the internal controls over programs funded with federal financial assistance.

Audits support the government's accountability for public resources. The requirements for independent audits provide assurance that taxpayers, legislators, creditors, and management can rely on annual audits to highlight critical information about these important issues.

There are exceptions to the annual audit requirements for sixth class cities. If a sixth class city receives **and** expends more than \$75,000 in a fiscal year, or less than \$75,000 and have long-term debt, audit requirements only apply in odd-numbered fiscal years. If these cities receive and expend less than \$75,000 and have **no** long-term debt, they are not required to have an audit for that particular fiscal year. Sixth class cities must continue to comply with the publishing requirements of KRS 424.220 in any year that is not audited. Section III provides a detailed discussion of governmental auditing and requirements for Kentucky cities.

# CHART OF ACCOUNTS

## Technical References

KRS 91A.050

GASB Codification Sections 1100, 1200, 1300, 1700, 1800 and 1900

GAAFR (the Blue Book), Appendix C

Kentucky cities are encouraged to follow the chart of accounts included in the GFOA publication, *Governmental Accounting, Auditing and Financial Reporting*, (the Blue Book). The Blue Book provides a comprehensive outline for structuring a chart of accounts for any state or local government within most governmental financial accounting software applications. A chart of accounts patterned after Appendix C in the Blue Book will comply with the "model system of accounts" as prescribed by KRS 91A.050.

A chart of accounts is used to identify and appropriately classify financial transactions, balances, etc. The chart of accounts presented in this manual presents an illustrative simplified chart of accounts for smaller governmental units. A smaller government unit may use the simplified chart of accounts presented in this section, or expand the chart of accounts to identify all revenues by sources, all expenditures by function, and segregates these into the appropriate funds and departments.

### ***GASB CODIFICATION SECTIONS 1100***

Section 1100 outlines several basic principles for governmental accounting and reporting. These principles include:

- The accounting system should support the preparation of financial statements in accordance with generally accepted accounting principles and demonstrate compliance with applicable laws and regulations.
- Governmental accounting systems should be based on a fund accounting system to segregate resources in compliance with legal and contractual restrictions. (This does not mean that a separate checking account is required for each fund.)
- Governmental funds include the following:
  - General Fund
  - Special Revenue Funds
  - Capital Projects Funds
  - Debt Service Funds
- Proprietary funds include the following:
  - Enterprise Funds
  - Internal Service Funds
- Fiduciary funds include the following:
  - Pension Trust Funds
  - Investment Trust Funds
  - Expendable Trust Funds
  - Nonexpendable Trust Funds
  - Agency Funds
- Account groups include the following:
  - General Fixed Asset Account Group
  - General Long-Term Debt Account Group

- Governmental entities should establish and maintain those funds required by law. However, GASB encourages governments to create only the minimum number of funds necessary to provide efficient management of programs and services.
- Fixed assets and liabilities are designated as either "fund" assets and liabilities or "general" assets and liabilities. Governmental "fund" assets and liabilities are reported within the appropriate fund and "general" assets and liabilities are reported within account groups, a specialized fund type. All fixed assets and liabilities of proprietary and fiduciary funds are reported within the individual funds.
- Fixed assets are recorded at cost. Depreciation is not recorded in governmental funds, but proprietary operating statements do include depreciation for fixed assets.
- Governmental entities use either modified accrual or accrual basis of accounting. This principle will be discussed in more detail in Section I-C.
- Accounting systems should support accounting and reporting transactions in accordance with a legally adopted budget.
- Interfund transfers and proceeds of general long-term debt should be classified separately from fund revenues and expenditures.
- Governmental fund revenues should be classified by fund and source.
- Governmental expenditures should be classified by fund, function (or program), organization unit, activity, character, and objects.
- Proprietary fund revenues and expenses should be classified using a structure that is similar to the private sector format for that particular type of business.
- Governments should follow the terminology and classification outlined in the GASB Codification and apply these principles consistently throughout the budget, general ledger accounting system, and financial reporting.
- The accounting system should support the reporting requirements outlined in the GASB Codification and relevant state laws and regulations and provide interim reporting for program management.

## **GASB CODIFICATION SECTIONS 1200**

Section 1200 highlights the primary characteristics of generally accepted accounting principles (GAAP).

Section 1200 emphasizes the importance of an accounting system that will demonstrate accounting and reporting compliance with both GAAP requirements and legal requirements. The chart of accounts should be designed to allow management to demonstrate compliance with:

- ◆ Legally adopted budget
- ◆ KRS accounting and reporting requirements
- ◆ Bond indentures
- ◆ Grant agreements
- ◆ Other legal and contractual restrictions

## **GASB CODIFICATION SECTIONS 1300**

Section 1300 outlines the basic principles of the fund accounting system.

Funds are critical for governmental entities to segregate resources in compliance with legal and contractual restrictions. GASB establishes three fund categories, two account groups, and seven major fund types, as summarized above in Section 1100. This format provides a consistent structure for all governmental entities and comparability in governmental financial statements. The chart of accounts should be organized based on the fund structure prescribed by the GASB Codification. Management can exercise professional judgment to designate the funds that are necessary to demonstrate compliance with laws and regulations within the concepts established by GASB.

## **GASB CODIFICATION SECTIONS 1700**

Budgets provide the legal authorization to expend public resources and deliver services and programs. Once established, budgets can only be amended with the proper legal authority. Information about budget organization, development and reporting is outlined in Section II of this manual.

The chart of accounts should reflect the organization of the budget. In addition, the general ledger system should provide information to monitor compliance with the budget ordinance. Budget information within the general ledger system must reconcile to the legally adopted budget. Budgetary controls are improved and strengthened if the general ledger system includes both the budgetary accounting and the financial accounting information.

Special budget accounts are necessary to provide summary totals to reconcile the general ledger system to the budget. These amounts can also be used to estimate the ending fund balance based on year-to-date actual operating results. The special accounts that should be included within the "Liabilities and Fund Balance" section of the Balance Sheet codes are:

295	Budgeted Change in Fund Balance
296	Total Budgeted Revenues
297	Total Budgeted Expenditures

The actual numbers or coding for these accounts should be assigned based on the chart of accounts as structured for each individual city.

## **GASB CODIFICATION SECTIONS 1800**

Section 1800 summarizes the basic principles for classifying transfers, revenues, expenditures, and expenses for governmental entities and requires governmental entities to use a common terminology and classification consistently throughout the budget, accounts, and financial reporting. Use of these terms and classifications is important to:

- ◆ Provide uniform reporting among governmental entities
- ◆ Demonstrate compliance with GAAP, laws, and regulations
- ◆ Simplify governmental financial reporting for users of the financial statements
- ◆ Illustrate accountability for public resources

Section 1800 provides the basic concepts for the chart of accounts. These concepts are illustrated in the chart of accounts in Appendix C of the Blue Book. In the governmental sector,

this Appendix is recognized as the link between the GAAP requirements of Section 1800 and the practical implementation for most governments.

## **GASB CODIFICATION SECTIONS 1900**

Section 1900 outlines the basic GAAP requirements for financial reporting.

The structure of any chart of accounts or accounting system should support all these reporting requirements. Manual systems will generate a trial balance that is used to prepare financial reports while more sophisticated automated systems may generate the actual reports. In either case, it is more efficient to organize the accounting records so that consolidations, summaries, and analysis in the preparation of financial reports are consistent with the GAAP accounting and reporting principles. In addition, interim reports to management and the legislative body should be consistent with the Comprehensive Annual Financial Report and any regulatory reports generated from the financial records.

## **GAAFR (THE BLUE BOOK)**

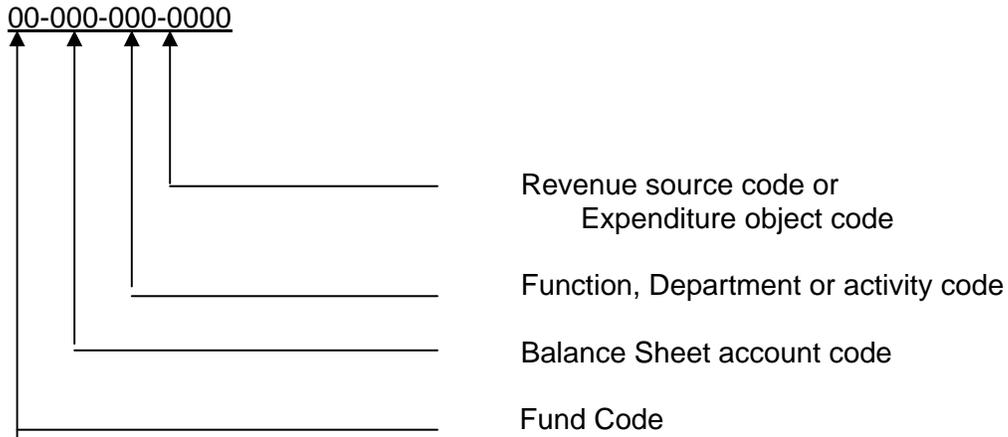
Government Finance Officers Association publishes an important book for governmental financial managers. *Government Accounting, Auditing and Financial Reporting* (GAAFR or the Blue Book) is considered to be the most authoritative practical guidance for implementing GASB standards for governmental accounting. Appendix C of the GAAFR includes an illustrative chart of accounts that has been adapted to provide a model chart of accounts for Kentucky cities.

Coding of accounts is a system of classifying each receipt and disbursement with a code (numerical or alphabetical) to facilitate proper identification of the transaction in the accounting records of the governmental unit by reference to the assigned code. It eliminates the necessity of writing out the names or titles of accounts to which they are to be posted, and it is particularly essential for automated accounting.

Coding the accounts reveals the relationships between the various accounts more clearly and facilitates the preparation of financial statistics. Through a combination of code numbers it is possible to recognize immediately the fund involved and the source of revenue or the specific nature of an expenditure. Efficiency is improved if the same object account carries the same code number regardless of the fund within it is used, with the exception of the number identifying the fund itself. Likewise, the revenue source code or function, department or activity and balance sheet account codes should be identical for all funds. This organization will allow computerized systems to consolidate financial information based on designated codes.

The model system of accounts is organized using funds, balance sheet accounts, departments (or functions), and object codes. The numbering sequence and number of digits in each category is dependent on the organizational structure of the automated system and the number of funds and accounts necessary to track a city's operations. The following illustration uses a 12-digit account number; 2 digits for the fund, 3 for the balance sheet, function codes, and 4 digits for object codes. A city may adopt any numbering sequence that supports the financial reporting and budgetary compliance requirements while providing financial information to the management team. The numbering should be organized to fit the needs of each city and its accounting system. Only the titles in the model chart of account are important to provide consistent reporting among Kentucky cities.

A fully coded transaction would appear as follows:



Fund Code:

- 01 General Fund
- 10 Special Revenue Funds
- 20 Capital Project Funds
- 30 Debt Service Funds
- 50 Enterprise Funds
- 60 Internal Service Funds
- 70 Trust Funds
- 80 Agency Funds
- 90 Account Groups

Balance Sheet Codes:

- 100 – 199 Asset Accounts
- 200 – 299 Liabilities and Fund Balance (Retained Earnings)
- 300 – 399 Revenue Accounts
- 400 – 499 Expense Accounts, including the Expenditure Object Codes

Function or Department Codes:

- 100 General Government
- 200 Public Safety
- 300 Streets and Roads
- 400 Sanitation
- 500 Parks and Recreation
- 600 Community Development
- 700 Public Utilities

Object Codes:

3100	Property taxes
3200	Licenses and permits
3300	Intergovernmental revenues
3400	Charges for services
3500	Fines & forfeitures
3600	Investment income
3700	Other income
3800	Transfers
3900	Other sources
4100	Personnel services
4200	Fringe benefits
4300	Contractual services
4400	Materials & supplies
4500	Other costs
4600	Capital outlay
4700	Debt service
4800	Transfers and other uses

This illustration highlights the major classifications that should be segregated within the chart of accounts. Additional accounts should be added to provide sufficient detail for monitoring operations and programs. An illustrative chart of accounts follows.

# ILLUSTRATIVE CHART OF ACCOUNTS

## Fund Codes:

- 01 General Fund
  
- 10 Special Revenue Funds
  - 11 Municipal Aid
  - 12 LGEAF
  - 13 Community Development Block Grant
  - 14 Other
  
- 20 Capital Project Funds
  - 21 Main Street Parking Garage
  - 22 City Hall Renovation
  - 23 Finley Park Improvements
  - 24 Fire Station #2 Construction

Use a separate fund for each bond issue and construction project.
  
- 30 Debt Service Funds
  - 31 General Obligation, Series 1985
  
- 40 This section is reserved for a new type of fund created by GASB Statement 34.
  
- 50 Enterprise Funds
  - 51 Water Utility
  - 52 Sewer Utility
  - 53 Gas Utility
  - 54 Electric Utility
  - 55 Other
  
- 60 Internal Service Funds
  - 61 Equipment Maintenance Fund
  - 62 Stores Revolving Fund
  - 63 Insurance Revolving Fund
  
- 70 Trust Funds
  - 71 Police & Fire Pension Fund
  - 72 Regional Investment Pool
  
- 80 Agency Funds
  - 81 Deferred Compensation
  - 82 Property Tax Collections
  
- 90 Accounts Groups
  - 91 General Fixed Assets Account Group
  - 92 General Long-Term Debt Account Group

## BALANCE SHEET ACCOUNTS

### Assets

101	Cash in Bank #1
102	Cash in Bank #2
103	Cash in Bank #3
104	Cash in Bank #4
111	Petty Cash
112	Certificates of Deposit
113	U S Treasury Obligations
114	Other investments
121	Accounts Receivable
122	Notes Receivable
123	Accrued Interest Receivable
124	Special Assessments Receivable
131	Property Tax Receivable - current
132	Property Tax Receivable - delinquent
133	Deposits Receivable
141	Due from Other Governments
142	Due from Other Funds
151	Inventories
161	Land
162	Buildings
163	Improvements Other than Buildings
164	Office Furniture and Equipment
165	Machinery and Equipment
166	Automobiles and Trucks
171	Prepaid Expenses
181	Other Assets
191	Amounts Available for Debt Service
192	Amounts to be Provided for Debt Service

## **Balance Sheet Accounts (continued)**

### **Liabilities**

201	Accounts Payable
202	Notes Payable
211	FICA Taxes
212	Federal Withholding Taxes
213	State Withholding Taxes
214	Other Withholding Taxes
215	Benefits Payable
221	Sales Tax Payable
231	Contracts Payable
232	Construction Contracts Payable
241	Due to Other Governmental Units
242	Due to Other Funds
251	Matured Bonds Payable
252	Matured Interest Payable
253	Bonds Payable
261	Contributions from Governmental Units
262	Contributions from Other Funds
263	Contributions from Customers
264	Contributions from Developers
271	Reserve for Debt Service
272	Other Reserves
273	Contributed Capital
274	Retained Earnings
275	Fund Balance
280	Investment in General Fixed Assets
295	Budgeted Change in Fund Balance
296	Total Budgeted Revenues
297	Total Budgeted Expenditures

## **FUNCTION OR DEPARTMENT CODES**

### **GENERAL GOVERNMENT**

- 100 Administrative
- 110 Executive
- 120 Legislative
- 130 City Clerk
- 140 Finance
- 150 City Attorney
- 160 Planning and Zoning

### **PUBLIC SAFETY AND HEALTH**

- 210 Police Department
- 220 Fire Department
- 230 Building Inspection
- 240 Animal Control
- 250 Health Services

### **STREETS AND ROADS**

- 310 Streets and Roads
- 320 Maintenance

### **SANITATION**

- 410 Sanitation
- 420 Recycling

### **PARKS AND RECREATION**

- 510 Parks
- 520 Golf Course

### **COMMUNITY DEVELOPMENT**

- 610 Economic Development
- 620 CDBG Housing Programs
- 630 CDBG Economic Development

### **PUBLIC UTILITIES**

- 710 Water Utility
- 720 Sewer Treatment
- 730 Electric Utility

## REVENUE OBJECT CODES

- 3100 TAXES
  - 3110 General Property Taxes - Current
  - 3120 Prior Year's Taxes - Delinquent
  - 3130 Hotel/Motel Tax
  - 3140 Restaurant Tax
  - 3150 Insurance Premium Tax
  - 3160 Local Deposits Franchise Tax
  - 3180 Payments in Lieu of Taxes
  - 3190 Penalties and Interest
  
- 3200 LICENSES AND PERMITS
  - 3210 Occupational License Fee - Payroll
  - 3211 Occupational License Fee - Net Profits
  - 3212 Business Licenses
  - 3220 Auto Stickers
  - 3230 Alcoholic Beverage License Fees
  - 3240 Taxi Licenses
  - 3240 Vending Machines Licenses
  - 3250 Animal Licenses
  - 3260 Building Permits
  - 3261 Electrical License/Inspection
  - 3262 Building Inspections
  - 3263 Development Impact Fees
  - 3270 Utility Franchise Fees
  - 3290 Penalties & Interest
  
- 3300 INTERGOVERNMENTAL REVENUE
  - 3310 Municipal Road Aid
  - 3311 Local Government Economic Assistance
  - 3312 Police Training Incentive Grant
  - 3313 Fire Training Incentive Grant
  - 3314 Base Court Revenue
  - 3315 Area Development Fund Grant
  - 3316 Community Development Block Grants
  - 3320 Other County Grants
  - 3330 Other Local Government Grants
  - 3340 Federal Grants

- 3400 CHARGES FOR SERVICES
  - 3410 Parking
  - 3411 Meters
  - 3412 Parking Facilities
  - 3420 Parks and Recreation Fees
  - 3430 Sanitation
  - 3431 Refuse Collection
  - 3432 Recycling
  - 3440 Ambulance Services
  - 3450 Rental Income
  - 3460 Transit Authority
  - 3470 Airport Fees
  - 3480 Special Assessments
  - 3481 Police Contractual Services
  - 3490 Utility Charges
  - 3491 Electric Utility Fees
  - 3492 Water Utility Fees
  - 3493 Gas Utility Fees
  
- 3500 FINES & FORFEITURES
  - 3510 Fines
  - 3520 Parking Citations
  - 3530 Other Fines
  
- 3600 OTHER REVENUE
  - 3610 Sale of Surplus Property
  - 3620 Local Contributions
  - 3630 Investment Interest
  - 3690 Miscellaneous
  
- 3800 TRANSFERS AND OTHER SOURCES
  - 3810 Transfers in
  - 3820 Bond Proceeds
  - 3830 Note Proceeds

## **EXPENDITURE OBJECT CODES**

### **4100 SALARIES AND WAGES**

- 4110 Salaried employees
- 4120 Hourly or weekly employees
- 4130 Part-time employees
- 4140 Training Incentive
- 4150 Longevity
- 4160 Uniform allowance

### **4200 FRINGE BENEFITS**

- 4210 Medical and hospital insurance
- 4220 Social Security (FICA)
- 4230 Workers' Compensation Insurance
- 4240 Other employee benefits

### **4300 CONTRACTUAL SERVICES**

- 4310 Advertising, duplicating, and printing
- 4320 Professional, technical, and other fees
- 4330 Maintenance and repairs
- 4340 Utilities and telephone
- 4350 Rents and leases
- 4360 Insurance and bonds
- 4370 Other contractual services

### **4400 MATERIALS AND SUPPLIES**

- 4410 Books, subscriptions, and memberships
- 4420 Public notices
- 4430 Technical supplies
- 4440 Office expense and supplies
- 4450 Equipment - supplies and maintenance
- 4460 Buildings and grounds - supplies and maintenance
- 4470 Motor fuel and lubricants
- 4480 Construction materials
- 4490 Agricultural supplies

### **4500 OTHER CHARGES**

- 4510 Claims and judgments
- 4520 Collection costs
- 4530 Travel & training
- 4540 Grants & Outside Agencies

- 4600 CAPITAL OUTLAY
  - 4610 Land
  - 4620 Buildings
  - 4630 Improvements other than buildings
  - 4640 Equipment & furniture
  - 4650 Vehicles
  - 4660 Infrastructure
  
- 4700 DEBT SERVICE
  - 4710 Principal on bonds
  - 4720 Interest on bonds
  - 4730 Trustee fees
  - 4740 Note principal
  - 4750 Note interest
  - 4760 Capital lease payments
  
- 4800 INTERGOVERNMENTAL CHARGES AND TRANSFERS
  - 4810 Transfers to other funds
  - 4820 Grants to other governments

# **BUDGET SCHEDULE AND OVERVIEW**

## **TECHNICAL REFERENCES**

Kentucky Constitution, Section 157b  
KRS 42.455  
KRS 83A.060  
KRS 91A.030  
KRS 174.100  
KRS 424.110 & 424.240  
GASB Codification Section 1700

## **INTRODUCTION**

City budgets are adopted by local ordinance and are legal documents. The statutes and the Kentucky Constitution mandate compliance with these local laws. Expenditures or operations that do not conform to the legally adopted budget are illegal expenditures, not just variances from the budget goals or targets.

The KRS provide authority for cities to amend local ordinances and the budget ordinance is no exception. Unusual events, unexpected downturns in the local economy, or increased demands for services can cause changes in the available resources and necessary expenditures. These changes should be implemented with a budget amendment to ensure compliance with the KRS.

Cities in Kentucky are required by the state Constitution (§157b) and KRS 91A.030 to adopt annual budgets to appropriate funds for the financial operations of the city. The budgeting process necessitates that each city closely examine its service priorities in relation to its revenue capacity, and to formulate a financial plan that best accomplishes the goals of the city. Once a budget has been adopted, the statutes specifically prohibit anyone from binding the city beyond the amount of funds appropriated for that purpose in the budget.

Consistent with the requirements imposed by KRS 91A.030(5), the mayor is responsible for preparation of the budget proposal in cities operating under the Mayor-Council plan, while the City Commission, as a body, is responsible for developing the budget proposal in cities operating under the Commission form of city government. In cities operating under the City Manager plan, the City Manager is specifically delegated the responsibility of preparing a budget proposal for consideration by the city's Board of Commissioners.

## **BASIC REQUIREMENTS FOR MUNICIPAL BUDGETING**

The statutory requirements for Kentucky cities are grounded in two primary sources: Kentucky Constitution 157b and KRS 91A.030. The basic premise in these requirements is clear -- cities cannot expend funds without budgetary authorizations in place. The legal provisions do not make exceptions based on sources or uses of funds. All monies expended by cities must be authorized by a legally adopted budget. The provisions of Kentucky Constitution 157b provide the basic framework. Note the use of terms like "any", "every" and "total" in the following:

*§ 157b Adoption of budget required for cities, counties, and taxing districts - Expenditures not to exceed revenues for fiscal year.*

- *Prior to each fiscal year, the legislative body of each city, county, and taxing district shall adopt a budget showing total expected revenues and expenditures for the fiscal year.*

- *No city, county, or taxing district shall expend any funds in any fiscal year in excess of the revenues for that fiscal year.*
- *A city, county, or taxing district may amend its budget for a fiscal year, but the revised expenditures may not exceed the revised revenues.*
- *As used in this section, "revenues" shall mean all income from every source, including unencumbered reserves carried over from the previous fiscal year, and "expenditures" shall mean all funds to be paid out for expenses of the city, county, or taxing district during the fiscal year, including amounts necessary to pay the principal and interest due during the fiscal year on any debt.*

KRS 91A.030 outlines more specific guidance and addresses the following issues:

- Budgets must be adopted annually.
- Monies held in trust for external parties can be excluded from the budget.
- Carryover provisions are imposed if a city fails to adopt a budget.
- Budget can only cover one fiscal year.
- Executive authority has responsibility for preparation of the budget.
- Local ordinances provide the guidance for form and content.
- The budget message must be delivered to the legislature at least 30 days prior to the beginning of the fiscal year.
- The legislative body adopts the budget and can revise the executive budget proposal. Appropriations cannot exceed estimated revenues for the year plus the appropriated prior year ending fund balance.
- The full amount of debt service must be included in the budget.
- Legislative bodies may amend the budget ordinance.
- Administration & implementation of the budget is the executive authority's responsibility.
- Budget format should match the accounting system, if possible.
- Contracts, agreements, or obligations in excess of the legal appropriations are void.

These requirements apply to all funds and all sources of revenues for Kentucky cities. This includes **all federal grant programs, local contributions, and state financial assistance**. Most public properties corporations are component units of the local government as are utility commissions and are also subject to these requirements. The only exclusion is trust funds administered for the benefit of external parties. These activities would include pension funds that were closed in 1988 as cities transferred to the County Employees Retirement System.

## **DEFINITION OF THE BUDGET PROCESS**

The budget consists of activities that encompass the development, implementation, and evaluation of a plan for the provision of services and capital assets.

An effective budget process includes several essential features, including, but not limited to the following:

- Incorporates a long-term perspective
- Establishes links to broad organizational goals
- Focuses budget decisions on results and outcomes
- Involves and promotes effective communication with stakeholders
- Is based on a "team approach" for program managers and administrative management
- Provide incentives to government management and employees

Each city develops its own system for analyzing historical data, developing initial budget proposals, approving the budget and monitoring the actual results to determine compliance. The budget document is a communication tool that guides the day-to-day management of any city. Department heads and program managers provide important feedback about the costs and benefits of programs to the management staff. Management, then in turn, uses this information to discuss priorities and evaluate the availability of resources to fund these programs. The legislative body must balance the available resources with the demand for services and establish the priorities that can be accomplished with the resources at hand. Those decisions go back to the department heads and program managers who are charged with implementation of goals and objectives set by the legislators.

## **BUDGET ORDINANCE**

Statutes governing the development, adoption and implementation of city budgets outline several specific requirements for Kentucky city budgets. However, city legislative bodies are given sufficient latitude to adopt local requirements for the implementation of these requirements. Specifically, 91A.030(6) requires the executive authority to submit the proposed budget in the form and detail required by ordinance.

In deciding on the level of specific line-items to be required in the budget proposal, the legislative body must make a balanced decision regarding the level of detail necessary for proper oversight of city operations, and the latitude necessary for the executive authority to administer the budget. While the city legislative body should ensure it has sufficient information to properly perform its oversight responsibilities. The council/commission should strive to develop a framework that doesn't require amendments for minor changes.

The detail required in budget proposals is something that has to be determined by each city. Budget development must begin at the line-item level. The chart of accounts defines the levels of budget adoption.

- Fund level includes all accounts within a specific category, such as the General Fund, Municipal Road Aid Fund, and Pension Trust Fund.
- Balance sheet/operations segregates revenues from expenditures, but still uses broad summary information.
- Department (or program) provides more detail for expenditures and program revenues to identify source and program use of monies.
- Function code adds more detail by focusing on functional classifications such as property tax, licenses and permits, intergovernmental revenues, or personnel,

contractual services, materials and supplies, capital outlay and debt service in expenditures.

- Line-item presents even more specific information, such as real property tax, personal property tax, bank franchise tax or intangible tax within the property tax object code and full-time salaries, part-time salaries, overtime or longevity within personnel object code.

The budget ordinance can include operational controls to improve the oversight that the legislative body can exercise. The legislative body **cannot** delegate authority for budget amendments to the executive authority.

The ordinance that specifies form and detail for the city's budget should also prescribe the operational controls that allow legislative oversight of aggregated budgets. This ordinance should be adopted on the premise that budget policies and procedures should be consistent from one year to another. The policies and procedures ordinance should have a long-term approach to assure that controls are sufficient to provide effective legislative oversight.

## ASSIGNMENT OF BUDGET PREPARATION DUTIES

	<b>Mayor-Council</b>	<b>Commission</b>	<b>City Manager</b>
Who is responsible for preparation?	The Mayor is responsible as the executive authority	The commission is responsible as the executive authority.	The City Manager is responsible.
May anyone be designated to be responsible for the preparation of the budget?	Yes. The Mayor may designate an individual to be responsible for preparation of the proposed budget. (83A.130)	Yes. The commission may designate an individual or committee to be responsible for coordination of the process. (83A.140)	The commission may delegate budget preparation responsibilities to other officers or employees as directed by municipal order. (83A.150(9))

This table summarizes the assignment of budget preparation as outlined in the KRS for budgets and city administration. The city should also adopt procedures for the analysis of financial information, setting initial goals and objectives, and developing the initial proposal. These procedures should designate a person or committee and specify the responsibilities for budget analysis and preparation, at a minimum, to include:

- 1. Development of budget forms.**
- 2. Accumulation of the necessary historical data for distribution.**
- 3. Distribution of and assistance in preparation of budget request forms to appropriate department heads.**
- 4. Collection and review of departmental budget requests.**

### BUDGET CALENDAR

Budget planning must begin early to meet the statutory deadlines for public notice and presentation to the legislative body.

Budgets should also consider the historical perspective of the city's financial operating results and current financial position. If the budget process starts too early, current financial statements do not provide relevant details about the financial position at year-end. If the process starts too late, there may not be enough time for financial analysis to evaluate the impact of decisions. The historical analysis of financial results provides valuable trend information about changes in revenues and expenditures. This analysis is critical for developing reasonable revenue estimates.

The budget process must include sufficient time frames for public notice. Several grant programs administered by the Commonwealth of Kentucky provide additional funding for local governments. Some of these programs require public hearings to allow public input for the budget preparation. These public hearings must also be incorporated into the budget calendar.

The final piece in the budget process is the publication of the budget summary. KRS 424.240 includes the following requirements for this publication:

*“Immediately following the adoption of an annual budget by any county or city other than one of the first class, the county or city clerk shall cause a summary of the budget or the text of the budget ordinance to be advertised for the county or city by publication in a newspaper.”*

The various stages of the budget preparation process are summarized in the table at the end of this chapter. Critical dates for each phase are also included to assist cities with the planning process. This table can be used as a checklist each year to ensure compliance with the statutory provisions. Each city can add line items to address the city's local ordinances and budget policies and procedures.

## **BUDGET PROPOSAL/PREPARATION ORDINANCE**

There are actually two budget ordinances outlined in KRS 91A.030. First, the budget proposal and preparation ordinance outlines the policies and procedures to be followed in the development and enactment of the annual budget ordinance (the second budget ordinance). This ordinance can include any requirements deemed necessary by the city's legislative body. A budget preparation ordinance is authorized by the KRS 91A.030 (6), but not required.

This ordinance should include the policies and procedures that will be carried forward from one year to another. The following issues can be addressed in the budget preparation ordinance, but this list is certainly not all-inclusive. The statutes allow cities flexibility in the content of this ordinance.

**Criteria that can be included in this document include:**

- Designation of responsibilities for each phase of the budget preparation**
- Requirements for prior year(s) financial information**
- Type of budget, such as operating, capital, performance-based, or management by objective**
- Requirements for budget requests from departments**
- Procedures to obtain public input for the budgetary process**
- Procedures for budget amendments**
- Authorizations and spending limits for budget revisions and transfers**
- Interim reporting requirements from the executive authority to the legislative body**
- Once adopted, the form and detail must be followed until the ordinance is amended by another ordinance. Changes to this ordinance should not impair the authority of the legislative body or discourage public participation in the budget process.**

## **THE BUDGET ORDINANCE**

The budget ordinance may be in any form that the legislative body finds most effective to enable the necessary fiscal policy decisions. This form should present a format that also allows efficient implementation of the budget plan. Each fund should be presented separately in the budget ordinance with either separate columns for each fund or separate sections within the budget ordinance.

- Receipts should be detailed by source.
- Appropriations should be detailed by department and function, or to the level of control specified by the legislative body.
- Personnel worksheet should outline the salary levels (or the pay grade/step schedule) for authorized positions.
- Summary Section should present the total revenues, total appropriations, prior year fund balance, and projected ending fund balance.

As long as the budget ordinance complies with the provisions of the city's budget policies and procedures ordinance, the executive authority may use any format that meets their needs. The annual budget ordinance should include enough information to clearly define the intentions of

the legislative body in the financial plan for the fiscal year. Since the budget ordinance establishes the enabling legislation for all expenditures of the city, it should be comprehensive enough to provide effective controls and allow efficient program management. The primary objective is the delivery of public services within the available resources. Form and content of the budget ordinance should ensure that city officials can accomplish this objective.

## **THE ORDINANCE AND AMENDMENT PROCESS**

Budget ordinances are subject to adoption and publication requirements just like any other ordinance. The following statutes outline the requirements for the city ordinance process:

- ❑ KRS 83A.060
- ❑ KRS 424.240
- ❑ KRS 424.130

### ***Enactment of Ordinances 83A.060***

The following criteria apply to the adoption of budget ordinances:

- ❑ Each ordinance shall cover only 1 subject and shall have a clearly stated title.
- ❑ 1st & 2nd readings do not require an advertisement.
- ❑ Unless otherwise stated by statute, a majority of a quorum shall be sufficient to take action.
- ❑ Except in cities of the first class, no ordinance shall be effective until published pursuant to KRS Chapter 424.
- ❑ Ordinances may be published in full or in summary as designated by the legislative body.
- ❑ If summary form is used, the summary must be prepared and certified by an attorney licensed to practice law in Kentucky and must meet specific statutory requirements.
- ❑ All ordinances and orders of the city shall be attested by the signature of the city clerk.

### ***Times and Periods of Publication – KRS 424.130***

Ordinances in general should be published within 30 days of passage. Budget ordinances must be published immediately (424.240). Notices for public hearings must be published no less than seven days and no more than twenty-one days before the hearing. Any material changes made to the ordinance/amendment that affect what was advertised requires the process to start over. You may count the “change” as the 1<sup>st</sup> reading.

### ***Publication of Budget Ordinance - KRS 424.240***

A summary of the budget or the text of the budget ordinance must be published immediately after the legislative body adopts the annual budget ordinance.

### ***Emergency Situations (KRS 83A.060(7))***

There may be instances where the city must amend the budget to authorize emergency expenditures. For instance, after a natural disaster such as a flood or tornado, the city may find it necessary to expend funds for public safety or cleanup that were not anticipated in the original budget. Even if state or federal resources will reimburse these expenditures, the budget should be amended to provide budgetary appropriations for the costs. The following criteria apply to the adoption of ordinances for emergency purposes:

- ❑ Ordinance must name and describe the emergency
- ❑ May be passed with a single reading upon 2/3 vote of the members
- ❑ May become effective immediately

- ❑ Must be published within 10 days of enactment

Consult your city attorney when preparing any legal notices or publications.

<b>City Budget Preparation Timetable</b>					
	<b>Task</b>	<b>Suggested Time Frame (some time frames are statutory)</b>	<b>Time Frame Per your Budget Procedure Ordinance</b>	<b>Statute</b>	
1.	Review Adopted Budget Procedures Ordinance. (The suggested time table & process may vary based on requirements established by individual cities)	In time to allow for ordinance process to occur if any changes are desired in the Adopted Budget Procedures Ordinance		91A.030	
2.	Executive authority gathers fiscal data; budget goals and priorities are identified	February 1			
3.	<b>PRIOR YEAR</b> Revenues & Expenditures are entered on budget estimate forms	March 1			
4.	<b>CURRENT YEAR</b> to-date amounts entered on Budget Estimate forms (including Salary & Wages)	March 15			
5.	Forms are distributed to department heads or other persons responsible for input and consideration, including Capital Outlay request sheets	March 15			
6.	Compensation request sheet and Capital Outlay request sheets completed and received from department heads or other persons responsible	April 15			
7.	<b>COMING YEAR</b> data entered on Budget Estimate forms	April 15			
8.	Prepare Budget	May 1			
9.	Prepare Mayor's Budget Message	May 1		91A.030(7)	
10	Submit proposed budget and message to legislative body	May 1 recommended, but <b>must</b> be presented by June 1 (at least 30 days prior to beginning of new fiscal year)		91A.030(7)	
11	Advertise LGEA & MRA proposed use hearings	Notice shall be published not less than 7 nor more than 21 days prior to hearing date		42.455 174.100 424.130	

<b>City Budget Preparation Timetable (continued)</b>					
12 .	Legislative body meets to consider proposed budget ordinance	By June 1 (in time to allow for the normal ordinance process to take place prior to July 1)		91A.030	
13 .	Hold LGEA & MRA proposed use hearings				
14 .	First reading of proposed budget ordinance			83A.060 91A.030	
15 .	Legislative body accepts, or makes changes to the proposed budget	If changes, a first reading will, again be required. Such a reading may be held the day the changes are made			
16 .	Second reading and adoption	Prior to July		83A.060 91A.030	
17 .	Publish Budget Ordinance (with notice of availability for public inspection)	"Immediately following the adoption"		424.240	

# GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

## TECHNICAL REFERENCES

KRS 91A.020

GASB Codification Sections 1200,1400,1500,1600, and 1800

GFOA *Governmental Accounting, Auditing and Financial Reporting*, Chapters 1 and 3

## BACKGROUND

Generally accepted accounting principles (GAAP) are the basis for which financial transactions are recorded and reported. GAAP accounting also includes financial reporting that mandates the following reporting criteria:

- Understandable and credible,
- Comparability between entities,
- Consistency between accounting periods, and,
- Reliability for the users of financial statements.

Governmental accounting and reporting guidance provides the minimum uniform standards for the accounting operations, fair presentation in financial reporting and full disclosure of financial data. In Kentucky, cities are required by law to follow GASB standards. KRS 91A.020 establishes the requirements to follow the accounting principles established by GASB.

GAAP for governmental units is provided in the Codification of Governmental Accounting and Financial Reporting Standards (the Codification) issued by the GASB. The Codification provides the foundation for governmental GAAP. The Codification also includes Interpretations, Technical Bulletins and Concepts Statements issued by GASB. In June of each year GASB publishes two revised editions, *Original Pronouncements* and *Codification*, that include any new pronouncements issued during the previous year. GASB also has subscription services that provide newsletters, copies of due process documents, and final pronouncements.

The purpose of this manual is to provide implementation guidance for Kentucky cities. References to the technical pronouncements and Kentucky Revised Statutes are provided to direct financial managers to additional resources. The Department for Local Government recognizes that each city has different needs based on the public services provided. Examples are provided to illustrate application of governmental GAAP. Specific application of these principles will vary from one city to another.

## FUNDAMENTALS OF GAAP

A governmental accounting system must make it possible to do the following:

- a) Present fairly and with full disclosure the financial position and results of financial operations of the funds and account groups of the governmental unit in conformity with generally accepted accounting principles, and
- b) Determine and demonstrate compliance with finance-related legal and contractual provisions. (GASB Codification Section 1200; KRS 91A.020)

A governmental accounting system should be organized on a fund basis. A fund is defined as a fiscal and accounting entity with a self-balancing set of accounts including cash and other financial resources, plus all related liabilities and fund balances which are designated for the purpose of carrying on specific activities. Laws, regulations, or contractual agreements may

require these separate funds to achieve certain objectives in accordance with special regulations, restrictions, or limitations.

There are three main fund categories, seven major fund types, and two account groups in governmental accounting:

- Governmental funds
- General Fund
- Special Revenue
- Capital Projects
- Debt Service
- Proprietary funds
- Enterprise
- Internal Service
- Fiduciary funds
- Trust and Agency
- Account groups
- General Fixed Assets
- General Long-Term Debt

## **BASIS OF ACCOUNTING**

The phrase “basis of accounting” refers to when revenues, expenditures/expenses, transfers, and related assets and liabilities are recognized in the city’s accounts and reported in the financial statements. Specifically, it relates to the timing of the recognition of transactions. Cash basis measurements recognize transactions when cash is received or paid. Modified accrual measurements recognize transactions when revenues are earned or expenditures incurred and when resources are both measurable and available. Accrual basis measurements recognize transactions when revenues are earned or expenses incurred.

Another term that is used when discussing the basis of accounting is "measurement focus". Measurement focus refers to the scope of the basis of accounting and the objectives for measurement. The GASB Codification requires two types measurement focus in governmental accounting.

First, the "economic resources measurement focus" is associated with the accrual basis of accounting. Economic resources include capital assets and long-term liabilities. Economic resources measurement is a more comprehensive scope and includes all available resources. This measurement focus is used with enterprise, internal service, pension trust, investment trust, and nonexpendable trust funds.

Second, "current financial resources measurement focus" is associated with the modified accrual basis of accounting. Current financial resources **only** include cash, investments and those assets that can be readily converted to cash. Current liabilities such as accounts payable, payroll tax withholdings and short-term debt are also included in current financial resources because they reduce the availability of financial resources. This measurement focus is used with governmental and expendable trust funds.

### **Cash Basis**

**Cash basis accounting** refers to recognizing revenues when received, not earned, and expenditures when paid, not incurred. Cities that maintain their books of account on the cash

basis for interim periods must also comply with GAAP requirements for modified accrual and accrual basis of accounting in accordance with KRS 91A.020.

**Example:** If the cash balance is low at the end of the accounting period, cash may not be available to pay vendors for services or goods received. Under a cash basis of accounting, this shortfall would not be noted; under an accrual basis of accounting, the expenditures and accounts payable would be recorded when the good or services are received regardless of when the bill is actually paid.

### ***Modified Accrual***

Under the provisions of the GASB Codification, the **modified accrual basis** of accounting is used to account for the governmental type funds: General, Special Revenue, Capital Projects, Debt Service, Expendable Trust, and Agency Funds. The measurement focus of these funds is on the flow of current financial resources. GASB has adopted certain modifications to accrual basis accounting to recognize the flow of current financial resources of a governmental entity. These resources include cash and other short-term assets such as receivables and inventories, as well as current liabilities that create claims against these resources.

Under modified accrual accounting, revenues, transfers in, and other financial resource increments such as bond issue proceeds are recognized when they become measurable and available to finance current expenditures. The accounting definition of "Measurable" means that objective data exist so that the dollar amounts to be recorded in the accounts may be determined with reasonable accuracy. And the accounting definition of "Available" means collectible within the current fiscal year or soon enough thereafter to pay liabilities of the current fiscal year. Most expenditures and transfers out are recorded when liabilities are incurred.

One major exception to expenditure accrual is the recognition of principal and interest on general obligation long-term debt. Governmental funds only recognize the principal and interest that is due within the current period. Long-term liabilities are recorded in the general long-term debt account group. Governmental funds recognize expenditures for principal and interest as the periodic payments come due.

Another difference between accrual and modified accrual is the recognition for capital outlay. Governmental funds do not record fixed assets on the balance sheet. These amounts are reported as expenditures in the operating statement and asset inventories are maintained in the general fixed assets account group.

### ***Accrual***

The **accrual basis** of accounting is used to account for the proprietary-type funds: Enterprise, Internal Service, and Pension Trust. (The accrual basis is also used to account for Nonexpendable Trust Funds.) The measurement focus of these funds is on the flow of current economic resources, and recognizes the net economic effect of transactions on all resources, whether financial or capital.

Accrual accounting recognizes transactions as they occur, regardless of the timing of cash flows. Revenues are recorded in the accounting period in which they are earned and can be accurately determined. Expenses are recognized when incurred. Costs of supplies and prepaid items are recognized when consumed. Fixed assets are capitalized and depreciated. Debt proceeds are recorded as liabilities, not revenues.

**Example:** If a government unit provides electrical service to its customers, revenue is earned as electricity is used, not when the customer pays the bill, and becomes measurable when the electric meters are read. Costs incurred to produce electricity are expensed as materials are used by the utility (chemicals, operating supplies, etc) or, as services are rendered to the utility (legal and professional, subcontractors, etc).

Accrual basis of accounting in the governmental sector closely parallels the commercial environment. It is generally used for governmental activities that are similar to private entities. For instance, sewer treatment facilities, gas, electric or water utilities, and transportation services are often classified as enterprise funds. It is important to measure the economic impact for these business-type activities and to finance the costs of services with user charges.

## **SPECIFIC ACCOUNTING REQUIREMENTS**

A detailed discussion of the accounting requirements for individual transactions is outside the scope of this manual. City financial managers should refer to the GASB Codification for specific guidance. If you have questions or need assistance with these requirements please contact the Department for Local Government. This section of the manual will highlight some of the unique measurement issues for governmental entities.

### *Fixed Assets Accounting*

There are numerous systems, manual and automated, for handling the accounting and bookkeeping relating to fixed assets. Regardless of how a city chooses to account for fixed assets, KRS 91A.020 requires cities to maintain accounting records in such a way to "determine fairly and with full disclosure the financial operations of constituent funds and account groups in accordance with generally accepted governmental accounting principles."

Governmental fixed assets are reported differently than in the private sector. The modified accrual basis of accounting recognizes fixed asset costs as expenditures in the current period. Fixed assets records are maintained in the general fixed asset account groups for all governmental funds. Proprietary funds use the accrual basis of accounting and record fixed assets in the same manner as commercial enterprises.

### Fixed Asset Terminology

Fixed Assets: What is a *fixed asset*? The term "fixed asset" is synonymous with the term "property, plant, and equipment." Numerous types of assets are reported on the balance sheet under the "fixed assets" caption. The following individual line items are reported in the fixed assets section of the balance sheet, and each of the following components will be discussed in greater detail later in this chapter:

- Land (note: land is not depreciated)
- Land Improvements
- Buildings
- Accumulated Depreciation - Buildings
- Construction-in-progress
- Machinery and Equipment (includes vehicles)
- Accumulated Depreciation - Machinery and Equipment

However, many cities typically report water, sewer, gas, and electricity systems in enterprise fund financial statements. The GASB has already issued Statement 34, *Basic Financial Statements--and Management's Discussion and Analysis--for State and Local Governments*. This standard revises accounting and reporting requirements for capital assets and requires all

state and local governments to include infrastructure in their capital asset accounting and reporting.

### Fixed Assets vs. General Fixed Assets

**General fixed assets** do not belong to a specific fund, are acquired by governmental funds; and are used for general governmental services. General fixed assets are recorded in the General Fixed Asset Account Group because governmental funds use the current financial resources measurement focus. It should be noted that fixed assets are a economic resource, not a current financial resource.

**General Fixed Asset Account Group:** The general fixed asset account group (GFAAG) is not a fund. The GFAAG provides cumulative totals of a government's general fixed assets. Additions to and deletions from the GFAAG are disclosed in the notes to the financial statements. There are three schedules for the GFAAG that are required in the annual financial report.

- Schedule of fixed assets by category (land, buildings, improvements, equipment)
- Schedule of general fixed assets by function and activity (general government, public safety, streets and roads, sanitation, etc., with subcategories such as legislative, finance, city clerk personnel, police, fire, building inspection, etc. Columns present totals for land, buildings, improvements, equipment, etc.)
- Schedule of changes in general fixed assets by function and activity (same categories used above with beginning balances, additions, deletions, and ending balance columns)

### Significant Fixed Assets Policy Issues

There are several topics that every city should address in its fixed assets accounting policy:

- Capitalization policy
- Capital leases vs. Operating Leases
- Donated Fixed Assets
- Disposals/Surplus policy
- Inventory and Tagging procedures

### Capitalization Policy

As a matter of practicality, not all fixed assets are capitalized. For example, the following is an example of a fixed assets capitalization policy:

**Example:** Effective July 1, 2000 for fiscal year 2001 forward, the fixed assets capitalization policy will increase from \$500.00 to \$5,000.00 for equipment and vehicles. Therefore, assets and their component parts and qualifying accessories must cost \$5,000.00 or more to be capitalized/recorded in the accounting system.

This policy does not eliminate your responsibility to maintain a current inventory of equipment having a cost of \$100.00 or more and to maintain stewardship over these assets.

The preceding example of a capitalization policy cites specific dollar limits. There is no official dollar limit to which cities can refer for guidance. Each city must determine capitalization thresholds based on cost/benefit considerations and simple practicality.

### Capital Leases

There are certain leases that are essentially agreements to purchase an asset on an installment basis. Such leases are called **capital leases**. In most cases, a capital lease includes terms that

transfer ownership of the assets to the buyer at the end of the lease term for no additional payments or a bargain price. For instance, if the lease calls for 36 payments of \$3,000, plus \$1 at the end of the lease to transfer ownership, it is a capital lease. If the lease requires payment of the current fair market value of the equipment to transfer ownership or return of the asset to the lessor, the lease is an operating lease. GAAP requires all fixed assets financed by a capital lease agreement to be recorded in the city's fixed assets records. The outstanding portion of the lease payments is recorded as a long-term liability. Leases that do not qualify as capital leases are referred to as **operating leases**.

### Donated Fixed Assets

GAAP require entities to record donated assets in the accounting system at the assets' estimated fair market value *at the time each asset is received*. Each city should have a policy for recording donated assets, and that policy should be consistent with generally accepted accounting principles.

### Disposals/Surplus Policy

The city manager or administrator should ensure the city has a clear policy for the disposition of fixed assets. If the city has adopted the provisions of the Kentucky Model Procurement Code, these policies should comply with the provisions of KRS 45A.425 - Surplus or excess property. If the city does NOT adopt the Model Procurement Code, there are no statutory provisions that set forth procedures for the sale of surplus property by a city. Opinions from the Attorney General (OAG's 82-530, 82-41, and 81-331) outline that cities may sell surplus property in any manner that is in the best interest of the city. The disposition policy should clearly state which officials have the authority to approve asset disposals. In addition, it is recommended that cities develop a standard form to ensure each disposal is properly authorized and documented.

### ***Long-Term Liabilities***

Governmental debt is divided into two categories: fund debt and general debt. Proprietary funds, such as governmental utilities, should include all debt related to the business-type activity in the fund. Governmental funds, such as the General Fund, only report the amount of debt that will be paid with available resources. The long-term portion of general liabilities will be reported in the general long-term account group.

Enterprise funds use the economic resources measurement focus and the accrual basis of accounting. All long-term debt is reported within the fund, with distinctions for the current portion and the long-term balances. These are called the "fund liabilities" even when the full faith and credit of the city may be pledged as assurance that liabilities will be paid when due.

General long-term debt includes all other types of obligations for the government. Governmental funds use the current financial resources measurement focus and the modified accrual basis of accounting. Therefore, only the debt payments that will be paid with current financial resources are reported in the funds. Generally, these payments appear as expenditures because the payment and the due date occur in the same period. The "unmatured" principal and interest balances represents those amounts that will be due in future years, and is recorded in the general long-term debt account group.

Specific guidance for the recognition of long-term liabilities is included in the following sections of the GASB Codification:

- B50, Bond, Tax, and Revenue Anticipation Notes
- C50, Claims and Judgments

- C60, Compensated Absences
- C65, Conduit Debt Obligations
- D20, Debt Refundings
- D25, Deferred Compensation Plans
- D30, Demand Bonds
- L10, Landfill Closure and Postclosure Care Costs
- L20, Leases
- P20, Pension Activities--Employer Reporting
- S40, Special Assessments

The unique accounting rules also affect the operating statement for governmental funds (general, special revenue, capital projects, and debt service funds). When the government borrows money, the receipts are reported as "Other Financing Sources" in the operating statement. Liabilities are not recorded in the fund, but they are added to the General Long-term Debt Account Group. Payments to retire these long-term liabilities are recorded as "Other Financing Uses" in governmental funds, as they come due. Other Financing Sources and Uses is presented in the operating statement after operating revenues and expenditures in order to highlight the nature of these transactions.

In general, most governments use debt service funds to account for the payment of long-term liabilities and the maintenance of restricted reserves set aside for additional security. Most bond indentures require that the government establish a debt service reserve that equals one year's payment for principal and interest. This reserve is invested until the bonds are paid in full. The debt service fund reports these restricted reserves, collection of interest on the investment, transfers from other governmental funds for debt service requirements, and the payment of principal and interest when due.

Debt service funds are required if they are legally mandated or if financial resources are being accumulated for principal and interest payments maturing in future years. KRS requirements do not generally require debt service funds, but most bond indentures for obligations of Kentucky cities require debt service reserves or sinking funds to accumulate principal and interest payments. A sinking fund is created with periodic deposits restricted for the next debt service payment. Debt service reserves may be created with a single deposit or several installments that are generally equal to one year's debt service. This reserve is held intact until the last payment is made on the outstanding bonds. There are exceptions, however, and cities should consult with their bond counsel to determine whether debt service funds are required.

Contingent liabilities create expenditures in some cases and disclosures in other cases. If the government is likely to make payments on a claim and the amount can reasonably be estimated, the government should recognize expenditures in governmental funds for the amount that will be paid with current financial resources. Any long-term portion will be added to the General Long Term Debt Account Group. Enterprise funds will recognize an expense for all of the estimated liability. If the city is not sure the payment will be required, or the amount cannot be estimated, the potential loss is discussed in the notes to the financial statements.

### **Fund Balance**

*In governmental fund accounting and reporting, use of the term **reserve** should be limited to the following:*

- *A portion of the fund balance is not available for expenditure, or,*
- *Balances that are legally segregated for a specific future use.*

*An example of the first type is the Reserve for Inventories, which indicates that the portion of fund balance represented by inventories is not available for appropriation and expenditure as of the date of the balance sheet. An example of a reserve indicating that a portion of fund balance is legally segregated is the Reserve for Encumbrances, which indicates that a portion of the fund balance has been segregated for expenditure on outstanding purchase orders.*

*Fund balance **designations** may be established to indicate tentative plans for financial resource utilization in a future period, such as for general contingencies or for equipment replacement. Such designations reflect tentative management plans or intent and should be clearly distinguished from reserves. Such plans or intent are subject to change and may not be formally authorized or result in expenditures. Designated portions of fund balance represent financial resources available to finance expenditures other than those tentatively planned. Fund balance designations should be reported as part of the unreserved fund balance "Designated for . . .," or disclosed parenthetically or in the notes to the financial statements.*

*The portion of Fund Balance that has not been designated or reserved should be reported as Unreserved Fund Balance. This balance is available for appropriations in future years and provides an excellent indication of the city's financial position. There are several benchmarks that can be used by local governments:*

- *A percentage of total revenues, usually 5% to 20%, depending on the services provided and the variability of revenues,*
- *A percentage of total expenditures, such as one to three months of operations, depending on the complexity of services provided and how easily the city can adjust costs if revenues decline, or,*
- *A flat amount, such as \$1 million, or \$50,000, that represents minimum cash balances necessary to meet obligations during lower revenue months.*

*These targets should be set individually for each city and should reflect the variability of revenues, complexity of services, size of total budget, and minimum cash balances. The city's executive authority and legislative body should agree on these balances and establish policies that these "minimum fund balances" are not surplus funds and should not be expended for additional projects or operating costs unless emergencies arise.*

*Credit rating agencies will review these balances to determine whether cities may be experiencing fiscal stress. Governments are not organized to generate profits or accumulate large surpluses of funds. However, some carryover is necessary to meet emergencies, provide a cushion for a downturn in revenues, and minimize short-term borrowing needs. Credit rating agencies and the public will consider these factors when they try to assess whether the fund balance is too low or too high.*

Reserves should be reported in the "Fund Balance" section of governmental fund balance sheets, not as liabilities or between liabilities and fund balance. The "Fund Balance" section may be subdivided between or among its reserved and unreserved components, or separate "Reserved Fund Balance" and "Unreserved Fund Balance" sections may be used.

### **Governmental Revenues**

Revenues also create unique accounting and reporting requirements for governmental entities. Proprietary funds use accrual basis of accounting and generally recognize revenues using the same criteria as private businesses. Governmental funds, however, use modified accrual and have different criteria for recognizing revenues. Governments have revenue sources that are not usually found in the commercial sector. For instance, grants and entitlements are primary

resources for local governments. Interfund transfers are another special source that causes differences in the governmental operating statement. The most unique source is taxes, since the "customer" is required to make payments to the government that do not always reflect the value of goods or services received.

Revenues must be both *measurable and available* to liquidate liabilities of the current period under the recognition criteria for modified accrual. Governmental revenues fall into six major categories.

- ❑ Taxes
- ❑ Licenses and fees
- ❑ Intergovernmental revenue
- ❑ Charges for services
- ❑ Fines and forfeitures
- ❑ Other

Available can include any of the following conditions:

- Due or past due and receivable within the current period,
- Collected within the current year, or
- Expected to be collected soon enough after the year-end to be used to pay liabilities of the current period.

The GASB Codification provides guidance about the modifications for revenues that cannot be accrued. Revenues that are usually accrued include property taxes, billed charges for services (utility charges, garbage collection fees or contractual services), grants, interfund transfers, and interest income. Revenues that are not normally accrued include golf course collections, parks and recreation fees, contributions, and fines.

In January 1999, GASB issued Statement 33, *Accounting and Financial Reporting for Nonexchange Transactions* to provide more consistent guidance for recognition of governmental revenues. Governments are required to implement this Standard for financial statements for periods beginning after June 15, 2000.

Many governmental resources are obtained in transactions where a government gives (or receives) value without directly receiving (or giving) equal value in exchange. These types of transactions are termed "nonexchange".

There are four types of nonexchange transactions addressed in Statement 33.

- ❑ Derived tax (income or sales taxes)
- ❑ Imposed nonexchange (property taxes, fines, property forfeitures)
- ❑ Government-mandated (federal, state & local mandates among governments)
- ❑ Voluntary nonexchange (donations, contributions, grants)

**Derived tax revenues** are the assessments imposed by governments on exchange transactions. These assessments require the wage earner (income taxes) or consumer (sales taxes) to pay a tax based on an exchange transaction. In some cases, these assessments are restricted to specific purposes by the legislative body. For instance, motor fuel taxes are often restricted to fund road improvements.

**Imposed nonexchange revenues** originate with assessments on other types of transactions. For instance, property ownership incurs property taxes; failure to feed the parking meter will get you a parking ticket; and property forfeiture can occur with certain illegal acts. A government

imposes these assessments on an act committed or omitted by the taxpayer. Legislatures can impose time requirements or purpose restrictions on these revenues as well. Property taxes are generally imposed for a particular fiscal year and may be designated to fund specific services, such as streetlights or garbage collection.

**Government-mandated nonexchange transactions** arise when one government provides resources to another government and requires the recipient to use these funds for specific purposes. There are often time limits for the use of funds or eligibility requirements for participation or both. These revenues are distinguished from voluntary nonexchange transactions because the programs are required to be implemented by the recipient government. For instance, states are required to provide unemployment compensation for unemployed workers. These programs are funded with a combination of premiums assessed on employers and federal funds.

**Voluntary nonexchange transactions** are based on legislative or contractual agreements. Certain grants are included in this category because the grant programs are voluntary. Community Development Block Grants are an example of voluntary nonexchange grants. These programs are not mandated for the recipient, but there are often eligibility requirements to qualify for funds.

Accounting guidance for nonexchange transactions can be summarized as follows:

- Derived tax revenues are recognized when the underlying exchange has occurred. Receivables should be recorded if the exchange occurs before the cash is received.
- Imposed nonexchange revenues are recognized in the period when resources are required to be used. Receivables are recorded when the government has an enforceable legal claim to collect the revenues.
- Government-mandated and voluntary nonexchange revenues are recognized in the period when all eligibility requirements, including time requirements, have been met. Advance receipts are reported as deferred revenues until the government has satisfied the restrictions for use.
- Modified accrual accounting adds one additional requirement for revenue recognition, the funds must be available before revenues are accrued.

### ***Governmental Expenditures***

In general, governments recognize costs as those costs are incurred. The modified accrual basis of accounting, however, requires certain adjustments to reflect the *flow of current financial resources* (cash and liquid assets). These adjustments generally result from liability payments that extend to more than one fiscal year. Governmental funds only include expenditures that will be paid with current financial resources. For instance, accounts payable and payroll taxes on employee salaries will be paid with current resources and are generally due within a short period of time. Bonds payable, on the other hand, usually require payments for several years. These costs are recognized as payments are made from current financial resources, not as the liabilities are incurred.

Some of the operating costs that are affected by the adjustments for modified accrual basis of accounting include the following:

- Claims, judgments and compensated absences (GASB Section C50 & C60)
- Pension and Special Termination Benefits (GASB Section P20 & T25)
- Leases (GASB Section L20)
- Landfill Closure and Postclosure Care (GASB Section L10)
- Long-term Debt (GASB Section 1500)

If there are no specific requirements for adjustments, governments should accrue governmental fund liabilities and expenditures in the period in which the government incurs the liability.

*Encumbrance Accounting*

Encumbrances are purchase orders or other commitments for goods or services that have not yet been received. These transactions do not become expenditures and liabilities until receipt of those goods or services. Encumbrances are formally recorded in the general ledger as budgetary control accounts. The formal recognition of encumbrances in the accounts generally requires two entries. When a purchase order or contract is issued, the encumbrances control account is debited and the reserve for encumbrances is credited. When goods are received or services have been rendered, the original encumbrance entry is reversed and a liability and associated expenditure is recorded. Reserve for encumbrances is a fund balance account and represents a reservation of the unreserved fund balance.

**Example:** A city signs a contract for a consulting firm to evaluate its office procedures and to make recommendations for improvements. At the time the contract for services is signed, the following entry is made in the general fund:

Encumbrances		\$23,750
Reserve for encumbrances		\$23,750
<i>To record encumbrance for consulting contract.</i>		

Two months later, the city receives a bill for the consulting services rendered to date, in the amount of \$5,500. Because this amount is part of the original encumbered contract, a reversing entry in the general fund is necessary:

Reserve for encumbrances		5,500
Encumbrances		5,500
<i>To reverse original encumbrance relating to portion of consulting contract performed to date.</i>		

Because the consultants have now performed services on the contract, the city has now incurred a liability and must record this obligation by making the following entry in the general fund:

Expenditures		5,500
Contracts Payable		5,500
<i>To record the amount due to consultants on portion of contract completed.</i>		

*GASB Section 1700.129 requires cities to use encumbrance accounting to the extent necessary to assure effective budgetary control. In addition, KRS 91A.030(1) prohibits cities from expending any monies from any fund, except in accordance with a budget ordinance adopted pursuant to KRS 91A.030. An encumbrance system to track the issuance of purchase orders is critical for ensuring compliance with KRS 91A.030 and the adopted budget. Encumbrances provide an accurate accounting of commitments against the legally adopted appropriations and the available balance for future commitments. If there is no encumbrance system, it will be very difficult to monitor the status of spent and unspent appropriations.*

# FUND ACCOUNTING

## TECHNICAL REFERENCES:

KRS 91A.020

*GASB Codification of Governmental Accounting and Financial Reporting Standards*

*GFOA Governmental Accounting, Auditing and Financial Reporting*

*Accounting for Governmental and Nonprofit Entities*, Leon E. Hay, Seventh Edition

## BACKGROUND

The complex fund accounting system used for governmental accounting was developed to address several unique governmental issues:

- diversity of governmental operations
- the need to achieve and demonstrate legal compliance
- enhance financial administration
- segregate programs by source of funds

Three categories of fund types are used in governmental accounting: **governmental**, **proprietary**, and **fiduciary**. Two account groups are also used in governmental accounting: the **General Fixed Assets Account Group (GFAAG)** and **General Long-Term Debt Account Group (GLTDAG)**. Governmental funds are used to report the activities and balances related to the financing of governmental-type activities. The account groups are used to maintain control and accountability over certain capital assets and long-term liabilities. These assets and liabilities are acquired or incurred with the flow of financial resources in governmental operating statements.

The GASB Codification (Section 1300.107) emphasizes that governments should only establish the minimum number of funds consistent with legal specifications, operational requirements and the basic principles for fund classification. The fund structure should be cost-efficient and demonstrate accountability for public funds.

## GOVERNMENTAL FUNDS

State and local governmental entities use four types of governmental funds: **general**, **special revenue**, **debt service**, and **capital projects**. Activities and balances are accounted for in one of these fund types depending on the sources of financial resources, the nature of the activities reported, and the need to maintain separate funds for legal compliance and accountability purposes.

The chief operating fund of a city is known as the **general fund**. The GASB's *Codification*, Section 1300.104, states that the general fund is used "to account for all financial resources except those required to be accounted for in another fund." In other words, all of a government's financial activities should be accounted for in the general fund unless there is a *compelling* reason to report them in some other fund type (e.g., legal requirements). Also it should be noted that a city may never report more than one general fund. In practice, it is typically the general fund that is of chief interest to financial statement users.

**Special revenue funds** are created to segregate and identify, expenditures relating to certain revenues received (such as the creation of a special revenue fund for Municipal Road Aid or federal grant programs) for accounting purposes.

**Capital projects funds** are used to account and report construction, renovation or acquisition projects. These funds are often used to report the use of bond proceeds for capital construction. Once the project is complete, the fund is closed.

**Debt service funds** provide accounting and reporting for debt service payments as well as maintenance of required reserves. The general fund (or other appropriate funding source) will make transfers to the debt service funds for payment of principal and interest. The debt service fund accumulates the earnings on reserves and demonstrates compliance with bond indenture requirements.

### ***General Fund***

The general fund accounts for most of the government's public services. These activities usually include the following public goods and services:

- General government administration;
- Courts;
- Police;
- Fire protection;
- Streets and highways;
- Public health; and
- Other public services.

Examples of governmental activities can include:

- Garbage collection;
- Parks and recreation programs
- Golf courses
- Parking facilities
- Transportation services

As a general rule, those expenditures of local government that benefit the community as a whole should be included in the general fund, excluding special enterprise functions and funds segregated to meet statutory requirements. The basic principle of budgeting and comparable financial reporting is to reflect the total amount of revenues and expenditures in each budgetary fund.

### ***Special Revenue Fund***

Often certain revenue sources are “earmarked” for a specific purpose. For example, a city may levy a tax that is restricted for the development of parks and green space. Similarly, legal restrictions on grant proceeds often require that they be spent only for specified purposes. The GASB’s *Codification*, Section 1300.104, states that the special revenue fund type may be used “to account for the proceeds of specific revenue sources (other than expendable trusts or for major capital projects) that are legally restricted to expenditure for specified purposes.”

There is only one instance in which the use of the special revenue fund type is required. A government sometimes includes legally separate “component units” as part of its financial statements. In some instances, the funds of these component units are treated as though they were the funds of the government itself, called “blending”. The general funds of component units are reclassified as special revenue funds for that purpose (*Codification*, Section 2600.117).

### ***Debt Service Fund***

Debt service funds are used to account for the accumulation of resources for, and the payment of, general long-term debt principal and interest. However, debt service may be paid from certain other governmental funds, such as the general fund. Debt service funds are required only when they are legally mandated and/or if resources are being accumulated for general long-term debt principal and interest payments maturing in future years. Also, a debt service fund is required if grant resources are received that are restricted to the payment of principal or interest on general long-term debt.

In determining how many individual debt service funds are needed, governments should distinguish between the demands of accounting and those of financial reporting. A single debt service fund is often sufficient for purposes of GAAP financial reporting, provided that information on balances related to individual debt issues is maintained in the government's accounting system. Even if the bond indenture calls for separate funds, individual divisions within a single debt service fund could satisfy these requirements.

Matured, but unpaid bonds, and interest coupons are a liability of the debt service fund. They should be shown as liabilities on the year-end balance sheet and the amount to be paid for their redemption should be included in expenditures of the year in which they matured.

Since debt service is a contractual obligation of the government unit which must be promptly and fully discharged, all debt service requirements must be regularly budgeted as a part of the city's annual budget (KRS 91A.030(9)). Each debt issue constitutes a separate obligation with its own legal restrictions and servicing requirements. The budgeting and accounting for each issue must give cognizance to such restrictions and requirements.

### ***Capital Projects Fund***

Local governments often undertake significant capital acquisition and construction projects. In some cases, governments wish to account for such capital activity separately from their other operations. The GASB's *Codification*, Section 1300.104, states that the capital projects fund type may be used "to account for financial resources to be used for the acquisition or construction of major capital facilities (other than those financed by proprietary funds and trust funds)."

Once again, absent a legal requirement, the use of a capital project fund is permitted, but not required. The single exception is the case of capital grants from other governments. The GASB's *Codification*, Section G60.105, states that "capital grants or shared revenues restricted for capital acquisitions or construction, other than those associated with enterprise and internal service funds, should be accounted for in a capital projects fund."

No hard and fast rule stipulates the number of capital projects funds to use. Each general obligation bond issue may require a separate capital projects fund. Grants, entitlements, or other intergovernmental resources used in purchasing or constructing major capital facilities may require their own capital projects fund. The city should establish only the number of funds that are necessary to provide efficient accounting for capital projects and meet the legal requirements for individual projects.

## **PROPRIETARY FUNDS**

Proprietary funds are used to account for a government's ongoing organizations and activities that are similar to those often found in the private sector. In Kentucky, cities generally use

proprietary funds for water, gas, electric and sewer utilities, centralized fleet management services, and hospitals. All assets, liabilities, equities, revenues, expenses, and transfers relating to the government's business and business-type activities – where net income and capital maintenance are measured – are accounted for through proprietary funds.

Business-type activities of a government are those activities that receive a significant portion of their funding through user charges. These activities are accounted for in the enterprise fund or an internal service fund, depending on whether the customers are external or internal. Enterprise funds are used for business-type activities with external customers. Internal service funds report goods and services provided internally to the government and its agencies.

### ***Enterprise Fund***

Enterprise funds are established for operations that the government unit chooses to account for as though they were private enterprises. An enterprise fund might be established because an operation is expected to cover its costs (including depreciation expense) through user charges or because the governing body believes it is necessary to account for income and capital maintenance.

The GASB's *Codification*, Section 1300.104, states that the enterprise fund type may be used to account for operations:

- That are financed and operated in a manner similar to private business enterprises – where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or,
- Where the governing body has decided that periodic determination or revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

Note: It should be noted that only one of the two criteria set forth in this definition needs to be met if a government wishes to use the enterprise fund type.

City enterprise funds use the same basis of accounting as similar privately owned utilities or other business organizations.

The accounting system focuses on the determination of whether or not the utility is operating at a profit or a loss. The primary difference between governmental and commercial business activities is that governments often subsidize their operations with other resources. Transportation services, for instance, are usually funded with user fees, but these fees rarely cover all the costs. Subsidies from general tax revenues or grants from federal and state sources are used to expand public transportation services and keep fees low enough for low-income citizens who rely on the service.

Management and the legislative body will want to monitor the operating results to determine the significance of subsidies and grants. They may establish goals or objectives for the percentage of costs that should be funded by user fees. The accounting system should provide information that clearly demonstrates the level of reliance on user fees and external sources so that the government can efficiently allocate resources.

A city may decide that part of the cost of operating or constructing an enterprise is to be financed by the city rather than users. Monies received from property tax levies and other city revenues are handled one of two ways depending upon the usage of the monies. If the monies

are to be used for the construction or capital improvements of an enterprise, the contributions should be credited to the local contributions equity. If the monies are to be used for operating purposes, the transaction should be reflected as an operating transfer.

Certain expenses of a utility or other enterprise are treated in a different manner than are expenditures of the governmental funds of a city. Purchases of fixed assets for the utility or enterprise are charged directly to fixed asset balance sheet accounts and these costs are allocated to operations through annual depreciation charges spread over the estimated useful life span of the fixed assets acquired. Interest paid constitutes an expense to be charged against revenues, but expenditures for the retirement of bonds result in reduction of a liability and are charged to the bonds payable account. Materials and supplies on hand at the end of each year should be inventoried and set up in the books so that expense accounts are charged only with the actual materials and supplies consumed during the year.

### ***Internal Service Fund***

Internal service funds are established to provide financing for activities, usually of a service nature, such as shops and garages, central purchasing, central stores, or a motor pool. These services are rendered to other departments of the city on a cost-reimbursement basis. An internal service fund should only be used if a government intends to recover the full cost of providing a service (including depreciation expense) through user charges.

The GASB's *Codification*, Section 1300.104 states that the internal service fund can be used:

*To account for the financing of goods or services provided by one department or agency to other departments or agencies of the governmental unit, or to other governmental units, on a cost-reimbursement basis.*

The main purpose of an internal service fund is to identify and allocate costs related to the provision of specific goods and services within the government. It is important that costs related to separate activities be accounted for separately. Separate internal service funds are normally established for each unrelated activity.

The use of an internal service fund is never required by generally accepted accounting principles. GASB Statement No. 10, however, does make it one of only two acceptable options available to governments that wish to use a single fund to account for a given type of risk financing activity.

Cities often establish self-insurance or pooled insurance funds to reduce the costs of insuring risks. If the self-insurance or public entity risk pool provides risk management services only for the primary government and its component units, the government may use either the general fund or an internal service fund for these activities. If the public entity risk pool provides services to external entities, such as other unrelated governmental entities, the pool should use an enterprise fund. Guidance for risk management activities can be found in GASB Codification Sections C50 and Po20.

Another common use of internal service funds is a centralized fleet management operation. If there is one division that provides all the maintenance services for the city, an internal service fund could be used to account for this division. It is not required, however, and this division may also be included within the general fund.

## FIDUCIARY FUNDS

Fiduciary funds are used to account for assets held by a governmental unit acting as a trustee or agent for individuals, organizations, other governmental units, or other funds of the same governmental unit. Some fiduciary funds closely resemble governmental funds and, therefore, follow the modified accrual basis of accounting; others, in which the principal of the fund must be maintained use the accrual basis of accounting.

Fiduciary funds are often identified in governmental financial reports as Trust and Agency Funds. In law, there is a clear distinction between an agency relationship and a trust relationship. A trust fund is generally used where a government has fiduciary responsibility to manage funds. Agency funds are only used if the government has **no** administrative responsibilities, merely collects, and distributes funds. For instance, a pension fund for employees imposes fiduciary responsibilities for investments of contributions and payment of retirement benefits. A tax collection fund, on the other hand, allows a government to collect property taxes for several jurisdictions and disburse these collections to other governments. The pension fund is a trust fund. The tax collection fund is an agency fund.

### ***Pension Trust Funds***

**Pension trust funds** are used to account for public employee retirement systems (PERS). PERS provide retirement annuities to eligible government employees and may also provide related benefits such as disability and survivor annuities. In many cases, a government maintains a single PERS to account for resources held in a fiduciary capacity for all of its qualified employees. The primary objective of PERS financial statements and note disclosures is to provide financial information to help pension plan participants in assessing:

- The funding status of a PERS on a going-concern basis;
- The progress that has been made in accumulating assets to pay benefits when due; and
- The extent to which the employer is making contributions to the PERS on the basis of actuarially determined rates.

***Kentucky cities will only have a pension trust fund if they still have a closed fund for retirees who were receiving benefits when the city transferred active employees to the CERS system. For instance, Lexington allowed employees to choose between CERS and the City Employees Pension System when the merger with Fayette County was enacted. No new employees were allowed to join the city system, but that fund still exists for the employees who elected to stay in the fund in 1975.***

### ***Expendable Trust Funds***

**Expendable trust funds** are those whose principal and income may be expended in the course of their designated operations. Expendable trust funds are most often used to account for income amounts transferred to them from non-expendable trust funds. Expendable trust funds may also be used to account for endowments whose principal may be expended in the course of their designated operations. However, the use of expendable trust funds should generally be limited to instances where legally mandated or where a formal legal trustee relationship exists. Amounts currently available for expenditure for general governmental operating purposes should generally be accounted for in the general fund or in special revenue funds.

A city might use an expendable trust fund to account for legally restricted funds for special projects. For instance, Bowling Green receives trust income that is dedicated to a specific park named for the donor. Funds designated from the trust are set aside in the expendable trust fund to finance improvements to the park.

### ***Nonexpendable Trust Funds***

**Nonexpendable trust funds** are used to account for activities with principal that must be preserved intact. Nonexpendable trust funds are most often used to account for the principal portion of endowments provided to a government by private donors with the stipulation that their principal be preserved intact.

In Kentucky nonexpendable trust funds are often used for cemetery perpetual care. If the principal amount from contributions or the sales of lots is to be maintained intact and invested, the city should use a nonexpendable trust fund to account for these operations.

### ***Agency Funds***

**Agency funds** are custodial in nature (assets equal liabilities) and do not involve measurement of operations. Agency funds are merely clearing accounts. At any given point in time, total agency fund assets are equally offset by related liabilities, including amounts due to the parties for whom the assets are being held by the government. Agency funds have no fund equity. Since revenues, expenditures and expenses are increases and decreases in fund equity, agency funds do not involve measurement of revenues, expenditures, or expenses. Agency funds do not have GAAP operating statements.

Governments are permitted to temporarily account for resources of other funds in agency funds. However, agency funds may not be used to defer revenue recognition for individual revenue items beyond the period in which they would otherwise be recognized.

Common examples of agency funds are:

- tax collection funds used to account for property taxes billed and collected by one local government on behalf of another; and
- performance deposit funds used to account for refundable deposits required of various licensees.

Some governments also use agency funds to account for the accumulation of employee payroll withholdings to be remitted in lump sums to appropriate vendors. However, such amounts may also properly be accounted for in the funds from which the related salary amounts are paid.

## **INTERFUND TRANSACTIONS**

Governmental entities use unique terminology in references to interfund transactions. Fund accounting provides a detailed accounting for the inflow and outflow of resources for specific purposes. However, governmental entities do have authority to transfer monies among the funds. It is very important to maintain records for interfund transactions that reflect proper accounting and demonstrates compliance with KRS restrictions.

GASB discusses the terminology for interfund transactions in Section 1800.102 -.108. Some interfund transactions are really revenues or expenditures, while others represent reallocation of resources. For instance, if the general fund pays fees to the water and sewer fund for water usage, these monies are revenues to the water and sewer fund and expenditures for general fund. If the general fund transfers resources to the park development to expand the park

acquisition program, this transfer is an operating transfer out for general fund and an operating transfer in for the park development fund.

GASB discusses two types of interfund transactions:

- **Quasi-external transactions** are those that would be treated as revenues and expenditures between unrelated parties. Reimbursements are included in this category.
- **Transfers** include nonrecurring transfers of equity or transfers to subsidize operations.

The accounting treatment is different for quasi-external transactions than it is for transfers. Transactions that are actually revenues (expenditures or expenses) are included in the operating section of the operating statement. Water sales to the general fund are reported as revenues, for instance. Transfers, on the other hand, are reported "below the line" after the operating results and segregated on the financial statements to clearly identify the nature of these reallocations of resources.

Cities can also make temporary transfers among funds. If a fund makes a loan to another fund that will be repaid within a short period time, or there are periodic payment requirements for long-term repayment, the transfer is actually a loan. If the monies are not likely to be repaid, the transfer should be recorded as either a residual equity transfer or an operating transfer. An example of a loan would be an advance from General Fund to a grant fund to finance expenditures that will be reimbursed by the grantor at a later date.

# Financial Administration Systems

## TECHNICAL REFERENCES

KRS 91A.020 - Accounting Records

GASB Codification Sections 1100, 1300, 1600, 1700, 1800 and 1900

GFOA Blue Book - Chapters 4 through 12

## FINANCIAL ADMINISTRATION – GENERAL

The system of accounting for expenditures and revenues can be divided into three categories: source documents, journals, and ledgers. **The source documents include receipts, requisitions, purchase orders, vouchers and checks. There are basically four journals: cash receipts, purchases, cash disbursements, and general journal. The General Ledger is used to summarize all transactions and compile the annual financial statements.**

The financial investment for a financial management system will be an important decision for any city. Ideally, the system should provide reliable reporting, enhance internal controls over financial assets and reporting, and require minimal upgrades and maintenance. In today's technology, however, many computer systems become outdated in three to five years. Cities should carefully evaluate the available alternatives, costs of acquisition, installation and maintenance, and the availability of ongoing technical support.

Some cities may continue to use manual systems to track the city's finances. This manual is applicable for electronic and manual systems. Even if the city does not use financial accounting software, they may be able to use spreadsheet programs to automate the recordkeeping system.

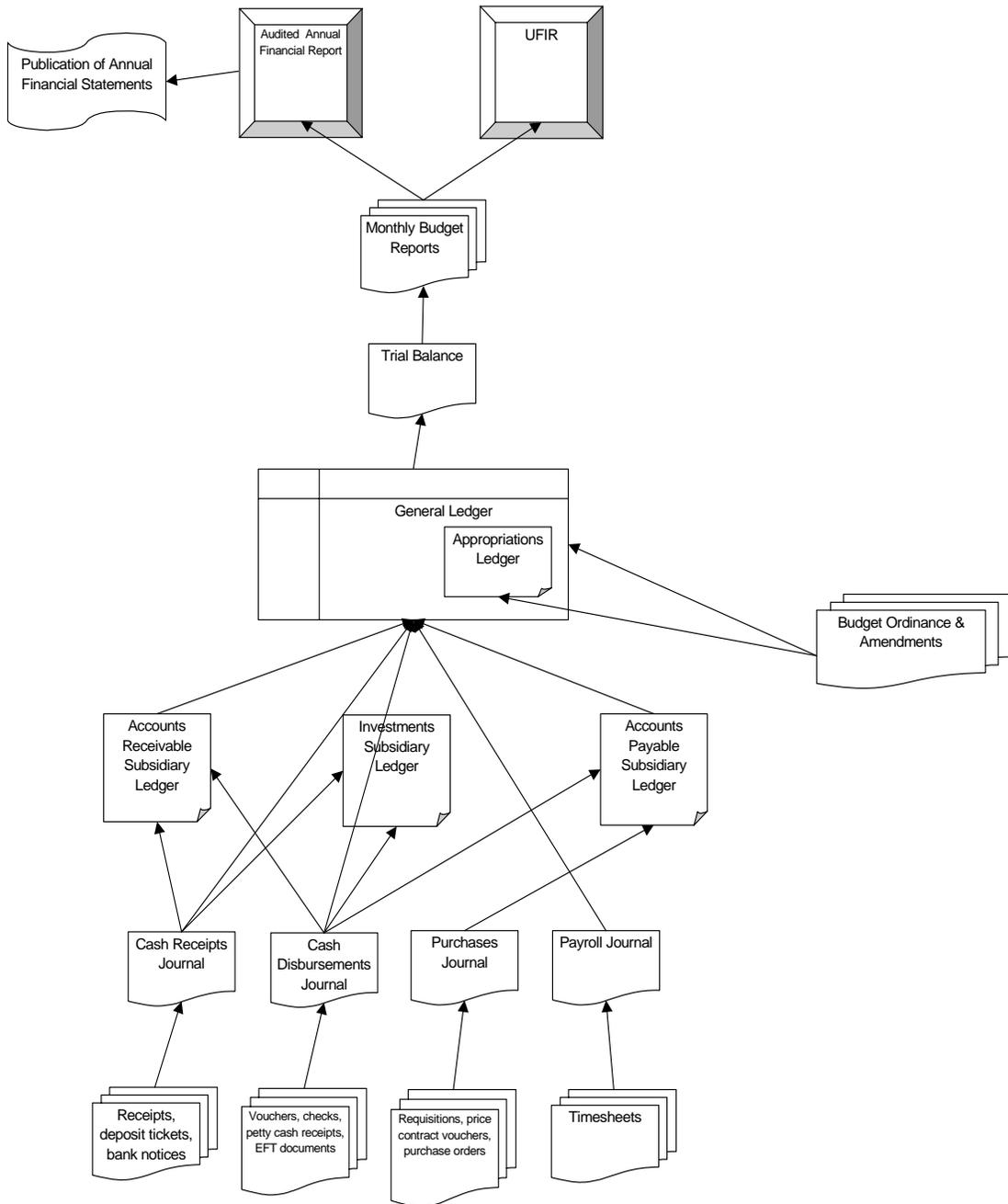
### ***Receipts***

The city receives money in the form of checks and cash. The money may be received through the mail or from walk-in traffic, citizens, other governments, or commercial entities. The system of tracking receipts will vary from one type of revenue to another. Each receipt should be recorded in the cash receipts journal. Periodically, usually monthly, the cash receipts journal will be totaled for all sources of revenues and the totals will be posted to the appropriate accounts in the general ledger. All sources of funds should be recorded in the Cash Receipts Journal.

### ***Expenditures***

On the opposite side, cities expend funds for a variety of purposes. The source documents for all expenditures should clearly describe the nature of the expenditure, which department (and/or program) incurred the cost, amounts incurred, and the appropriate fund that should be charged for the cost.

**GOVERNMENTAL FINANCIAL MANAGEMENT SYSTEM**



Cities should be using a purchase order system to provide adequate controls over the purchase of goods and services and compliance with the legally adopted budget. The Purchases Journal is used to record each purchase order as it is issued. Payments to vendors who received purchase orders should also be recorded in the Purchases Journal to maintain accurate balances for outstanding commitments against the budget appropriations.

All expenditures should be recorded in a cash disbursement journal. There may be several disbursement journals. For instance, cash payments should be recorded in a Petty Cash Journal; checks in the Accounts Payable Journal, payroll checks in the Payroll Journal, or a separate journal for recording electronic transactions. The cash disbursement journals are totaled monthly, and totals are recorded in the appropriate accounts of the General Ledger.

### ***General Ledger***

The general ledger is a summary by fund of the receipts and expenditures. The general ledger includes accounts for all assets, liabilities, fund equity, revenues and expenditures (expenses). A governmental general ledger should also reflect the legally adopted budget with additional columns for adopted budget, encumbrances, and available balances. Balances in the general ledger provide the basis for the financial statements, both annual and interim, for the governmental entity.

There are also transactions that are not recorded in receipts or disbursement journals. The general journal is used to record accruals that have not yet generated cash, corrections of entries in the receipts and disbursement journals, reversing entries to "undo" prior period accruals, and closing entries to close revenues and expenditures at the end of the fiscal year. Entries from the general journal should be documented with source documents to support the purpose, authorization, and nature of the transaction.

The general ledger is a critical component of the accounting system. All transactions are summarized in the general ledger and all financial reports should be generated from the balances in the general ledger. Amounts posted to the general ledger must be recorded accurately, in accordance with generally accepted accounting principles, and organized to demonstrate compliance with legal and contractual requirements.

### ***Accounting Policies and Procedures***

Accounting policies and procedures should clearly outline the city's requirements for maintaining the accounting records. These policies and procedures should be in writing and approved by either the Executive Authority or the legislative body or both, depending on the form of city government.

The city's accounting manual should address the following issues:

- ❑ Standard forms for budgeting, procurement, receipts and disbursements.
- ❑ Approvals required for purchases, payments, budget revisions, general journal entries, and refunds.
- ❑ Procedures and documentation required for voiding checks and issuance of replacement checks.
- ❑ Requirement for internal financial reports and due dates for presentation to the Executive Authority and legislative body.
- ❑ Procedures for developing, adopting and revising the annual budget.
- ❑ Procedures for issuance of payroll checks and preparation of quarterly & annual payroll returns.

- ❑ Procedures for purchasing goods and services and vendor payments.
- ❑ Responsibilities for bank reconciliations.

This list is not all-inclusive. There may be unique issues, or more complex issues, that merit more discussion. A city accounting manual should also provide enough information to allow new staff to maintain the accounting system in case of sudden changes in personnel. Even experienced staff should be able to rely on written policies and procedures to support consistent application of generally accepted accounting principles.

## **ELEMENTS OF ACCOUNTING SYSTEM**

### ***Cash Receipts Journal***

The cash receipts journal is a daily, chronological listing of all receipts. The listing is the book of original entry for all city revenues. The journal should indicate the date money is received, a description of the revenue source, the revenue account code, the total amount received, and the fund(s) that should receive the revenue. The cash receipts journal is totaled monthly and the total amount for each account code is posted to the appropriate accounts in the general ledger.

Cities may decide to maintain a separate cash receipts journal for each fund. This method ensures that restricted funds are recorded properly and deposited to designated funds. A city may also elect to maintain a centralized receipt account that receives all monies and makes periodic distributions to the appropriate funds or accounts. A centralized receipt account can provide additional internal controls if there is a separate cash receipts staff, but it also requires more documentation to ensure compliance with legal and contractual requirements for restricted funds. Smaller cities will likely find it easier to deposit receipts in the appropriate accounts when received and avoid the additional procedures for a centralized account.

It is important to record all receipts in the Cash Receipts Journal. Some taxpayers will also want a receipt to document their payment. The city should be able to provide receipts whenever necessary, but not all revenues will require a receipt. For instance, checks received for grant draws or payments from citizens using checks, will not require a receipt. **All cash payments must be documented with a receipt.** The city's accounting policies and procedures should outline the internal policies for writing receipts for collections. However, do not confuse the receipt document given to the payor with the requirement to record all receipts in the Cash Receipts Journal.

Most receipts should be classified as revenues. Cities do receive reimbursements for costs they paid on behalf of other parties. Revenues should be recorded separately, not as reductions of expenditures. Revenues are generated when the city provided goods or services, satisfied eligibility requirements, or invested funds. Reimbursements represent amounts that were disbursed for a different fund, paid in error, or advanced to other parties. Reimbursements may be deducted from the appropriate expenditure, but only if these transactions meet the criteria for reimbursements.

- Grant awards are revenues, even if the grant specifies that the city will be reimbursed for specific expenditures. Receipts in accordance with contractual agreements for grants are always revenues.
- Employee payments for personal use of telephones or postage are reimbursements.
- Payments charged to the General Fund (Street Department) that should have been paid from the Municipal Aid fund can be reimbursed by the Municipal Aid fund.

- Donations received for specific capital projects are revenues. Restricted amounts that are unspent at year-end should be closed to reserves or restricted fund balance, depending on the restrictions for the use of the resources.
- Contractual services for providing security or special services are revenues, even if the price is based on the city's actual cost of providing the service.

### ***Appropriation Ledger***

The appropriation ledger reflects, by account number, the original budget appropriation, the payee, increases/decreases by amendment or transfer, expenditures, and the remaining balance. The appropriation ledger should also reflect the status of outstanding purchase orders and the commitments against budgeted appropriations. The appropriation ledger can be maintained manually or with an automated computer system. The appropriations ledger can also be incorporated into the general ledger system. An integrated system allows multiple uses of single entries.

A separate appropriation ledger should include the following information:

- **Fund** designated to account for this particular program.
- **Name of account** indicates the type of revenue (expenditure) within this fund (Example: Salaries – clerk)
- **Account code** assigned to this account from the Chart of Accounts.
- **Budgetary appropriations** included in the legally adopted budget for this revenue or expenditure.
- **Revenues (Expenditures)** represent amounts of the actual transactions during the fiscal year.
- **Encumbrances** represent the balance of outstanding purchase orders charged to this account.
- **Budget variance** presents the difference between legal appropriations and actual transactions.

Entries in the appropriation ledger record the “Annual Appropriations” and the collection or use of those budgetary amounts. At any given point in time, the appropriations entries should reflect the current availability of legal appropriations and the outstanding commitments already in place. If the appropriations ledger is incorporated with the revenues and expenditures accounts in the general ledger, columns can be added for budgetary appropriations and available balances. This consolidates requirements for both the general ledger and appropriations ledger.

In some cases, cities will **re-appropriate** budgets for projects or purchases that were not complete by June 30. Incomplete projects will increase the carryover to the subsequent year available funds. Re-appropriations should be added to the current year's budget after the legislative body approves the ordinance that details these carryover projects. In addition, the executive authority should review carryover fund balance to be sure that re-appropriations and the adopted budget do not create a deficit.

As purchase orders are issued and approved they should be entered in the proper appropriation ledger(s). When a purchase order is posted the date, name/vendor, purpose, and purchase order number information should be entered. If it is a blanket purchase order that fact should be noted under the “Purpose” column. The amount of the purchase order should be posted to the “debit” column. The amount in the “Balance” column is reduced by the amount of the purchase order. The new balance represents the remaining amount that can be encumbered for that particular account code.

When the expenditure is made and recorded in the cash disbursement journal, it should then be posted to the correct appropriation ledger(s). The amount expended should be recorded in the "Amount of Warrant" column. If the purchase order was originally recorded at the amount of the actual check, no other entry is needed. However, if the purchase order was for more than the actual check then an adjustment must be made in the "credit-adjustment" column. This would increase the "balance" column. If the expenditure is significantly more than the original purchase order the purchase order should be amended with proper approval (in advance of the actual purchase), and posted before the payment is issued. In the case of a blanket purchase order the adjustments described above would only be recorded when the blanket purchase order expired.

**At the end of each month, the expenditures from the cash disbursements journal and purchases from the purchases journal are posted on each appropriation ledger page. The monthly total is added to the previous year-to-date total to arrive at the new year-to-date total. Accurate posting to the general ledger is assured when all debit entries equal the total of all credit entries. If the appropriation ledger is maintained separate from the general ledger, the only method for "proofing" the ledger entries is to total all monthly entries in the ledger and match these amounts against the corresponding totals in the respective ledgers.**

#### Procurement Policy & Procedures

##### ***Purchase Orders***

There are three issues that we will highlight in our discussion of a purchase order and encumbrance system for Kentucky cities:

- GOLD **Strongly Recommends** that Kentucky cities utilize a purchase order system to ensure compliance with KRS for use of public funds.
- Local Governments are required to Bid Purchases in excess of \$20,000.
- KRS 45A.343 to 45A.460 provide statutory authority for cities to adopt the Model Procurement Code used by the Commonwealth.

##### Purchase Order Recommendations

The following recommendations are the minimum requirements of a city's purchase order system.

- No purchases in excess of set dollar limits shall be made without an approved purchase order (The City's accounting policies should determine the various levels for purchase authorizations.).
- Only the executive authority, or designee, should issue purchase orders from only one location.
- Blank purchase orders shall not be issued.
- All purchase orders shall be accounted for and pre-numbered.
- All purchase orders shall indicate the appropriation account number and a written description for the goods and services to be acquired.
- No purchase order shall be issued in an amount that exceeds the available line item appropriation.

The process of using purchase orders not only facilitates the ordering of the merchandise and services, it is also a part of the budgetary process. Purchase orders provide authority to purchase goods and services and provide documentation to record commitments against the legally adopted appropriations. Each purchase order should be posted to the proper appropriation ledgers upon issuance and before the goods and services are acquired. This

posting creates an "encumbrance" (obligation) against the appropriation. This ensures that the funds have been budgeted for this expenditure. When an appropriation account reflects zero, then no more purchase orders should be entered into until the taxing authority increases that account's appropriation.

Purchase orders should be numbered consecutively. Each purchase order should include duplicate copies. Two copies should be filed with the clerk who documents the purchase authorization and forwards one copy to the vendor. The clerk's copy should be used as a source entry for posting in the appropriation ledger. The third copy should be returned to the department or division initiating the purchase order or requisition, as the case may be. An additional copy can be sent to the department or division to be used as a receiving copy. When the goods or services are received in good condition, the receiving copy can be returned to the city clerk (or the finance office) to authorize payment to the vendor. The receiving copy should be matched with the clerk's copy and the invoice to provide documentation of the authorization to purchase, receipt of goods or services and payments to the vendor.

Each purchase order should provide the following information:

1. Purchase order number (consecutively numbered)
2. Requisition number reference (if applicable)
3. Date
4. Name of city
5. Name of vendor
6. Account code
7. Quantity, unit description, price per unit, and amount
8. Name and title of person authorizing purchase order
9. Division or department requesting purchase authorization
10. Delivery address
11. Method of shipment (when applicable)

#### Flow of the Purchase Order

1. Department or division requesting purchase authorization should prepare a requisition, memo, or written request, depending on the policy outlined in the city's adopted administrative regulations.
2. After appropriate approval has been given to the purchase requisition, the city clerk or other appropriate staff will enter the number, date, approvee, appropriation account, description, to whom issued, maximum amount, on a prenumbered purchase order and enter the purchase order into the log at time of issue. This function can also be assigned to city administrator's (or city manager) staff or the finance office.
3. City clerk or the designated official will distribute the copies of the purchase order. The original purchase order should be sent to the vendor.
4. City clerk or other appropriate staff should enter the exact amount, vendor, and date of purchase into the purchase order journal.
5. Receiving copy is returned to the city clerk (or finance) when the goods are received in good condition or services have been rendered in satisfaction of contractual agreements.
6. Once the invoice is received, enter the date received and the amount of the invoice into the purchase order journal.
7. Follow appropriate procedures outlined in the city's adopted administrative regulations (procedures).
8. Enter the date paid and the amount paid into the purchase order journal.

The purchase order journal is a journal to record all encumbrances and purchases. All purchase orders, including those voided, are to be recorded. The journal should include the following:

- purchase order number,
- the date issued,
- vendor name,
- brief description of item,
- maximum amount for which the purchase order is approved,
- fund and appropriation account number to which the item is charged,
- Invoice number,
- Invoice amount, and,
- claims list date.

The purchase order journal should also reflect adjustments to purchase orders for variances in final purchase price, change orders, or cancellation of outstanding purchase orders. Each purchase order should eventually be reduced to a zero balance as a result of vendor payments, minor adjustments for price changes or change orders, or cancellation of the purchase authorization. Computerized accounting systems should generate reports that reflect outstanding balances on individual purchase orders, balances by department and account code, and balances by vendor. Manual systems should generate the same information. The city's accounting policies should specify required reporting and how often these reports are generated.

### Bidding Requirements

Any discussion of the bidding requirements for Kentucky cities focuses on three issues:

- **Bid Threshold is \$20,000**
- **Bidding Statute” KRS 424.260**
- **Kentucky Model Procurement Code (KRS 45A)**

All purchases in excess of \$20,000 must follow the competitive bidding requirements of KRS 424.260, unless the city adopts the model procurement code provisions of KRS 45A.

It is important to note that many interpretations of procurement practices generally conclude that the \$20,000 limit should be applied to the annual total for purchases of the same item. For instance, a city should not purchase a large piece of equipment in components to avoid the \$20,000 limit. If the city needs 10 computers to serve the same function, the computers should not be purchased one at a time to avoid the limit. Some cities may apply this limit to aggregated purchases of similar items, such as office supplies. If the city will likely purchase more than \$20,000 worth of office supplies, they can advertise for bids from office supply dealers. Bids can be awarded to multiple vendors for large quantities of small items. City employees can be authorized to purchase office supplies from several vendors for a specified discount, rather than specific prices.

Provisions of KRS 424.260 provide broad guidance for bidding requirements. Additional guidance is provided by opinions from the Attorney General for application in specific cases.

### Model Procurement Code

KRS 45A outlines the requirements for procurement by all state agencies and the Commonwealth of Kentucky. It does not specifically apply to cities, but cities can follow or adopt the requirements in KRS 45A.345 to 45A.460 to provide guidance for the local procurement.

KRS 45A.345 to 45A.460 are the only sections that apply to local governments. The statute allows local governments to adopt these provisions to provide more specific purchasing guidance. The objectives of the Model Procurement Code include the following:

- a) To simplify, clarify, and modernize the law governing purchasing by the Commonwealth;
- b) To permit the continued development of purchasing policies and practices;
- c) To make as consistent as possible the purchasing laws among the various states;
- d) To provide for increased public confidence in the procedures followed in public procurement;
- e) To insure the fair and equitable treatment of all persons who deal with the procurement system of the Commonwealth;
- f) To provide increased economy in state procurement activities by fostering effective competition; and
- g) To provide safeguards for the maintenance of a procurement system of quality and integrity.

- 1) If the city adopts the Model Procurement Code, they must review contractor performance with other applicable regulatory statutes. These statutes include the requirements for payment of state income taxes, sales & use taxes, wage and hour, occupational safety, unemployment and workers compensation laws.
- 2) Specific requirements are included for the development and administration of guaranteed energy savings contracts.
- 3) Cities should document, in writing, any decisions or findings related to procurement.
- 4) Cities may adopt administrative regulations to address issues that are not specifically included in the KRS Model Procurement Code. These policies may address any of the following:
  - a) Delegations of purchasing authority
  - b) Bidder qualification, suspension, debarment and reinstatement
  - c) Modification and termination of contracts
  - d) Conditions & procedures for the purchase of perishables
  - e) Conditions, including emergencies, and procedures when competitive sealed bids are not required
  - f) Rejection of bids
  - g) Confidentiality of technical data and trade secrets
  - h) Partial, progressive, and multiple awards
  - i) Supervision of store rooms and inventories
  - j) Definitions and classes of contractual services
  - k) Procedures for the verification and auditing of local public agency procurement records
  - l) Annual reports from purchasing authority
  - m) Other administrative regulations, as needed
- 5) Procedures for competitive sealed bids include disclosure of the bid selection method (lowest bid price or lowest evaluated bid price), adequate public notice, opening bids in a public meeting, and awarding contracts on a timely basis.
- 6) Provisions for competitive negotiation include the criteria that are suitable for competitive negotiation, public notice to solicit proposals, communications with vendors submitting proposals, and equal distribution of specifications and proposal requirements to all potential vendors.
- 7) Guidance for negotiating contracts when competitive sealed bids exceed available funds or no bids were received.

- 8) Noncompetitive negotiation is allowable under certain conditions that must be documented in writing.
- 9) Cities may use small purchase procedures for any contract under \$10,000. These regulations should be included in the administrative policies discussed in 45A.360. Note that this limit is lower than the provisions in KRS 424.260. Cities that adopt the model procurement code must advertise for bids if the purchases exceed \$10,000, however, legislation has been introduced to increase the limit of \$10,000 prescribed by KRS 45A.385 to \$20,000.
- 10) The city may cancel a request for bids or reject all bids if officials determine that it is in the best interest of the local public agency.
- 11) Written determination about whether the bidder has provided a responsive bid is required. In addition, the bidder must certify that he has not violated campaign finance laws.
- 12) Suppliers may be pre-qualified as responsible prospective contractors.
- 13) Cost or pricing data must be accurate, complete and current. Costs or pricing adjustments must exclude increases resulting from errors in the bid preparation.
- 14) City officials are allowed to audit or inspect contractor locations.
- 15) Specifications should assure the maximum practical competition. Specifications may be proprietary when certain conditions are met.
- 16) Guidance is provided for the disposition of surplus or excess property.
- 17) Bid bonds, contract performance and payment bonds may be required to ensure that vendors satisfy bidding and contract commitments.
- 18) Procurement terms are defined in 45A.445.
- 19) Restrictions are imposed for conflicts of interest, gratuities, kickbacks, and the use of confidential information to protect the public trust.
- 20) Items transferred or received in breach of ethical standards may be recovered from both the employee and the nonemployee.
- 21) Cities may utilize the state price contracts to benefit from cooperative purchasing agreements. Cities may also establish cooperative agreements with other local public agencies.

These statutory provisions provide the basic framework for governmental purchasing policies and procedures. Cities also have the authority to impose specific purchasing guidelines to safeguard public resources and ensure fair and open competition among all vendors. The Model Procurement Code is an excellent guideline for "best practices" that should be adopted by local governments.

#### Local Purchasing Policies

Your own purchasing procedures may be more restrictive than the statutes. If so, local procedures should be followed. Policies and procedures in the city accounting manual should address the following issues:

- Levels of purchasing authority and thresholds requiring additional approval
- Documentation required to request purchase authorization
- Procedures to amend purchase orders
- Requirements for price quotes or proposals for acquisitions less than \$10,000
- Procedures for obtaining personal service contracts
- Petty cash policies and procedures
- Procedures for recording and distributing purchase orders
- References to KRS and/or the model procurement code in KRS 45A

### Exceptions To Bidding Requirements

There are basically two instances that are exempt from the bidding requirements for purchases in excess of \$20,000. First, professional service contracts are exempt from the provisions of KRS 424.260. Second, the statute allows for alternative procedures if an emergency exists. The chief executive officer of the city should certify that an emergency exists, and must file a copy of the certificate with the chief financial officer of the city. If the purchase requires an ordinance, such as to amend the budget to appropriate funds for the purchase, the following requirements of KRS 83A.060(7) will apply:

- ❑ Ordinance must name and describe the emergency
- ❑ Ordinance may be passed with a single reading upon 2/3 vote of the members
- ❑ Ordinance may become effective immediately
- ❑ Ordinance must be published within 10 days of enactment

### ***Check Disbursements Journal***

The check disbursement journal is a chronological listing of daily disbursements by fund. The ledger must indicate the date, the check number, the payee, the account code and the amount. In a manual system, separate columns should be used for all major accounts. In a computerized system, the account coding will send the transaction to the correct account and fund classification. Checks are to be posted numerically and all checks are to be recorded, including voided checks. Voided checks should not be used for replacement checks when payments must be reissued.

### Checks

As with any check or warrant, the date, payee, amount (numerical and written), and signature should be completed. The account code(s) and the amount(s) allotted to each account can be written on each check and/or check stub. All checks should be pre-numbered. The supply of unused checks should be adequately safeguarded and under the custody of persons who do not sign checks manually or control the use of facsimile signature plates. In small cities, this may be impossible. However, blank checks should be maintained in a safe place with controls in place to prevent theft or unauthorized use.

Whenever an invoice is received and payment is made, the payment should be recorded on the original invoice, and the invoice should be marked as paid so that duplicate payments will not be made. Payments should not be authorized from copies or facsimiles. In cases where the original invoice has been lost or is not available, adequate documentation should be available to ensure that duplicate payments are not issued. A careful study of invoices is necessary to eliminate the possibility of payments being made on inappropriate invoices. Errors and revisions should be monitored to ensure that funds have not been used for illegal purchases and that goods or services were actually received by the city.

At least the mayor and one other authorized person should sign all checks. Even in small jurisdictions, it is advisable to authorize three individuals to sign checks and require at least two of those three signatures on the checks. This system provides smooth operations for the city even if one authorized signor is out of town or unavailable. Unexpected events do arise and the accounting policies should address these types of contingencies. **Authorized check signors should NEVER sign blank checks.** There should also be adequate controls to ensure that the proper documentation is in place before checks are presented for signature. Signature stamps and plates should be closely safeguarded to protect against unauthorized use.

### ***Investments Ledger***

The investment ledger is a subsidiary ledger for the general ledger to record the purchase and liquidation of investments. The ledger should include the date of the investment purchase, the check number (which should reconcile with the check distribution ledger), the depository, type of investment, identifying serial number, fund identity, amount, date of maturity, earnings amount, earnings deposit date, and description of principal disposition (KRS 91A.060(2)). **A properly maintained investment record shows how each investment was made and the return of each investment to the active funds of the city.**

The investment ledger should include the following information:

- ❑ **Date** – The date on which the transaction occurred.
- ❑ **Description** – The type of investment, maturity date, interest rate, amount and financial institution involved.
- ❑ **Number** – The Certificate of Deposit number. (If the investment is in treasury bills, post the bill numbers as well as the Custody Receipt number.) In addition, the fund that is making the investment should be recorded in this slot or under description.
- ❑ **Receipt Number** – The receipt number for interest received from the banking institution.
- ❑ **Check Number** – The check number of the check written to the bank to make the investment. (If a check is issued)
- ❑ **Maturity Date** – This column should reflect the maturity date of the investment to provide a reminder for upcoming maturities and reinvestment of any surplus funds.
- ❑ **Purchased** – The principal amount invested.
- ❑ **Redeemed** – The principal amount redeemed when the investment matures. If there is no redemption amount, the investment should still be outstanding.
- ❑ **Balance** – The total amount of investments.

The exact form of the investment ledger is flexible. Some entities use a ledger book with individual pages for each investment. Others use the financial accounting software to track investment activity and print reports on the current status of investments.

The Kentucky League of Cities has developed a model investment policy. Cities can use this sample format to develop the local investment policy.

### ***General Ledger***

The principal ledger that contains all journals of the balance sheet and income statement accounts is called the “general ledger.” All transactions, regardless of the ledger in which journalized, are posted to the general ledger. The general ledger should include the following columns for all accounts:

- ❑ Debit
- ❑ Credit
- ❑ Balance

The following columns should also be included for all revenue and expenditures accounts to incorporate the budgetary accounting in the general ledger:

- ❑ Legally adopted budget amount
- ❑ Encumbrances
- ❑ Available appropriation balance

If additional detail about a specific account is required, then a subsidiary may be created to supply information beyond that included in the general ledger. For example, the general ledger account for Accounts Receivable includes only amounts. For a city to adequately control its

collections from customers or taxpayers, additional detail about the Accounts Receivable must be maintained in the subsidiary ledger.

This information can include the following:

- names and addresses of taxpayers,
- the amount each taxpayer owes,
- the payments made by each taxpayer, and
- the balance owed by each taxpayer.

This detailed information is not included in the general ledger, so an Accounts Receivable subsidiary ledger is created to include such detail. Every journal entry that affects Accounts Receivable must be posted both to the Accounts Receivable account in the General Ledger and to the individual taxpayer's account in the Accounts Receivable subsidiary ledger.

All transactions in the individual journals and subsidiary ledgers (source journals) should be posted to the general ledger at least monthly. Computerized systems actually post transactions through the entire accounting system as each transaction is recorded. Manual systems will require that entries in the journals and subsidiary ledgers should be totaled and balanced before posting to the general ledger.

After all monthly entries are posted to the general ledger, a trial balance should be prepared to demonstrate that the general ledger is "in balance". A trial balance is simply a listing of all balances in the general ledger. Every balance as of the reporting date should be listed and it is important to be sure that transaction dates are consistent throughout the general ledger. Separate totals should be calculated for debit and credit balances. **Total debits must equal total credits.** If these amounts do not agree, transactions are missing or have been posted incorrectly. The "double-entry" system for a GAAP basis accounting system requires equal entries for debits and credits on each entry. Therefore, the total debits and credits on the trial balance should equal at any point during every month. The trial balance provides the basis for all financial accounting reports prepared for the city and the annual audit of the fiscal year.

## **MONTHLY RECONCILIATION AND SUMMARY REPORT**

This section will highlight the recommendations for interim financial reporting and illustrate how these reports are compiled from the general ledger system.

Interim financial statements report the cumulative operating results and the current financial position of the city. KRS 91A.030(11) requires the executive authority to provide reports for the legislative body no less than quarterly, however monthly financial statements are recommended.

Some financial accounting systems will generate simple financial reports with just a selection of the report type and date or period to be included. Many cities prepare a trial balance and a general ledger report and then use spreadsheet software to type the financial statements for the legislative packet. Many software vendors can customize their reporting features to compile a report that includes the specific information and columns that the legislative body wants to see.

At a minimum, the interim reports should include the following statements:

- Balance sheet
- Statement of operations with a budgetary comparison
- Cash and investment summary
- Collateral report

Other reports that can also be prepared include the following:

- Prior year statements (or presented as additional columns on basic statements)
- Listing of disbursements
- Cash flow forecasts
- Outstanding encumbrances

Interim reporting need not be cumbersome. Financial reporting should be condensed to a level that provides a status report that is easily reviewed. The supporting detail should be available at any time for legislators (and the executive authority) to study if necessary. Also, the financial staff should be able to prepare special reports on request to give legislators information they need to allocate resources, set priorities, or approve additional obligations.

The interim reports should also include budgetary comparisons. Monitoring budgetary compliance is a primary function of the executive authority and the legislative body. Management needs information about significant changes in operations early to detect the need for additional budget amendments. KRS 91A.030 mandates budgets for all funds and prohibits the use of any city monies without budgetary authority. Interim budgetary comparisons will provide the framework for the budget amendment process to ensure compliance with KRS 91A.030.

## **COMPENSATING CONTROLS**

One of the most frequent audit findings is related to a lack of segregation of duties. This problem occurs frequently in smaller cities where resources do not allow hiring additional staff. The Auditor of Public Accounts has recommended the following compensating controls to give smaller local governments the ability to use existing staff and still achieve oversight to monitor cash receipts and disbursements. Smaller cities can use these recommendations to highlight alternatives to improve accountability for public funds.

- Cash receipts are recounted and deposited by an elected official.
- An elected official performs surprise cash counts
- Monthly reports are reconciled to source documents and to receipt and disbursement ledgers by someone who did not prepare the monthly reports or journal entries.
- An elected official spot-checks work and cross-trains employees.
- All disbursement checks are signed by two of three authorized check signers.
- Elected official examines payroll checks prepared by another employee and distributes checks to employees.
- An elected official examines other disbursement checks prepared by another employee for proper supporting documentation.
- An elected official mails disbursements.

The city's auditor may be able to recommend specific compensating controls that would improve oversight without adding new staff. These controls should be customized to fit the form of government and the services provided by the city. It may be helpful to use legislative members to provide additional oversight, but legislative officials cannot infringe on the executive authority of the mayor.

**It is important to note that while these suggested compensating controls are consistent with KRS 83A.140, which governs the commission form of government, the controls may not be appropriate for the very small cities that operate under a mayor/council form of government. This is due to a restriction contained in KRS 83A.130(11), which specifically**

**prohibits a member of the legislative body from performing any executive function not assigned by state law.**

These statutory restrictions do not provide the same flexibility for sharing administrative duties that can be used in the mayor/commission form of government. Smaller cities that follow the mayor/council form of government simply have fewer choices for compensating controls. Many audit reports for these cities include audit findings that segregation of duties creates weaknesses in internal controls. City officials should understand that these weaknesses are difficult to resolve under the current statutory provisions of 83A.130. Unless the city has the resources to hire staff to provide adequate segregation of duties, these weaknesses in internal control will continue. City officials can explore other alternatives for oversight and monitoring the use of public resources, but the legislative body cannot perform duties that are assigned to the executive authority.

## AUDIT STANDARDS

### TECHNICAL REFERENCES

KRS 91A.040

AICPA Auditing Standards

*Government Auditing Standards* issued by U S Comptroller General

Single Audit Act Amendment of 1996

OMB Circular A-133, *Audits of State, Local Governments and Nonprofit Organizations*

### BACKGROUND

Governmental entities are subject to three levels of audit standards. Kentucky law requires city audits to be conducted in accordance with *Government Auditing Standards* issued by the U S Comptroller General. Therefore, the minimum audit requirements for Kentucky cities mandate that auditors follow the AICPA Auditing Standards AND the *Government Auditing Standards* because both these standards are integrated in *Government Auditing Standards*. The third level of auditing standards is required when a Kentucky city expends more than \$300,000 of federal financial assistance in any fiscal year.

Governmental auditing standards are established by the Comptroller General of the United States, in the publication, *Government Auditing Standards*, or the Yellow Book as it is more commonly called. Throughout this manual, we will use either the Yellow Book or GAGAS when referencing auditing standards issued by the Comptroller General.

The Single Audit Act Amendments of 1996 and OMB Circular A-133 are actually enacted by Congress. These provisions are not considered audit standards, but these requirements are federal law. There were several changes in the audit requirements for recipients of federal financial assistance in 1996 and 1997. Prior to the changes in 1996, there were two circulars, A-133 for not-for-profit organizations, and A-128, for state and local governments receiving federal financial assistance. In 1996, the Single Audit Act and provisions of A-133 were revised and Circular A-128 was rescinded. Therefore, the OMB implementation of the Single Audit Act was consolidated into a single pronouncement that applied to both nonprofit entities, as well as state and local governments.

This section will highlight the AICPA requirements to help city officials know what to expect from their auditors.

## KRS 91A.040 - KENTUCKY AUDIT REQUIREMENTS

- ❑ **There are several provisions of KRS 91A.040 that should be highlighted before we discuss the audit requirements from the public accounting perspective. City officials are responsible for obtaining audit services, negotiating the contracts for the annual audit, and submitting audit reports to GOLD. These contracts must address the following issues outlined in KRS 91A.040:**
- ❑ Audits must be conducted by the Auditor of Public Accounts or a certified public accountant.
- ❑ Audits must be completed by February 1 immediately following the fiscal year.
- ❑ Within ten days of the completion of the audit and the presentation to the city legislative body, the city should forward three copies of the audit report to GOLD.
- ❑ Sixth class cities have different audit requirements:
- ❑ Sixth class cities that receive **and** expend less than \$75,000 and have no long-term debt are not required to have an audit for that year. These cities prepare a financial statement in accordance with **KRS 424.220** and forward one copy of that report to GOLD Cities Branch.
- ❑ Sixth class cities that receive **and** expend more than \$75,000, or have long-term debt, are required to have audits in odd years and comply with the provisions for other cities. In even years, these cities prepare the KRS 424.220 financial statement and send one copy to GOLD Cities Branch.
- ❑ **The auditor's contract should include the following provisions:**
- ❑ The auditor will examine the general purpose financial statements of **all** the city's funds.
- ❑ The auditor will include the LGEA funds in the audit of general purpose financial statements. **The auditor's report on internal control and compliance should include an opinion on the city's compliance with KRS 42.450 to 42.495.**
- ❑ The audit should be conducted in accordance with generally accepted governmental auditing procedures. State or federal guidelines should also be followed, where applicable.
- ❑ The reporting package should include the general purpose financial statements and the auditor's opinion.
- ❑ The auditor must express an opinion as to whether the general purpose financial statements present fairly the financial condition of the city or state the reasons why an overall opinion cannot be expressed. KRS 91A.020 requires cities to follow GAAP, so this opinion should address whether the statements have been prepared in accordance with GAAP.
- ❑ The completed audit and the management letter should be presented to the city legislative body at a regular or special meeting.
- ❑ Any contract with a certified public accountant shall require the CPA to forward a copy of the audit report and management letter to the Auditor of Public Accounts upon request of the city or the Auditor of Public Accounts. The Auditor of Public Accounts has the right to review the certified public accountant's workpapers on request.
- ❑ The annual audit report can be used to respond to any official request to a city for financial data.
- ❑ Cities can elect to publish the financial statement required by KRS 424.220 or the prescribed sections of the auditor's report.
- ❑ If the city elects to publish the auditor's report, the city must publish a notice by September 30 that the financial statement required by KRS 424.220 has been prepared and that copies have been distributed to the media who have filed written requests for these statements.

- ❑ **If the city elects to publish the auditor's report, the following sections should be included in the legal advertisement:**
- ❑ Auditor's opinion letter
- ❑ Combined balance sheet for all fund types and account groups
- ❑ Combined statement of revenues, expenditures and changes in fund balance for all governmental fund types
- ❑ Combined statement of revenues, expenses, and changes in retained earnings/fund balances for all proprietary fund types and similar trust funds
- ❑ Combined statement of changes in financial position for all proprietary fund types and similar trust funds
- ❑ Statement that a complete copy of the audit report is available at city hall for public inspection.
- ❑ If the city elects to publish the KRS 424.220 statement, the statement must be published within 60 days of the close of the fiscal year.
- ❑ This section imposes financial penalties for any person who violates KRS 91A.040.

The timelines in KRS 91A.040 are designed to generate timely information about the city's financial position and demonstrate the city's accountability for managing public resources. Publishing requirements are also built on the availability of audit information to communicate the auditor's findings to the public. The statutes also include time limitations for completion of the audit to ensure that the audit is completed promptly after the end of the fiscal year. Those cities that participate in the GFOA Certificate of Excellence in Financial Reporting are required to submit completed the Comprehensive Annual Financial Report to GFOA by December 31.

Exceptions for sixth class cities recognize the unique considerations in the smaller cities. Cities that receive and expend less than \$75,000 and have no outstanding long-term debt have fewer resources for incurring audit costs. The alternative reporting and publishing requirements allow these cities to demonstrate accountability with costs that are more affordable in their limited budgets.

Publishing requirements are also important in the governmental sector. KRS 91A.040 and 424.220 dictate how cities must publish the actual financial data. There are options that provide some flexibility, but the underlying requirement is the same. Annually, the city must publish appropriate financial statements to demonstrate accountability for public funds.

Note the due dates and mark your calendars to be sure that these requirements are satisfied.

- **If the city elects to publish the KRS 424.220 statement, it must be published within 60 days after completion of the audit.**
- **Sixth class cities that are not subject to audit requirements should publish this statement within 60 days of the year-end - AUGUST 31.**
- **If the city elects to publish the audit report, it must be published upon completion of the audit, which must be completed by February 1.**

### **GENERALLY ACCEPTED AUDITING STANDARDS (GAAS)**

All of the GAAS provisions apply to governmental engagements. However, certain pronouncements have special significance for the governmental sector.

The expectation gap standards, Statement of Auditing Standards (SAS) 53 (Errors and Irregularities), SAS 54 (Illegal Acts), and SAS 78 (Internal Control), are directly related to governmental engagements. **GAO has emphasized the provisions of these standards in the**

**Yellow Book, *Government Auditing Standards*. Illegal acts, in particular, take on a special connotation for governments because of the multitude of laws and regulations that restrict and govern the operations of governmental entities.**

SAS 53 and 54 were amended when the Auditing Standards Board issued SAS 82, *Consideration of Fraud in a Financial Statement Audit*. SAS 82 requires auditors to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. **Auditors must communicate with the appropriate level of management whenever the auditor has determined that there is evidence that fraud may exist.** When the auditor has identified risk factors that indicate weak controls for deterring or detecting fraud, the auditor is required to consider whether these risk factors represent reportable conditions that should be communicated to senior management. Reportable conditions must be outlined in the auditor's report on internal control and compliance.

**The auditor may also be required to report possible fraud to parties other than the client's senior management.** In most cases, the auditor only communicates with the client, but the following circumstances expand the auditor's reporting requirements under generally accepted auditing standards:

- **Compliance with certain legal and regulatory requirements,**
- **Communication with a successor auditor,**
- **Response to a subpoena, or**
- **Notice to a funding agency in accordance with requirements for the audits of entities that receive governmental financial assistance.**

SAS 68 and its successor, SAS 74, *Compliance Auditing Applicable to Governmental Entities and Other Recipients of Governmental Financial Assistance*, specifically address the auditor's responsibilities in a governmental engagement. **The most notable requirement in SAS 68 is the requirement for the auditor to notify the governmental client if the auditor determines that the scope of the audit engagement may not satisfy the audit requirements imposed on the client.** These requirements can originate with laws, regulations, contract, agreement, or policy.

SAS 69, "The Meaning of *Present Fairly in Conformity with Generally Accepted Accounting Principles* in the Independent Auditor's Report", is another statement with direct impact on governmental engagements. Basically, this standard requires auditors to issue a modified opinion if a governmental entity does not follow GASB standards to prepare the annual financial report. Since Kentucky cities are required to follow GAAP, they cannot obtain a "clean" opinion unless they have followed GASB standards.

### ***Scope of the Governmental Engagement***

KRS 91A.040 outlines two requirements that affect the scope of the governmental audit. First, the audit must be conducted in accordance with *Government Auditing Standards*. If the city expends more than \$300,000 in federal financial assistance, the audit must also be conducted in accordance with the requirements of the Single Audit Act Amendment of 1996 and OMB Circular A-133. Second, the audit must include all funds of the city. KRS focus on sources of public monies, not just the segregated "funds" of governmental accounting. The statute anticipates and *Government Auditing Standards* require that auditors consider the legal and regulatory compliance issues for all government resources in the audit of a Kentucky city.

Once the auditor has determined the type of audit to be conducted and the standards that apply to that type of audit, the next question is “What is the reporting entity?” State and local governments often create component units to provide certain goods and services to either the public or the government itself. For instance, a local government may have created a utility company that is operated independently of the governmental entity. GASB 14, *The Financial Reporting Entity*, establishes the criteria for determining the reporting entity.

The final consideration in determining the scope of the audit will be a review of the client’s accounting system and financial statements. Computers have also improved the accounting systems for many small governments, allowing part-time personnel the ability to maintain accounting records more efficiently. The auditor should make time to review the accounting records prior to the execution of the audit contract and agreement on the audit fee.

### ***Auditor Independence***

KRS 91A.040 requires cities to obtain an audit by either the Auditor of Public Accounts or a certified public accountant. Kentucky accountancy laws (and the Professional Codes of Conduct of the AICPA and the Kentucky Society of Certified Public Accountants) require CPAs to be independent when conducting audits. AU Section 220.01-.03 provides the following definition of independence:

- .01 *The second general standard is:  
In all matters relating to the assignment, an independence in mental attitude is to be maintained by the auditor or auditors.*
- .02 *This standard requires that the auditor be independent; aside from being in public practice (as distinct from being in private practice), he must be without bias with respect to the client since otherwise he would lack that impartiality necessary for the dependability of his findings, however excellent his technical proficiency may be.*
- .03 *It is of utmost importance to the profession that the general public maintain confidence in the independence of independent auditors. Public confidence would be impaired by evidence that independence was actually lacking, and it might also be impaired by the existence of circumstances which reasonable people might believe likely to influence independence.*

Smaller cities frequently ask local CPAs to perform accounting services in addition to the audit of city funds. These engagements can pose problems for independence if the CPA assumes the role of employees or management. **The city must retain responsibility for the financial statements and cannot ask the CPA to serve as both the city's financial officer and the auditor. The CPA cannot complete transactions, have custody of assets, or exercise authority on behalf of the city.** The city's personnel must prepare the source documents on transactions in sufficient detail to identify clearly the nature and amount of all the city's financial transactions.

Accounting services should only include recording the source documents to generate the city's financial statements in accordance with the city's financial reporting policies. **An independent auditor can provide "computer time" to maintain the city's financial records. An independent auditor cannot determine how the city's transactions should be recorded.**

### ***Materiality Issues in the Governmental Engagement***

Materiality is one of the most significant issues in the planning stages of any audit engagement, governmental as well as commercial. However, the concept of what is material becomes much more complex in the governmental sector. The materiality benchmarks will determine how

much testing the auditor conducts and when errors are serious enough to change the auditor's opinion about the financial statements.

After the auditor determines the base for materiality calculations, the next step is the determination of benchmarks for the auditor's materiality judgments. The purpose of this materiality analysis is to allow the auditor to rely on testing and statistical samples rather than examining all transactions in the process of obtaining sufficient evidential matter to support an opinion that the **financial statements** are free of **material** misstatements. **Auditor's judgments about whether errors or misstatements are material will determine if the auditor can issue a "clean" opinion on the city's financial statements.**

The 1994 Yellow Book includes a new discussion in 4.9 to emphasize that materiality levels may be lower in a governmental audit. Materiality is not always as simple as a numeric calculation. Public perception plays a key role in evaluating which projects and transactions are more significant than others. While an auditor may determine that a \$50,000 loss in the investment portfolio is not material based on the mathematical calculations, the local newspaper editor will most likely not share that opinion. **The issue of accountability takes on a different perspective for governmental entities than it does for commercial enterprises because the visibility and sensitivity of government programs will significantly impact materiality.**

### ***Risk Factors***

There are risk factors that are unique to the governmental environment. Laws, regulations and compliance issues head the list of governmental risk factors. SAS 53 and 54 (AU §316 & 317) require the auditor to design the audit to provide reasonable assurance of detecting errors, irregularities and illegal acts that are material to the financial statements. Reasonable assurance is a lower risk than absolute assurance.

Small organizations with limited resources often have problems with the appropriate segregation of duties. The level of independent oversight can often decrease this type of risk for some levels of government. The audit workpapers should include the auditor's evaluation and other factors that will increase or decrease this risk. Auditors will often suggest alternative controls that can minimize the risks for organizations with limited resources for hiring staff.

New grant programs or complex requirements combined with limited technical expertise of the employees can increase risk for some agencies. Assessments of this risk should include inquiries of responsible personnel about changes in policies that address new programs.

### ***GAAS Compliance Auditing***

Compliance auditing begins with SAS 54 and 82. Governmental entities operate within a multitude of laws and regulations, so the provisions of these two SAS's overlap considerably in a governmental engagement. The auditor must consider laws and regulations that have a direct and material effect on the determination of financial statement amounts. These laws and regulations should be considered in relation to audit objectives for the financial statement assertions.

The audit must be designed to provide reasonable assurance that material errors, irregularities and illegal acts will be detected. The auditor assesses the control and inherent risks that errors, irregularities or illegal acts will cause material misstatements. Audit planning follows this risk assessment, but the auditor will continually reevaluate risk assessments during the audit engagement as additional information is examined and documented.

The auditor will review minutes of the legislative meetings to determine whether the government has entered into contracts or grant agreements that may impose significant audit requirements. The minutes will provide clues about the amount and source of unusual revenue sources. Further reviews of the contracts, grant documents, or bond indentures will lead the auditor to more specific information. These reviews are usually conducted as early as possible so that audit procedures are designed properly.

The tests of transactions in the governmental audit must include examination of supporting documentation that demonstrates the government's compliance with state and local laws and regulations. These issues actually create an additional assertion by the governmental auditee—*Transactions are in compliance with applicable laws and regulations*. Many of these laws and regulations may have a direct and material effect on the financial statements while others may have an indirect effect.

# AUDIT PROCUREMENT

## TECHNICAL REFERENCES

*How to Avoid a Substandard Audit: Suggestions for Procuring an Audit*, National Intergovernmental Audit Forum, May 1988

## BACKGROUND

The basic issues for obtaining audit services has not changed substantially since the National Intergovernmental Audit Forum published the brochure, *How to Avoid a Substandard Audit: Suggestions for Procuring an Audit*. Members of this group include federal audit officials, representatives from Office of Management and Budget and local government officials. This section includes the entire text from that publication to assist cities with selecting the auditor to conduct the annual (or biennial) audit required by KRS 91A.040.

One important audit requirement was added with the 1994 revision to *Government Audit Standards*. These provisions mirror the requirement in AICPA standards that require audit organizations to have an appropriate internal quality control system in place and undergo an external quality control review. Kentucky State of Board of Accountancy regulations also mandate that CPA's conducting audits should have quality control reviews on a regular basis. *Government Audit Standards* goes one step further in 3.36.

*Audit organizations seeking to enter into a contract to perform an audit in accordance with these standards should provide their most recent external quality control review report to the party contracting for the audit. Information in the external quality control review report often would be relevant to decisions on procuring audit services. Audit organizations also should make their external quality control review reports available to auditors using their work and to appropriate oversight bodies. It is recommended that the report be made available to the public.*

KRS 91A.040 mandates that audits of Kentucky cities be conducted in accordance with *Government Auditing Standards*. Therefore, city officials should request, and auditors must provide, copies of the auditor's most recent external quality control review before the audit contract is completed. AICPA Quality Control Standards include provisions that external reviewers must inspect at least one governmental engagement if the firm conducts governmental audits. The reviewer's report should disclose significant problems with the firm's quality control for governmental engagement. The quality control review gives city officials an indication of how well the audit firm performs audit engagements.

One other issue should be considered when drafting the audit contract. Some cities include preparation of the Uniform Financial Information Report as part of the services provided by the auditor. DLG suggests that cities discuss this reporting requirement with the auditor to determine who will be responsible for preparing and transmitting the UFIR to DLG by May 1.

The rest of this section reproduces the NIAF brochure.

## INTRODUCTION

Regardless of the type or size of public entity you are affiliated with—from the smallest town or local entity to the largest state or federal agency, from a neighborhood health clinic to a major hospital, from a grade school to a university—an effective audit can improve management operations and yield significant dollar savings. It can also help you avoid wasting your entity's resources on a substandard audit. **If your responsibilities include hiring a certified public accountant (CPA) or any other independent auditor, this handbook can help you get the most for your money.**

Taking steps to ensure a quality audit is especially important in light of a General Accounting Office (GAO) report that identified 34 percent of CPA audits it reviewed as substandard. Another GAO report disclosed that entities with ineffective procurement systems stood a 46-percent chance of receiving a substandard audit; that figure dropped dramatically to 17 percent for entities that followed systematic audit procurement practices.

Public entities should never select auditors without considering five basic elements of an effective audit process:

1. planning (determining what needs to be done and when),
2. fostering competition by soliciting proposals (writing a clear and direct solicitation document and disseminating it widely),
3. technically evaluating proposals and qualifications (authorizing a committee of knowledgeable persons to evaluate the ability of prospective auditors to effectively carry out the audit),
4. preparing a written agreement (documenting the expectations of both the entity and the auditor), and
5. monitoring the auditor's performance (periodically reviewing the progress of that performance).

This handbook discusses these five elements of audit procurement. It also addresses the use of audit committees—-independent committees composed of persons with knowledge of accounting, auditing, finance, or management—which, among other things, can assist entities in procuring audit services and overseeing the audit process. In addition, because many small entities—in this context, those that contract for audits costing less than \$10,000—do not have procurement systems that are as formal as those of large state or local governments, we present information at the end of each section on how the critical elements of a procurement system can be applied to the special needs of small entities.

*Specific procurement issues that only apply to Kentucky cities will also be highlighted, where KRS provisions apply to audit procurement. This information will appear in Italics to distinguish this guidance from the discussion in the NIAF publication. Kentucky cities that adopt the Model Procurement Code outlined in KRS 45A.343 - 45A.460 should also follow the provisions that apply to personal service contracts.*

Finally, we have included a short bibliography of procurement guidelines. Keep in mind, however, that if the guidance that this handbook provides conflicts with applicable laws or regulations or relevant grant conditions, the laws, regulations, or conditions are controlling.

## PLANNING: AN ESSENTIAL FIRST STEP

Planning to procure a quality audit requires time and attention. But the resources an entity spends on planning are likely to be rewarded by a smoother, more timely, and often less expensive audit.

### ***Matters to Consider***

- Defining the entity to be audited. Governments and other public organization are often composed of numerous smaller, sometimes legally separate entities. You should decide which of these units to include in the scope of your audit, taking into account any legal requirements and generally accepted accounting principles. *KRS 91A.040 requires an audit of all funds of the city. This should include separate organizations that are controlled by the city's legislative body or executive authority, such as utility boards, tourism commissions, or affiliated not-for-profit organizations.*
- Delineating the scope of the financial audit. For audits of financial statements, you need to determine whether you want the auditor to limit the examination to the general-purpose financial statements, the minimum allowable audit scope, or to extend the examination to cover additional statements, such as the combined, individual fund, and account-group financial statements. *KRS 91A.040 requires an audit of the general-purpose financial statements, at a minimum. GOLD recommends that the audit scope should also include combining statements, individual fund, and account-group statements if these schedules are included in the annual financial report to the legislative body.*
- Determining the specific audit requirements. To determine your audit requirements—a sometimes difficult task—you may want to seek the assistance of knowledgeable persons. This assistance is ideally provided by an audit committee composed of people with backgrounds in accounting, auditing, finance, or management. Entities without audit committees may want to seek the assistance of other government personnel with specialized knowledge of accounting and auditing. *KRS 91A.040 outlines the broad guidelines for city audits and requires auditors to include a certification of compliance for LGEA funds expended under KRS 42.450-42.495.*
- Deciding on the appropriate auditing standards. While generally accepted auditing standards (GAAS) are typically used for both private and public sector audits, your organization may be subject to grant terms, state statutes, federal regulations, or the Single Audit Act and thus may be required to use generally accepted government auditing standards (GAGAS), which are issued by the Comptroller General of the United States. GAGAS incorporate GAAS but involve additional auditor responsibilities, including special reporting on internal controls and on compliance with applicable laws and regulation. You will need to determine and specify the appropriate standards for your auditor to follow. *KRS 91A.040 requires city audits to be conducted in accordance with "Government Auditing Standards" issued by the Comptroller General of the United States.*
- Determining whether the Single Audit Act applies to your organization. The Single Audit Act of 1984 established supplemental audit requirements in the areas of internal control and compliance reviews. You should find out if your organization is affected by this legislation. A good reference document is the American Institute of Certified Public Accountants' (AICPA) guide for audits of state and local governmental units. *Amendments to the Single Audit Act in 1996 revised audit requirements for cities expending federal grants. Currently, Single Audits are required for cities expending more than \$300,000 in federal financial assistance. Audit requirements are included in the*

*Single Audit Act, as amended, and OMB Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations."*

- Identifying the attributes necessary in an auditor. We suggest that the personnel performing the audit have experience with audits of similar entities as well as continuing professional education in governmental accounting and auditing. Moreover, they should comply with applicable requirements for peer review and continuing professional education. *Current continuing education requirements in the Yellow Book mandate that auditors should include 24 hours of governmental courses in the 80 hours of continuing education required every two years.*
- Deciding how to evaluate prospective audit firms. Developing a systematic procedure for evaluating firms' qualifications is essential. Although price is important, technical qualifications should be a critical criterion in selecting an auditor.
- Reviewing legal requirements. You should review applicable laws, regulations, and grant conditions to ensure that both the procurement process and the audit itself will meet legal requirements. *The Appendices include the full text of applicable KRS.*
- Considering a multiyear agreement. The first year of an audit engagement usually involves significant start-up costs as auditors devote considerable time to learning about the entity and its internal control systems. Having completed this groundwork, the auditor usually is able to work at less cost in the succeeding years. If authorized by law, a multiyear agreement—perhaps a 1-year agreement with the option to extend the agreement for up to 5 years—has a dual advantage: It enables an auditor to propose a price that takes into account the savings to be realized in subsequent years and saves the entity the costs associated with repeating the selection process.
- Evaluating the auditor rotation option. Some people argue that changing auditors at the end of a multiyear contract infused the audit process with fresh views and new perspectives. Others contend that these benefits can be achieved through internal rotation of audit staff and that maintaining a long-term, ongoing relationship with a firm, however, will not necessarily enable the entity to seek out and take advantage of lower priced audits. It makes sense to carefully consider the advantages and disadvantages of auditor rotation as well as applicable legal requirements before setting a policy.
- Establishing a work schedule. You should develop a schedule both for yourself and for the auditor you eventually select that sets forth dates by which certain milestones in the audit process must be reached. The only way to ensure the timely preparation and issuance of financial statements and related reports is to develop and adhere to such a schedule. *KRS 91A.040 requires audits to be complete by February 1 following the June 30 year-end. Copies of audit reports must be submitted to GOLD within 10 days of presentation to the legislative body. In addition, the Uniform Financial Information Report is due to GOLD by May 1.*

### **Small Entities**

All of the following foregoing suggestions—especially creating and using an audit committee—can help a small entity achieve a quality audit. Even the smallest organization can appoint a two- or three-person audit committee that understands what is to be audited and how the audit should be performed.

## COMPETITION AND SOLICITATION: COMMUNICATING AUDIT REQUIREMENTS

Full and open competition is basic to government procurement. Encouraging as many qualified audit firms as possible to submit their proposals for auditing your organization increases the likelihood that you will receive a quality audit at a fair price. The next step, then, is to communicate your audit needs to potential bidders. This step is critical, because bidders who do not clearly understand exactly what services you want might not respond.

### ***How to Solicit an Audit***

There are many ways to solicit bids for your audit, but the most reliable method—and the one we suggest—is a written request for proposal, or RFP. RFPs should be clearly written; set forth all terms, conditions, and evaluation criteria as well as the scope of the work required; and be sufficiently well distributed and publicized to ensure full and open competition.

Using your audit committee to advise you when writing your RFP is a good idea. Committee members should have a clear understanding of both the audit function and what your organization requires of the audit.

You may want to consider compiling a list of potential auditors from general and professional directories and from your past experiences with audit firms. Maintaining an updated list makes it easy to distribute your RFP to the firms that are most likely to be interested in bidding on your audit. *The State Board of Accountancy publishes the "Register of Kentucky Accountancy" that lists all licensed CPAs in the state. This directory includes a listing of firms in each city as well as an alphabetical listing of individual CPAs. GOLD cannot recommend or endorse any particular firm.*

*KRS 45A.380 allows noncompetitive negotiation of contracts for services of a certified public accountant for those cities that adopt the Model Procurement Code. KRS 424.260 requires contracts that exceed \$20,000 are subject to requirements for competitive sealed bids, but professional service contracts are generally exempt from these requirements. GOLD recommends that cities use a request for proposal to solicit proposals from qualified audit firms. Other provisions of the Model Procurement Code that may apply to the audit procurement process include the following:*

- *Administrative regulations should include the city's policies for procurement of professional service contracts.*
- *City procurement policies should specify whether the city uses competitive sealed bids, competitive negotiation or noncompetitive negotiation for audit procurement.*
- *45A.375 provides guidance for action when no bids are received or when all bids exceed available funds.*
- *The city's policies for purchases under \$10,000 should address audit procurement if those costs are generally less than \$10,000.*
- *45A.395 requires a written determination to document whether proposals are responsive to the specifications in the request for proposals.*
- *45A.400 allows a city to develop a list of audit firms that are prequalified to provide proposals for audit services.*
- *Specifications should allow competition among audit firms and should not be so restrictive that only one audit firm can respond to the RFP.*
- *Audit procurement is also subject to the restrictions on conflict of interest, gratuities and kickbacks, and the use of confidential information.*

### ***What to Include in Your RFP***

The prime consideration in preparing your RFP is that it contains enough information to provide bidders with a common basis by which to prepare proposals that address all your audit needs. It is also important, however, that you consult with your purchasing office and/or legal counsel to ensure that your RFP conforms with the laws, regulations, and grant terms applicable to your organization. At a minimum, your RFP should contain the following:

- the name and address of your organization;
- the entity to be audited, scope of services to be provided, and specific reports, etc., to be delivered;
- the period to be audited (with an explanation if the RFP calls for a multi-year procurement);
- the name and telephone number of a contact person at your organization;
- the format in which you want proposals to be prepared;
- the address to which proposals should be delivered or sent;
- the date and time proposals are due;
- the number of proposal copies to be submitted;
- the criteria to be used in evaluating the bid and their relative importance to each other;
- the method and timing of payment;
- any other important points, including the consequences if due dates are missed or work does not meet audit standards.

Your chances of receiving high quality proposals will be enhanced if you:

- explain the work that your organization does;
- explain what is to be audited, e.g., general-purpose financial statements, specific funds, or both;
- describe in some detail your organization's accounting system, administrative controls, records, and procedures;
- inform prospective bidders whether the Single Audit Act applies to this audit;
- identify the appropriate auditing standards;
- inform prospective bidders if data from prior years (audit reports, management letters, etc.) will be available, whether major audit findings remain open from prior years, and whether any audits of sub-recipients are required;
- notify prospective bidders of requirements for work-paper retention and for making the workpapers available to the entity as well as governmental auditors if they request them;
- describe expected audit products, the required format of the audit report, and the format of any required progress reports;
- explain any assistance that your organization will offer, such as staff support to assist the auditor (which could materially reduce your audit cost); and
- outline the expected schedule of work (completing fieldwork, issuing reports, presentation to legislative body, etc.).

Finally, a well-prepared RFP will elicit certain information from prospective bidders. For example, it will ask bidding firms to state:

- how they would conduct the audit and, if it were a multi-year contract, how they would approach the work efforts of the subsequent year(s);
- their qualifications, those of their local office, if applicable, and those of the proposed audit staff, including their prior government auditing experience;
- their policies on notification of changes in key personnel;

- whether the proposed staff have received continuing professional education in governmental accounting and auditing during the last 2 years;
- whether they are independent, as defined by applicable auditing standards;
- whether they have received a positive peer review within the last 3 years (*The 1994 revision to "Government Auditing Standards" requires auditors to provide a copy of their latest quality control review report to the party contracting for the audit.*);
- whether they have been the object of any disciplinary action during the past 3 years; and
- their fee.

### ***Bidders' Conference***

Although you will have been as thorough as possible in preparing your RFP, you may overlook some information that prospective bidders will find useful. One effective way of communicating additional information to bidders is to invite them to a bidders' conference, where you can provide additional information and they can ask any unanswered questions. Although these purposes could be served by letters and individual conversations, bringing all bidders together at the same time to hear the same information is efficient and helps ensure that all bidders are treated equally. This is especially important, since unsuccessful bidders may challenge the procurement if their competitors were given significantly different or more information.

### ***Small Entities***

Obtaining an extensive list of potential bidders may be difficult for small entities in rural areas. Soliciting lists from nearby, larger entities and from CPA's in your region that have experience with governmental audits often is helpful.

Furthermore, preparing a detailed RFP for a small engagement may be economically impractical in many cases. Abbreviated RFPs, designed for small engagements and requiring only a little tailoring to meet individual needs, may be available through state and regional government organizations. At a minimum, such RFPs should clearly define the work to be done, including the reports and opinions to be delivered.

## **TECHNICAL EVALUATION: SELECTING A QUALIFIED AUDITOR**

Once the due date for proposals has passed, you can begin evaluating the bidders' qualifications. The technical evaluation is important for two reasons:

- it provides a systematic framework for selecting an auditor on the basis of the entity's established RFP criteria and
- it documents that the auditor was selected fairly.

By comparing your entity's requirements with the auditors' plans, skills, experience, commitment, and understanding of the audit requirements and then reviewing bidders' price proposals, you will be able to select the firm that can provide the best audit at the fairest price.

### ***The Role of Committees***

To limit errors in judgment and to bring varied perspectives to the technical evaluation of the proposals, you will probably want to establish an evaluation committee. The committee should be composed of people with experience in accounting, auditing, budgeting, or another specialty field pertinent to the required audit work. Your audit committee can also play an important advisory role in this process.

## THE EVALUATION PROCESS

Separate evaluations of technical ability and price should be utilized if possible. The technical evaluation addresses the firms' technical and ability to perform the audit. Although the price for the work to be performed is a significant factor in the selection of a qualified audit firm, you will be more likely to get a high quality audit at a fair price if both price and technical ability are taken into account in selecting the successful bidder.

### ***Requiring Minimum Standards***

As a first step, we suggest that you require all bidders to meet certain minimum standards before evaluating either their technical qualifications or their price proposals. By doing so, you can spare your entity the needless and time-consuming technical evaluation of firms that do not meet your requirements. These minimum standards can be determined by the laws governing your entity, its general internal policies, and its policies regarding specific audit engagements. However you delineate them, we suggest that your minimum standards include that firms:

- meet the appropriate state licensing requirements,
- meet the applicable independence standard,
- have a record of responsible work, and
- comply with applicable requirements for peer review and continuing professional education.
- *The 1994 edition of "Government Auditing Standards" requires audit firms conducting governmental engagements to undergo an external quality control review every three years.*

### ***Technical Criteria***

The technical criteria set out in the RFP and used in the evaluation process can vary. At a minimum, however, the evaluation committee should be able to answer "yes" to the following questions:

- Does the proposal, both in the statement of the audit requirements and elsewhere, demonstrate that the firm has an understanding of the audit's objective(s), your organization's needs, and the final products to be delivered?
- Does the proposal contain a sound technical plan and a realistic estimate of time required to complete the audit.
- Does the proposal show the bidder's intention to start the audit when required and complete the audit in a timely fashion?
- Does the technical plan show a practical approach to meeting benchmarks and specific deadlines?
- Does the proposal indicate that the firm will use (1) a systematic approach to examining systems and internal controls and (2) effective procedures, including consideration of risk and materiality, to determine the extent of audit testing and review necessary?
- Does the proposal indicate the bidder's willingness to use other auditors' work, to the extent possible, to avoid duplication of effort?
- Does the firm have experience in performing the required work for entities of your type and size?
- Do prior clients have a positive opinion of the firm?
- Does the proposal clearly show the collective experience of the team to be assigned to the project?
- Does the proposal specify, in concrete language, that key personnel have education and experience in the type of work that the audit entails?
- Is the experience explained in terms of specific audit engagements?
- Is the continuing professional education of key personnel explained in detail?

- Does the proposal indicate the extent to which your entity's personnel would be expected to contribute to the work effort?
- Does the proposal specify that you must be notified in writing of changes in key personnel?
- If the proposal is for a multiyear contract, does it provide an approach for planning and conducting the work efforts of the subsequent year(s)?
- *Does the proposal indicate that staff members are familiar with KRS requirements that apply to Kentucky cities?*
- *Does the proposal indicate that staff members are familiar with the unique requirements of governmental audits outlined in "Government Auditing Standards" or OMB Circular A-133?*

### **Rating the Proposals**

Initial evaluations should be based on the bidders' proposals as submitted. As you evaluate the proposals, make a list of strengths and weaknesses for each to support its technical rating. After you complete the technical evaluation and review the prices offered by the bidders, you may be prepared to select the proposal that is most advantageous to your entity.

If, however, you feel you need more information before selecting a proposal, you should hold individual discussions with bidders who have a reasonable chance of being selected to allow them to respond to your concerns and submit revised proposals by a specified date. Care should be taken during these discussions not to reveal proprietary information submitted by other bidders. You should then evaluate the revised proposals as described above and award the contract on the basis of both technical competence and reasonable price.

### **Small Entities**

Using a committee to carry out the evaluation process is especially important for small entities with limited resources. A more comprehensive analysis of the bids is likely to be achieved by having more people involved in the evaluation process.

## **THE WRITTEN AGREEMENT: DOCUMENTING EXPECTATIONS**

The lack of a written agreement between the entity contracting for the audit and the audit firm can contribute to substandard audits performed by public accountants. To foster sound and productive communication and to avoid misunderstandings, both parties should agree in writing on important audit-related matters. Make clear at the start—before bidders spend time assessing the nature of the job and estimating its costs—that you expect to sign a formal document as the culmination of the proposal process. Audit firms unwilling to commit themselves to signing such a document are better avoided.

A signed agreement represents a contract and is binding upon both parties. For that reason, when drafting the agreement, seeking the advice of your purchasing office or legal counsel on the agreement's form and substance is important.

### **What to Include in a Written Agreement**

When an RFP has been used, the written agreement should incorporate by reference the terms of the RFP and those of the successful bidder's last proposal. The letter should be signed by the entity and the audit firm. *Most auditors will provide a standard engagement letter that conforms to AICPA and GAO audit standards.*

The written agreement will then clearly specify the following:

- audit scope, objective, and purpose;
- deadlines for work to be performed;
- audit cost
- report format;
- type and timing of support to be provided to the auditor by the entity; and
- professional auditing standards to be followed in performing the audit.

Furthermore, the agreement should make the following points about the auditor/entity relationship, changes in the kind or amount of work required, and access to and ownership of audit products.

- The relationship of the auditing firm to the entity is that of an independent contractor.
- At any time, the entity may, by written notice, make changes in or additions to work or services within the general scope of the agreement. If such changes are made, an equitable adjustment will be made in the cost of the audit using the rates specified in the agreement.
- If the contractor believes that a change in or addition to work is beyond the general scope of the agreement, it must notify the entity in writing within a specified time and before beginning that work. The agreement should indicate where the final administrative authority rests in deciding disputes.
- The workpapers prepared by the contracting auditor during the audit are its own property. These documents should be retained for a period to be designated in this agreement and made available to the entity and governmental auditors upon request.
- All reports rendered to the entity by the contracting auditor are the exclusive property of the entity and subject to its use and control, according to applicable laws and regulations.

### ***Small Entities***

In the absence of an RFP, many small engagements are documented only by an engagement letter, prepared by the CPA, which protects the CPA more than the entity being audited. If you decide to use an engagement letter as your written agreement, we advise including the information listed above and ensuring that the document is signed by both parties.

### **AUDIT MONITORING: ENSURING A QUALITY AUDIT**

Monitoring the progress of the audit is the most effective way to ensure that your organization receives both the type and quality of audit services specified in the written agreement. This is a role that your audit committee can carry out most effectively. This group of experts can evaluate the audit while it is taking place, thereby addressing and resolving problems before the audit is completed. It can also review audit results and assist in post-audit quality evaluation. Thus, not only does the audit product improve but also working relationships between the audited entity and auditor are enhanced.

Monitoring is especially beneficial during the first year of a new auditor's contract and during the audit of a particular unit or segment(s) of an organization that is unique or complex. Furthermore, monitoring is beneficial throughout the term of a multiyear contract: It provides status reports and helps coordinate the auditing firm's activities with the audit's requirements. While the responsibility for a quality audit rests ultimately with the auditor, monitoring the work being performed as a quality assurance measure is a good idea.

Monitoring can be accomplished by requiring periodic progress reports as well as by holding regular meetings to discuss issues that need to be resolved. Furthermore, meeting after the completion of the audit to discuss the draft report can help ensure a clear understanding of the report and its findings.

### ***Small Entities***

Few small entities have the resources to thoroughly monitor the work of an auditor. When audit committee members are unavailable within an organization, composing a committee from people outside the organization may be the answer.

## **AUDITOR ROTATION**

The KRS, AICPA audit standards, or Yellow Book audit standards do not discuss the rotation of the independent auditor. And, professional interpretations vary depending on whether an auditor has the engagement or is trying to obtain a new client. On the one hand, an auditor who has audited a particular city for several years of audits will be more familiar with the unique financial issues. On the other hand, the auditor may omit certain procedures because of prior experience with the city and may inadvertently miss errors and irregularities because prior audits did not indicate problems.

Cities should review audit contracts at least every five years, but preferably every three years. Cities should request proposals for audit services to evaluate the availability of qualified audit firms and the level of audit costs. The Yellow Book requires auditors to provide a copy of the quality control report to the agency contracting for governmental audit services. Audit firms are required to submit to a quality control review at least every three years and the contents of this report may vary from one review to another. City officials should review this report carefully to assess whether audit firms are still qualified to conduct governmental engagements. Periodic requests for proposals will allow cities to review the qualifications of available audit firms and select the best-qualified firm to provide audit services.

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*§ 3. Men are equal - No exclusive grant except for public services - Property not to be exempted from taxation - Grants revocable.*

All men, when they form a social compact, are equal; and no grant of exclusive, separate public emoluments or privileges shall be made to any man or set of men, except in consideration of public services; but no property shall be exempt from taxation except as provided in this Constitution, and every grant of a franchise, privilege or exemption, shall remain subject to revocation, alteration or amendment.

**§ 156a. General Assembly authorized to provide for creation, governmental structure and classification of cities.**

The General Assembly may provide for the creation, alteration of boundaries, consolidation, merger, dissolution, government, functions, and officers of cities. The General Assembly shall create such classifications of cities as it deems necessary based on population, tax base, form of government, geography, or any other reasonable basis and enact legislation relating to the classifications. All legislation relating to cities of a certain classification shall apply equally to all cities within the same classification. The classification of all cities and the law pertaining to the classifications in effect at the time of adoption of this section shall remain in effect until otherwise provided by law.

**§ 156b. General Assembly authorized to permit municipal home rule for cities.**

The General Assembly may provide by general law that cities may exercise any power and perform any function within their boundaries that is in furtherance of a public purpose of a city and not in conflict with a constitutional provision or statute.

**§ 157b. Adoption of budget required for cities, counties, and taxing districts - Expenditures not to exceed revenues for fiscal year.**

Prior to each fiscal year, the legislative body of each city, county, and taxing district shall adopt a budget showing total expected revenues and expenditures for the fiscal year. No city, county, or taxing district shall expend any funds in any fiscal year in excess of the revenues for that fiscal year. A city, county, or taxing district may amend its budget for a fiscal year, but the revised expenditures may not exceed the revised revenues. As used in this section, "revenues" shall mean all income from every source, including unencumbered reserves carried over from the previous fiscal year, and "expenditures" shall mean all funds to be paid out for expenses of the city, county, or taxing district during the fiscal year, including amounts necessary to pay the principal and interest due during the fiscal year on any debt.

**§ 158. Maximum indebtedness of cities, counties, and taxing districts - General Assembly authorized to set additional limits and conditions.**

Cities, towns, counties, and taxing districts shall not incur indebtedness to an amount exceeding the following maximum percentages on the value of the taxable property therein, to be estimated by the last assessment previous to the incurring of the indebtedness: Cities having a population of fifteen thousand or more, ten percent (10%); cities having a population of less than fifteen thousand but not less than three thousand, five percent (5%); cities having a population of less than three thousand, three percent (3%); and counties and taxing districts, two percent (2%), unless in case of emergency, the public health or safety should so require. Nothing shall prevent the issue of renewal bonds, or bonds to fund the floating indebtedness of any city,

county, or taxing district. Subject to the limits and conditions set forth in this section and elsewhere in this Constitution, the General Assembly shall have the power to establish additional limits on indebtedness and conditions under which debt may be incurred by cities, counties, and taxing districts.

**§ 160. Municipal officers - Election and term of office - Officers ineligible - Fiscal officers.**

The Mayor or Chief Executive, Police Judges, members of legislative boards or councils of towns and cities shall be elected by the qualified voters thereof: Provided, the Mayor or Chief Executive and Police Judges of the towns of the fourth, fifth and sixth classes may be appointed or elected as provided by law. The terms of office of Mayors or Chief Executives and Police Judges shall be four years, and until their successors shall be qualified, and of members of legislative boards, two years. When any city of the first or second class is divided into wards or districts, members of legislative boards shall be elected at large by the qualified voters of said city, but so selected that an equal proportion thereof shall reside in each of the said wards or districts; but when in any city of the first, second or third class, there are two legislative boards, the less numerous shall be selected from and elected by the voters at large of said city; but other officers of towns or cities shall be elected by the qualified voters therein, or appointed by the local authorities thereof, as the General Assembly may, by a general law, provide; but when elected by the voters of a town or city, their terms of office shall be four years, and until their successors shall be qualified. No Mayor or Chief Executive of any city of the first or second class, after the expiration of three successive terms of office to which he has been elected under this Constitution shall be eligible for the succeeding term. No fiscal officer of any city of the first or second class, after the expiration of the term of office to which he has been elected under this Constitution, shall be eligible for the succeeding term. "Fiscal officer" shall not include an Auditor or Assessor, or any other officer whose chief duty is not the collection or holding of public moneys. The General Assembly shall prescribe the qualifications of all officers of towns and cities, the manner in and causes for which they may be removed from office, and how vacancies in such offices may be filled.

**§ 161. Compensation of city, county, or municipal officer not to be changed after election or appointment or during term, nor term extended.**

The compensation of any city, county, town or municipal officer shall not be changed after his election or appointment, or during his term of office; nor shall the term of any such officer be extended beyond the period for which he may have been elected or appointed.

**42.455. Local Government Economic Assistance Program - Grants for priority expenditures - Administrative regulations - Public hearings - Reports - Directory of coal road system.**

(1) There is established within the Department for Local Government a Local Government Economic Assistance Program to consist of a system of grants to local governments to improve the environment for new industry and to improve the quality of life for the residents.

(2) Grants obtained under this program shall be used for priority expenditures. Thirty percent (30%) of all moneys in the fund shall be spent on the coal haul road system as described in subsection (7) of this section. The remaining seventy percent (70%) of the fund shall be spent on priority categories limited to the following, but in no event shall grants obtained under this program be used for expenses related to administration of government:

- (a) Public safety, including law enforcement, fire protection, ambulance service, and other related services;
  - (b) Environmental protection, including sewage disposal, sanitation, solid waste, and other related programs;
  - (c) Public transportation, including mass transit systems, streets, and roads;
  - (d) Health;
  - (e) Recreation;
  - (f) Libraries and educational facilities;
  - (g) Social services for the poor, the elderly, and individuals with disabilities;
  - (h) Industrial and economic development;
  - (i) Vocational education;
  - (j) Workforce training; and
  - (k) Secondary wood industry development.
- (3) The use of entitlement funds for repayment of debt as related to long-term bond issues is permissible as long as the revenue from the bond issues is expended on priority categories.
- (4) Grants obtained under this program may be used as local portion to secure federal programs as long as program expenditures are in the priority category area. Interest earned on funds received by local units of government shall be considered available for use by the local unit of government in the priority expenditure categories.
- (5) The Department for Local Government shall be responsible for the promulgation of rules and regulations necessary to implement the grants programs authorized by this section.
- (6) The Department for Local Government shall assure that a public hearing is held on the expenditure of funds received under KRS 42.450 to 42.495. Advertisement of the public hearing shall be published at least once but may be published two (2) or more times, provided that one (1) publication occurs not less than seven (7) days nor more than twenty-one (21) days before the scheduled date of the public hearing. The department shall submit an annual report to the Governor indicating how the grants were used and an evaluation of the program's effectiveness in improving the economy of the units of government receiving assistance.
- (7) On or before August 15, 1980, and each year thereafter, the Transportation Cabinet shall publish and furnish to the Department for Local Government a directory, including supporting maps and other documents, designating the official state coal road system in coal impact and coal producing counties which shall include all public highways, roads, and streets over which quantities of coal, sufficient to significantly affect the condition and state of repair of highways, roads, and streets, have been transported in the immediately preceding fiscal year. The cabinet shall further publish the total county mileage of the official state coal road system and the total ton/miles within each coal impact and coal producing county for said preceding fiscal year.
- (8) Every person shipping or transporting coal, and every carrier for hire or common carrier hauling coal over the public highways, roads, and streets shall file with the Transportation Cabinet such information and at intervals as the department shall designate by regulation duly adopted for the purpose of identifying those highways, roads, and streets comprising the coal haul road system and the quantities of coal transported thereon, in order that the cabinet can accurately calculate total ton/miles within each coal impact and coal producing county.
- (9) The Revenue Cabinet shall make available to the Transportation Cabinet coal severance and processing tax data for use in verifying and supplementing the information furnished under the provisions of subsection (8) of this section. The information shall be furnished in such a manner as to conceal the identity of individual taxpayers; if the data cannot be furnished without revealing the identity of individual taxpayers, it shall be withheld.

#### **42.460. Independent annual audit and certification of compliance - Exception.**

Except as provided in subsection (4)(b) of KRS 91A.040, any assistance granted under KRS 42.450 to 42.495 shall include an agreement that an independent annual audit shall be conducted and that the audit report shall include a certification that the funds were expended for the purpose intended. A copy of the audit and certification of compliance shall be forwarded to the Department for Local Government, in the case of assistance granted from the local government economic assistance fund, or to the Department for Coal County Development, Cabinet for Economic Development and the Kentucky Economic Development Finance Authority, in the case of assistance granted from the local government economic development fund, within eighteen (18) months after the end of the fiscal year.

#### **42.470. Allocation of funds among counties.**

Moneys in the local government economic assistance fund shall be allocated among the counties as follows:

(1) Funds allocated under KRS 42.4585;

(a) Sixty percent (60%) shall be distributed to each coal producing county on the basis of the ratio of tax collected on coal severed in each respective county to the tax collected statewide.

(b) Thirty percent (30%) shall be distributed to each coal producing county on the basis of per capita income (inverse order), ton miles of resource roads and population, equally weighted.

(c) Ten percent (10%) shall be distributed to non-coal producing counties impacted by the transport of coal on the basis of geographic area, ton miles of resource roads, and per capita income (inverse order), weighted on a basis of 30/100, 40/100, and 30/100, respectively. The expenditure of such funds shall be limited to the categories of projects set out in KRS 42.455(2)(c).

All counties shall receive an annual payment based on the average of total ton miles within the county during the most recent three (3) year period. To qualify for the funds distributed under the provisions of this paragraph, a county must have within its geographic boundaries in any single year twenty-five hundredths of one percent (0.25%) of the total ton miles within coal impact counties during the most recent three (3) year period.

(2) All funds allocated under KRS 42.450(2) shall be distributed among the mineral producing counties on the basis of the tax collected on minerals severed in each respective county.

#### **42.475. Allocation of funds to incorporated areas.**

Ten percent (10%) of the funds allocated to each county under the provisions of KRS 42.470 shall be allotted to the incorporated areas within the county based on the ratio that the population of each incorporated area bears to the total population of all the incorporated areas within the county; except that incorporated areas shall not be eligible for funds allocated to counties under the provisions of KRS 42.490 and 1980 Acts, ch. 394, sec. 11.

#### **42.495. Effect of reduction of local general tax effort.**

(1) If a qualifying local government unit reduces its general tax effort for any fiscal year, below the level of fiscal year 1991-92, that governmental unit shall forfeit funds that would otherwise be available under the provisions of KRS 42.450 to 42.495 on a dollar-for-dollar basis.

(2) For purposes of this section, "general tax effort" shall mean the total revenues raised in fiscal year 1991-92 from the levy of all of the taxing district's taxes in fiscal year 1991-92. Taxes based upon the 1991 assessment of property shall be considered to be taxes levied and collected for fiscal year 1991-92.

**45A.343. Local public agency may adopt provisions of KRS 45A.345 to 45A.460 - Effect of adoption - Contracts required to mandate revealing of violations of and compliance with specified KRS chapters - Effect of nondisclosure or noncompliance.**

(1) Any local public agency may adopt the provisions of KRS 45A.345 to 45A.460. No other statutes governing purchasing shall apply to a local public agency upon adoption of these provisions.

(2) After July 15, 1994, any contract entered into by a local public agency, whether under KRS 45A.345 to 45A.460 or any other authority, shall require the contractor and all subcontractors performing work under the contract to:

(a) Reveal any final determination of a violation by the contractor or subcontractor within the previous five (5) year period pursuant to KRS Chapters 136, 139, 141, 337, 338, 341, and 342 that apply to the contractor or subcontractor; and

(b) Be in continuous compliance with the provisions of KRS Chapters 136, 139, 141, 337, 338, 341, and 342 that apply to the contractor or subcontractor for the duration of the contract.

(3) A contractor's failure to reveal a final determination of a violation by the contractor of KRS Chapters 136, 139, 141, 337, 338, 341, and 342 or to comply with these statutes for the duration of the contract shall be grounds for the local public agency's:

(a) Cancellation of the contract; and

(b) Disqualification of the contractor from eligibility for future contracts awarded by the local public agency for a period of two (2) years.

(4) A subcontractor's failure to reveal a final determination of a violation by the subcontractor of KRS Chapters 136, 139, 141, 337, 338, 341, and 342 or to comply with these statutes for the duration of the contract shall be grounds for the local public agency's disqualification of the subcontractor from eligibility for future contracts for a period of two (2) years.

**45A.345. Definitions for KRS 45A.343 to 45A.460.**

As used in KRS 45A.343 to 45A.460, unless the context indicates otherwise:

(1) "Aggregate amount" means the total dollar amount during a fiscal year of items of a like nature, function, and use the need for which can reasonably be determined at the beginning of the fiscal year. Items the need for which could not reasonably be established in advance or which were unavailable because of a failure of delivery need not be included in the aggregate amount.

(2) "Capital cost avoidance" means moneys expended by a local public agency to pay for an energy conservation measure identified as a permanent equipment replacement and whose cost has been discounted by any additional energy and operation savings generated from other energy conservation measures identified in the guaranteed energy savings contract, except that for school districts capital cost avoidance shall also mean moneys expended by the district from one or more of the following sources:

(a) General fund;

(b) Capital outlay allotment under KRS 157.420; and

(c) State and local funds from the Facilities Support Program of Kentucky under KRS 157.440.

(3) "Chief executive officer" means the mayor, county judge/executive, superintendent of schools, or the principal administrative officer of a local public agency, or the person designated by the chief executive officer or legislative body of the local public agency to perform the procurement function.

(4) "Construction" means the process of building, altering, repairing, or improving any public structure or building, or other public improvements of any kind to any public real property. It

does not include the routine operation, routine repair, or routine maintenance of existing structures, buildings, or real property.

(5) "Contract" means all types of local public agency agreements, including grants and orders, for the purchase or disposal of supplies, services, construction, or any other item. It includes awards and notices of award; contracts of a fixed-price, cost, cost-plus-a-fixed-fee, or incentive type; contracts providing for the issuance of job or task orders; leases; letter contracts; and purchase orders. It also includes supplemental agreements with respect to any of the foregoing. It does not include labor contracts with employees of local public agencies.

(6) "Document" means any physical embodiment of information or ideas, regardless of form or characteristic, including electronic versions thereof.

(7) "Established catalogue price" means the price included in the most current catalogue, price list, schedule, or other form that:

(a) Is regularly maintained by the manufacturer or vendor of an item; and

(b) Is either published or otherwise available for inspection by customers; and

(c) States prices at which sales are currently or were last made to a significant number of buyers constituting the general buying public for that item.

(8) "Evaluated bid price" means the dollar amount of a bid after bid price adjustments are made pursuant to objective measurable criteria, set forth in the invitation for bids, which affect the economy and effectiveness in the operation or use of the product, such as reliability, maintainability, useful life, residual value, and time of delivery, performance, or completion.

(9) "Invitation for bids" means all documents, whether attached or incorporated by reference, utilized for soliciting bids in accordance with the procedures set forth in KRS 45A.365.

(10) "The legislative body or governing board" means a council, commission, or other legislative body of a city or urban-county; a county fiscal court; board of education of a county or independent school district; board of directors of an area development district or special district; or board of any other local public agency.

(11) "Local public agency" means a city, county, urban-county, school district, special district, or an agency formed by a combination of such agencies under KRS Chapter 79, or any department, board, commission, authority, office, or other sub-unit of a political subdivision which shall include the offices of the county clerk, county sheriff, county attorney, coroner, and jailer.

(12) "May" means permissive. However, the words "no person may ..." mean that no person is required, authorized, or permitted to do the act prescribed.

(13) "Negotiation" means contracting by either the method set forth in KRS 45A.370, 45A.375, or 45A.380.

(14) "Noncompetitive negotiation" means informal negotiation with one (1) or more vendor, contractor, or individual without advertisement or notice.

(15) "Objective measurable criteria" means sufficient information in the invitation to bid as to weight and method of evaluation so that the evaluation may be determined with reasonable mathematical certainty. Criteria which are otherwise subjective, such as taste and appearance, may be established when appropriate.

(16) "Person" means any business, individual, union, committee, club, or other organization or group of individuals.

(17) "Procurement" means the purchasing, buying, renting, leasing, or otherwise obtaining any supplies, services, or construction. It also includes all functions that pertain to the obtaining of any public procurement, including description of requirements, selection, and solicitation of sources, preparation and award of contract, and all phases of contract administration.

(18) "Request for proposals" means all documents, whether attached or incorporated by reference, utilized for soliciting proposals in accordance with the procedures set forth in KRS 45A.370, 45A.375, 45A.380, or 45A.385.

- (19) "Responsible bidder or offeror" means a person who has the capability in all respects to perform fully the contract requirements, and the integrity and reliability which will assure good faith performance.
- (20) "Responsive bidder" means a person who has submitted a bid under KRS 45A.365 which conforms in all material respects to the invitation for bids, so that all bidders may stand on equal footing with respect to the method and timeliness of submission and as to the substance of any resulting contract.
- (21) "Services" means the rendering, by a contractor, of its time and effort rather than the furnishing of a specific end product other than reports which are merely incidental to the required performance of service. It does not include labor contracts with employees of local public agencies.
- (22) "Shall" means imperative.
- (23) "Specifications" means any description of a physical or functional characteristic of a supply, service, or construction item. It may include a description of any requirement for inspecting, testing, or preparing a supply, service, or construction item for delivery.
- (24) "Supplemental agreement" means any contract modification which is accomplished by the mutual action of the parties.
- (25) "Supplies" means all property, including but not limited to leases on real property, printing, and insurance, except land or a permanent interest in land.
- (26) "Energy conservation measure" means a training program or facility alteration designed to reduce energy consumption or operating costs, and may include one (1) or more of the following:
- (a) Insulation of the building structure or systems within the building;
  - (b) Storm windows or doors, caulking or weatherstripping, multiglazed windows or doors, heat absorbing or heat reflective glazed and coated window or door systems, additional glazing, reductions in glass area, or other window and door system modifications that reduce energy consumption;
  - (c) Automated or computerized energy control systems;
  - (d) Heating, ventilating, or air conditioning system modifications or replacements;
  - (e) Replacement or modification of lighting fixtures to increase the energy efficiency of the lighting system without increasing the overall illumination of a facility, unless an increase in illumination is necessary to conform to the applicable state or local building code for the lighting system after the proposed modifications are made;
  - (f) Energy recovery systems;
  - (g) Cogeneration systems that produce steam or forms of energy such as heat, as well as electricity, for use primarily within a building or complex of buildings;
  - (h) Energy conservation measures that provide long-term operating cost reductions; or
  - (i) Any life safety measures that provide long-term operating cost reductions.
- (27) "Guaranteed energy savings contract" means a contract for the evaluation and recommendation of energy conservation measures and for implementation of one (1) or more of those measures. The contract shall provide that all payments, except obligations on termination of the contract before its expiration, are to be made over time and the savings are guaranteed to the extent necessary to make payments for the cost of the design, installation, and maintenance of energy conservation measures.
- (28) "Qualified provider" means a person or business experienced in the design, implementation, and installation of energy conservation measures and is determined to be qualified by the local public agency. The qualified provider shall be responsible for and shall provide the local public agency with the following information regarding guaranteed energy savings contracts:
- (a) Project design and specifications;
  - (b) Construction management;

- (c) Construction;
- (d) Commissioning;
- (e) On-going services as required;
- (f) Measurement and verification of savings for guaranteed energy savings contracts; and
- (g) Annual reconciliation statements as provided in KRS 45A.352(8).

#### **45A.355. Determinations - Finality.**

- (1) Every determination required by this code shall be in writing and based upon written findings of the public official making the determination. These determinations and written findings shall be retained in the official contract file.
- (2) The determinations required by KRS 45A.345 to 45A.460 shall be final and conclusive unless they are clearly erroneous, arbitrary, capricious, or contrary to law.

#### **45A.360. Administrative regulations.**

- (1) A local public agency may adopt regulations, not inconsistent with KRS 45A.345 to 45A.460, governing the following:
  - (a) Conditions and procedures for delegations of purchasing authority;
  - (b) Prequalification, suspension, debarment, and reinstatement of prospective bidders;
  - (c) Modification and termination of contracts;
  - (d) Conditions and procedures for the purchase of perishables and items for resale;
  - (e) Conditions, including emergencies, and procedures under which purchases may be made by means other than competitive sealed bids;
  - (f) Rejection of bids, consideration of alternate bids, and waiver of informalities in offers;
  - (g) Confidentiality of technical data and trade secrets information submitted by actual and prospective bidders or offerors;
  - (h) Partial, progressive, and multiple awards;
  - (i) Supervision of store rooms and inventories, including determination of appropriate stock levels and the management, transfer, sale, or other disposal of government-owned property;
  - (j) Definitions and classes of contractual services and procedures for acquiring them;
  - (k) Procedures for the verification and auditing of local public agency procurement records;
  - (l) Annual reports from those vested with purchasing authority as may be deemed advisable in order to insure that the requirements of this chapter are complied with; and
  - (m) Such other regulations as may be deemed advisable to carry out the purposes of KRS 45A.345 to 45A.460 or otherwise fulfill the local public agency's procurement responsibilities.
- (2) All local public agency ordinances and regulations pertaining to procurement, whether promulgated under KRS 45A.345 to 45A.460 or otherwise, shall be maintained by the local public agency and shall be available to the public upon request at a cost not to exceed the cost of reproduction.
- (3) Local school districts may adopt policies, not inconsistent with KRS 45A.345 to 45A.460, governing the conditions and procedures under which purchases of supplies may be made elsewhere. These policies shall include a provision that supplies purchased under this section shall meet any applicable contract specifications and not exceed two thousand five hundred dollars (\$2,500).

#### **45A.365. Competitive sealed bidding.**

- (1) All contracts or purchases shall be awarded by competitive sealed bidding, except as otherwise provided by KRS 45A.370 to 45A.385 and for the purchase of wholesale electric power by municipal utilities as provided in KRS 96.901(1).
- (2) The invitation for bids shall state that the award shall be made on the basis of the lowest bid price or the lowest evaluated bid price. If the latter is used, the objective measurable criteria to be utilized shall be set forth in the invitation for bids.
- (3) Adequate public notice of the invitation for bids shall be given prior to the date set forth for the opening of bids. The notice may include posting on the Internet or publication in a newspaper of general circulation in the local jurisdiction not less than seven (7) days before the date set for the opening of the bids. The public notice shall include the time and place the bids will be opened and the time and place where the specifications may be obtained.
- (4) The bids shall be opened publicly at the time and place designated in the invitation for bids. Each bid, together with the name of the bidder, shall be recorded and be open to public inspection. Electronic bid opening and posting of the required information for public viewing shall satisfy the requirements of this subsection.
- (5) A contract shall be awarded with reasonable promptness by written notice to the responsive and responsible bidder whose bid is either the lowest bid price or the lowest evaluated bid price.
- (6) The local public agency may allow the withdrawal of a bid where there is a patent error on the face of the bid document, or where the bidder presents sufficient evidence, substantiated by bid worksheets, that the bid was based upon an error in the formulation of the bid price.

#### **45A.370. Competitive negotiation.**

- (1) A local public agency may contract or purchase through competitive negotiation upon a written finding that:
  - (a) Specifications cannot be made sufficiently specific to permit award on the basis of either the lowest bid price or the lowest evaluated bid price, including, but not limited to, contracts for experimental or developmental research work, or highly complex equipment which requires technical discussions, and other nonstandard supplies, services, or construction; or
  - (b) Sealed bidding is inappropriate because the available sources of supply are limited, the time and place of performance cannot be determined in advance, the price is regulated by law, or a fixed price contract is not applicable; or
  - (c) The bid prices received through sealed bidding are unresponsive or unreasonable as to all or part of the requirements, or are identical or appear to have been the result of collusion; provided each responsible bidder is notified of the intention to negotiate and is given a reasonable opportunity to negotiate, and the negotiated price is lower than the lowest rejected bid by any responsible bidder.
- (2) Proposals shall be solicited through public notice pursuant to KRS 45A.365(3) or any other means which can be demonstrated to notify an adequate number of qualified sources to permit reasonable competition consistent with the nature and requirement of the procurement. The request for proposals shall indicate the factors to be considered in the evaluation and the relative importance of each factor.
- (3) Written or oral discussions shall be conducted with all responsible offerors who submit proposals determined in writing to be reasonably susceptible of being selected for award. Discussions shall not disclose any information derived from proposals submitted by competing offerors. Discussions need not be conducted:
  - (a) With respect to prices, where such prices are fixed by law or regulation except that consideration shall be given to competitive terms and conditions; or
  - (b) Where time of delivery or performance will not permit discussions; or

(c) Where it can be clearly demonstrated and documented from the existence of adequate competition or accurate prior cost experience with that particular supply, service, or construction item that acceptance of an initial offer without discussion would result in fair and reasonable prices and the request for proposal notifies all offerors of the possibility that award may be made on the basis of initial offers.

(4) If discussions pertaining to the revision of the specifications or quantities are held with any potential offeror, all other potential offerors shall be afforded an opportunity to take part in such discussions. A request for proposals based on revised specifications or quantities shall be issued as promptly as possible, shall provide for an expeditious response to the revised requirements and shall be awarded upon the basis of the lowest bid price or lowest evaluated bid price submitted by any responsive and responsible offeror. No discussion shall be conducted with offerors after submission of revised proposals except for a compelling reason as determined in writing by the local public agency. The request for proposals shall state that an award is to be made without discussion except as herein provided.

(5) Award shall be made to the responsible offeror whose proposal is determined in writing to be the most advantageous to the local public agency based upon the evaluation factors set forth in the request for proposals.

#### **45A.375. Negotiations after competitive sealed bidding when all bids exceed available funds - Action when no bids received.**

(1) In the event that all bids submitted pursuant to competitive sealed bidding under KRS 45A.365 result in bid prices in excess of the funds available for the purchase, and the local public agency determines in writing:

(a) That there are no additional funds then available from any source so as to permit an award to the lowest responsive and responsible bidder; and

(b) The best interest of the local public agency will not permit the delay attendant to a resolicitation under revised specifications or revised quantities under competitive sealed bidding as provided in KRS 45A.365; then a negotiated award may be made as set forth in subsections (2) or (3) of this section.

(2) Where there is more than one (1) bidder, competitive negotiations pursuant to KRS 45A.370 shall be conducted with the three (3) (two (2) if there are only two (2)) bidders determined in writing by the local public agency to be the lowest responsive and responsible bidders to the competitive sealed bid invitation. Such competitive negotiations shall be conducted under the following restrictions:

(a) If discussions pertaining to the revision of the specifications or quantities are held with any potential offeror, all other potential offerors shall be afforded an opportunity to take part in such discussions; and

(b) A request for proposals, based upon revised specifications or quantities, shall be issued as promptly as possible, shall provide for an expeditious response to the revised requirements, and shall be awarded upon the basis of the lowest bid price or lowest evaluated bid price submitted by any responsive and responsible offeror. No discussion shall be conducted with offerors after submission of proposals except for a compelling reason as determined in writing by the local public agency. The request for proposals shall state that award is to be made without discussions except as herein provided.

(3) Where, after competitive sealed bidding, it is determined in writing that there is only one (1) responsive and responsible bidder, a noncompetitive negotiated award may be made with such bidder in accordance with KRS 45A.380.

(4) Where, after invitation for bids has been made in accordance with KRS 45A.365 and no bids have been received from responsive and responsible bidders, the local public agency may

proceed to acquire the supplies, services, or construction by noncompetitive negotiations in accordance with KRS 45A.380.

**45A.380. Noncompetitive negotiation.**

A local public agency may contract or purchase through noncompetitive negotiation only when a written determination is made that competition is not feasible and it is further determined in writing by a designee of the local public agency that:

- (1) An emergency exists which will cause public harm as a result of the delay in competitive procedures; or
- (2) There is a single source within a reasonable geographical area of the product or service to be procured; or
- (3) The contract is for the services of a licensed professional, such as attorney, physician, psychiatrist, psychologist, certified public accountant, registered nurse, or educational specialist; a technician such as a plumber, electrician, carpenter, or mechanic; or an artist such as a sculptor, aesthetic painter, or musician, provided, however, that this provision shall not apply to architects or engineers providing construction management services rather than professional architect or engineer services; or
- (4) The contract is for the purchase of perishable items purchased on a weekly or more frequent basis, such as fresh fruits, vegetables, fish or meat;
- (5) The contract is for replacement parts where the need cannot be reasonably anticipated and stockpiling is not feasible;
- (6) The contract is for proprietary items for resale;
- (7) In school districts the contract relates to an enterprise in which the buying or selling by students is a part of the educational experience;
- (8) The contract or purchase is for expenditures made on authorized trips outside of the boundaries of the local public agency;
- (9) The contract is for the purchase of supplies which are sold at public auction or by receiving sealed bids;
- (10) The contract is for group life insurance, group health and accident insurance, group professional liability insurance, worker's compensation insurance, and unemployment insurance; or
- (11) The contract is for a sale of supplies at reduced prices that will afford a purchase at savings to the local public agency.

**45A.385. Small purchases.**

The local public agency may use small purchase procedures for any contract for which a determination is made that the aggregate amount of the contract does not exceed ten thousand dollars (\$10,000) if small purchase procedures are in writing and available to the public.

**45A.390. Cancellation.**

An invitation for bid, a request for proposal or other solicitation may be canceled, or all bids or proposals may be rejected, if it is determined in writing that such action is in the best interest of the local public agency.

#### **45A.395. Determination of responsibility - Right of nondisclosure.**

(1) A written determination of responsibility of a bidder or offeror shall be made, based on a reasonable inquiry conducted by the local public agency. The unreasonable failure of a bidder or offeror to promptly supply information upon request may be grounds for a determination of nonresponsibility of such bidder or offeror.

(2) A written determination of responsibility of a bidder or offeror shall not be made until the bidder or offeror provides the local public agency with a sworn statement made under penalty of perjury that he has not knowingly violated any provision of the campaign finance laws of the Commonwealth and that the award of a contract to the bidder or offeror will not violate any provision of the campaign finance laws of the Commonwealth. "Knowingly" means, with respect to conduct or to a circumstance described by a statute defining an offense, that a person is aware or should have been aware that his conduct is of that nature or that the circumstance exists.

(3) Except as otherwise provided by law, information furnished by a bidder or offeror pursuant to this section may not be disclosed outside of the local public agency without prior written consent of the bidder or offeror.

#### **45A.400. Prequalification of bidders and offerors.**

Suppliers may be prequalified as responsible prospective contractors for particular types of supplies, services, and construction. No supplier shall be prequalified as a responsible prospective contractor until the supplier provides the local public agency with a sworn statement made under penalty of perjury that he has not knowingly violated any provision of the campaign finance laws of the Commonwealth and that the award of a contract to the supplier will not violate any provision of the campaign finance laws of the Commonwealth. "Knowingly" means, with respect to conduct or to a circumstance described by a statute defining an offense, that a person is aware or should have been aware that his conduct is of that nature or that the circumstance exists. Solicitation mailing lists of potential contractors of such supplies, services, and construction shall include, but shall not be limited to, such prequalified prospective contractors. Prequalification shall not foreclose a written determination:

(1) Between the time of bid opening or receipt of offers in the making of an award that a prequalified prospective contractor is not responsible; or

(2) That a prospective contractor who is not prequalified at the time of bid opening or receipt of offers is responsible.

#### **45A.405. Cost or pricing data.**

(1) A contractor shall submit cost or pricing data and shall certify that, to the best of his knowledge and belief, the cost or pricing data submitted was accurate, complete, and current as of a mutually determined specified date prior to the date of:

(a) Pricing of any negotiated contract where the total contract price is expected to exceed fifty thousand dollars (\$50,000), or such lesser amount as may be prescribed by the local public agency; or

(b) Pricing of any change order or contract modification which is expected to exceed twenty-five thousand dollars (\$25,000), or such lesser amount as may be prescribed by the local public agency.

(2) Any contract, change, or modification thereto under which a certificate is required shall contain a provision that the price to the local public agency, including profit or fee, shall be adjusted to exclude any significant sums by which the local public agency finds that such price

was increased because the contractor-furnished cost or pricing data which, as of the date agreed upon between the parties, was inaccurate, incomplete, or not current.

(3) The requirement of this section need not be applied to contracts where the price negotiated is based on adequate price competition, established catalogue or market prices of commercial items sold in substantial quantities to the general public, prices set by law or regulation, or in exceptional cases where it is determined in writing that the requirements of this section may be waived, and the reasons for such waiver are enumerated in the determination.

#### **45A.410. Inspection of contractor's place of business - Audit of records.**

(1) The local public agency may inspect the plant or place of business of a contractor or any subcontractor under any contract awarded or to be awarded by the local public agency.

(2) The local public agency may audit the books and records of any person who has submitted cost or pricing data under KRS 45A.405, at any time until the period of record retention as set forth in subsection (3) of this section shall have expired. The right to audit hereunder shall only extend to those books and records reasonably connected with cost or pricing data submitted under KRS 45A.420, and such books and records shall be maintained by the contractor or subcontractor for the period specified in subsection (3) of this section.

(3) The local public agency shall be entitled to audit the books and records of a contractor or any subcontractor under any negotiated contract or subcontract other than a firm fixed-price type contract, provided, however, that this subparagraph shall not limit the right to audit as set forth in subsection (2) of this section. Such books and records shall be maintained by the contractor for a period of five (5) years from the date of final payment under the prime contract and by the subcontractor for a period of five (5) years from the date of final payment under the subcontract.

#### **45A.415. Specifications.**

(1) The local public agency shall use specifications which assure the maximum practicable competition to meet the agency's needs.

(2) A specification which describes a product which is proprietary to one (1) company may be used only when:

(a) No other kind of specification is reasonably available to describe requirements; and

(b) Such specification includes language which specifically permits an equivalent product to be supplied. Such specification shall include a description of the salient characteristics of the product.

#### **45A.420. Cooperative purchasing - Price agreements with Commonwealth.**

(1) Any local public agency may enter into an agreement for cooperative purchasing with any other local public agency. When the contracting local public agency contracts for supplies, services or construction pursuant to KRS 45A.365, 45A.370, 45A.375, or 45A.380, all other parties to the agreement shall be deemed to have complied with the provisions of those sections.

(2) Nothing in KRS 45A.345 to 45A.990 shall deprive a local public agency from negotiating with vendors for supplies where such supplies are the subject of a price agreement with the Commonwealth of Kentucky provided, however, that no contract executed under this section would authorize a price higher than is contained in the price agreement with the Commonwealth of Kentucky for such specific supplies.

(3) Nothing in KRS 45A.345 to 45A.990 shall deprive a local school district from acquiring supplies outside of price agreements with the Commonwealth of Kentucky if the supplies meet the same specifications as the contract items and the supplies are purchased at a lower price than is contained in the price agreement with the Commonwealth of Kentucky for such specific supplies and the purchase does not exceed two thousand five hundred dollars (\$2,500).

#### **45A.425. Surplus or excess property.**

(1) A local public agency may sell or otherwise dispose of any personal property which is not needed or has become unsuitable for public use, or which would be suitable, consistent with the public interest, for some other use.

(2) A written determination as to need of suitability of any personal property of the local public agency shall be made; and such determination shall fully describe the personal property; its intended use at the time of acquisition; the reasons why it is in the public interest to dispose of the item; and the method of disposition to be used.

(3) Surplus or excess personal property as described in this section may be transferred, with or without compensation, to another governmental agency; or it may be sold at public auction or by sealed bids in accordance with KRS 45A.365.

(4) In the event that a local public agency receives no bids for surplus or excess personal property, either at public auction or by sealed bid, such property may be disposed of, consistent with the public interest, in any manner deemed appropriate by the local public agency. In such instances, a written description of the property, the method of disposal, and the amount of compensation, if any, shall be made. Any compensation resulting from the disposal of surplus or excess personal property shall be transferred to the general fund of the local public agency.

#### **45A.430. Bid bonds.**

(1) Bidder security shall be required for all competitive sealed bidding for construction contracts when the price is estimated by the local public agency to exceed twenty-five thousand dollars (\$25,000). Bidder's security shall be a bond provided by a surety company authorized to do business in this Commonwealth, or the equivalent in cash, in a form satisfactory to the local public agency. Nothing herein prevents the requirement of such bonds on construction contracts under twenty-five thousand dollars (\$25,000) when the circumstances warrant.

(2) Bidder's security shall be in an amount equal to at least five percent (5%) of the amount of the bid.

(3) When the invitation for bids requires that bidder security be provided, noncompliance requires that the bid be rejected, provided, however, that the local public agency may set forth by regulation exceptions to this requirement in the event of substantial compliance.

(4) After the bids are opened, they shall be irrevocable for the period specified in the invitation for bids, provided that, if a bidder is permitted to withdraw his bid before award because of a mistake in the bid as allowed by law or regulation, no action shall be had against the bidder or the bidder's security.

#### **45A.435. Contract performance and payment bonds.**

(1) When a construction contract is awarded in an amount in excess of twenty-five thousand dollars (\$25,000), the following bonds shall be furnished to the local public agency, and shall become binding on the parties upon the award of the contract:

(a) A performance bond satisfactory to the local public agency executed by a surety company authorized to do business in this Commonwealth, or otherwise supplied, satisfactory to the local public agency, in an amount equal to one hundred percent (100%) of the contract price as it may be increased; and

(b) A payment bond satisfactory to the local public agency, executed by a surety company authorized to do business in this Commonwealth, or otherwise supplied, satisfactory to the local public agency, for the protection of all persons supplying labor and material to the contractor or his subcontractors for the performance of the work provided for in the contract. The bond shall be in an amount equal to one hundred percent (100%) of the original contract price.

(2) Nothing in this section shall be construed to limit the authority of the local public agency to require a performance bond or other security in addition to those bonds, or in circumstances other than specified in subsection (1) of this section, including, but not limited to, bonds for the payment of taxes and unemployment insurance premiums.

#### **45A.440. Bond forms, filings, and copies.**

(1) The local public agency may promulgate by regulation the form of the bonds required by KRS 45A.430 and 45A.435, or it may adopt the form established by the state under KRS 45A.180 to 45A.200.

(2) The local public agency shall furnish a certified copy of a bond to any person who requests such and pays the reasonable fee for that copy. The copy shall be prima facie evidence of the contents, execution, and delivery of the original.

#### **45A.445. Definitions for terms used in KRS 45A.445 to 45A.460.**

As used in KRS 45A.445 to 45A.460, unless the context indicates otherwise:

(1) "Conspicuously" shall mean written in such special or distinctive format, print, or manner that a reasonable person against whom it is to operate ought to have noticed it.

(2) "Confidential information" shall mean any information which is available to an employee only because of his status as an employee of the local public agency and is not a matter of public knowledge or available to the public on request.

(3) "Debarment" shall mean the disqualification of a person to receive invitations for bids or requests for proposals, or the award of a contract by the local public agency for a specified period of time.

(4) "Financial interest" shall mean:

(a) Ownership of any interest or involvement in any relationship from which, or as a result of which, a person has, within the past three (3) years, received or is presently or in the future entitled to receive more than one thousand dollars (\$1,000) per year, or its equivalent; or

(b) Ownership of more than a ten percent (10%) interest in any business; or

(c) Holding a position in a business such as an officer, director, trustee, partner, employee, or the like, or holding any position of management.

(5) "Gratuity" shall mean a payment, loan, subscription, advance, deposit of money, services, or anything of more than fifty dollars (\$50) value, present or promised, unless consideration of substantially equal or greater value is received.

(6) "Immediate family" shall mean a spouse, children, grandchildren, parents, grandparents, brothers and sisters, and such other relatives as designated by the local public agency.

(7) "Official responsibility" shall mean direct administrative or operating authority, whether intermediate or final, either exercisable alone or with others, either personally or through subordinates, to approve, disapprove, or otherwise direct local public agency actions.

(8) "Suspension" shall mean the disqualification of any person to receive invitations for bids or requests for proposals, or to be awarded a contract by a local public agency for a temporary period, pending the completion of an investigation and any legal proceedings that may ensue.

**45A.450. Statement of public policy.**

- (1) Public employment is a public trust.
- (2) It is the policy and purpose of KRS 45A.345 to 45A.460 to promote and balance the object of protecting government integrity and of facilitating the recruitment and retention of personnel needed by local public agencies by prescribing essential restrictions against conflict of interest without creating unnecessary barriers to public service and by facilitating development of fair and competitive access to local public agency purchasing by responsible contractors.
- (3) Employees must discharge their duties and responsibilities fairly and impartially. They should also maintain a standard of conduct that will inspire public confidence in the integrity of the government of all local public agencies.

**45A.455. Conflict of interest - Gratuities and kickbacks - Use of confidential information.**

- (1) It shall be a breach of ethical standards for any employee with procurement authority to participate directly in any proceeding or application; request for ruling or other determination; claim or controversy; or other particular matter pertaining to any contract, or subcontract, and any solicitation or proposal therefor, in which to his knowledge:
  - (a) He, or any member of his immediate family has a financial interest therein; or
  - (b) A business or organization in which he or any member of his immediate family has a financial interest as an officer, director, trustee, partner, or employee, is a party; or
  - (c) Any other person, business, or organization with whom he or any member of his immediate family is negotiating or has an arrangement concerning prospective employment is a party.Direct or indirect participation shall include but not be limited to involvement through decision, approval, disapproval, recommendation, preparation of any part of a purchase request, influencing the content of any specification or purchase standard, rendering of advice, investigation, auditing, or in any other advisory capacity.
- (2) It shall be a breach of ethical standards for any person to offer, give, or agree to give any employee or former employee, or for any employee or former employee to solicit, demand, accept, or agree to accept from another person, a gratuity or an offer of employment, in connection with any decision, approval, disapproval, recommendation, preparation of any part of a purchase request, influencing the content of any specification or purchase standard, rendering of advice, investigation, auditing, or in any other advisory capacity in any proceeding or application, request for ruling or other determination, claim or controversy, or other particular matter, pertaining to any contract or subcontract and any solicitation or proposal therefor.
- (3) It is a breach of ethical standards for any payment, gratuity, or offer of employment to be made by or on behalf of a subcontractor under a contract to the prime contractor or higher tier subcontractor or any person associated therewith, as an inducement for the award of a subcontract or order.
- (4) The prohibition against conflicts of interest and gratuities and kickbacks shall be conspicuously set forth in every local public agency written contract and solicitation therefor.
- (5) It shall be a breach of ethical standards for any public employee or former employee knowingly to use confidential information for his actual or anticipated personal gain, or the actual or anticipated personal gain of any other person.

**45A.460. Recovery of value of anything transferred or received in breach of ethical standards.**

(1) The value of anything transferred or received in breach of the ethical standards of KRS 45A.345 to 45A.990 or regulations or rules issued thereunder by an employee or a nonemployee may be recovered from both the employee and the nonemployee.

(2) Upon a showing that a subcontractor made a kickback to a prime contractor or a higher tier subcontractor in connection with the award of a subcontract or order thereunder, it shall be conclusively presumed that the amount thereof was included in the price of the subcontract or order and ultimately borne by the local public agency and will be recoverable hereunder from the recipient. In addition, said value may also be recovered from the subcontractor making such kickbacks. Recovery from one (1) offending party shall not preclude recovery against other offending parties.

**58.180. Creation of nonprofit corporation to act as an instrumentality of governmental agency in the financing of public projects.**

(1) (a) As used herein, the term "public project" shall have the same meaning as ascribed to such term by KRS 58.010, and the term "public project" shall include, inter alia, but not by way of limitation, public facilities such as sewers, sewage treatment works, water systems, streets, sidewalks and other public ways, both vehicular and pedestrian, parks and recreational and sports facilities, hospitals and health facilities, educational facilities, drainage and reclamation projects, jails, municipal buildings, public docks, wharves and port facilities, solid waste disposal facilities, pollution control systems, mass commuting and transport systems, industrial parks, courthouses and other public buildings, public parking and garage facilities, and other edifices, projects and like things and objects intended for governmental and public purposes.

(b) As used herein, the term "governmental agency" shall mean any division of the Commonwealth which is a municipal corporation and political subdivision of the Commonwealth of Kentucky, or to which has been delegated the right to exercise part of the sovereign power of the Commonwealth.

(2) Any governmental agency may create a nonprofit corporation pursuant to the provisions of KRS 273.161 to 273.390, inclusive, to act as the agency and instrumentality and the constituted authority of such governmental agency in the acquisition and financing of any public project which may be undertaken by such governmental agency pursuant to the provisions of Kentucky law and thus accomplish a public purpose of such governmental agency. Such corporation, upon direction of such governmental agency, shall be authorized to issue its bonds, notes or other obligations on behalf of such governmental agency for the acquisition and financing of one or more public projects on behalf of such governmental agency, and may pledge for the amortization of such bonds, notes or other obligations all revenues derived from the operation of such public project or public projects, including specifically all revenues derived from the leasing of such public project or public projects directly to the governmental agency upon whose behalf and upon whose direction such bonds, notes or other obligations are issued. Provided, however, that no bonds or other obligations shall be authorized under the provisions of this chapter for the construction or acquisition of telephone, gas or electric facilities.

(3) It shall be provided in any such financing (i) that upon the retirement and discharge of the bonds, notes or other obligations issued by such corporation at the direction of and on behalf of such governmental agency, title to the public project or public projects so acquired shall vest in such governmental agency; (ii) that in the event of default with respect to such bonds, notes or other obligations, the governmental agency shall have the exclusive option to acquire the public project or public projects for the amount required to discharge such bonds, notes or other obligations, and is provided a reasonable time to exercise such option; (iii) that the issuance of

such bonds, notes or other obligations shall be directed by and approved by such governmental agency not more than sixty (60) days prior to the date of issue of such obligations; and (iv) that no bonds, notes or other obligations shall be issued by such corporation for and on behalf of such governmental agency except upon express direction of such governmental agency.

(4) Any governmental agency creating a corporation pursuant to this section to act for and on behalf of, and as the agency and instrumentality of, such governmental agency in the acquisition and financing of a public project or public projects shall, at all times either (i) exercise organizational control over such corporation by creating the corporation pursuant to this section, and retain authority at any and all times to alter or change the structure, organization, programs or activities of the corporation, including the power to terminate existence of the corporation, subject to any limitation on the impairment of contracts entered into by such corporation, or shall (ii) exercise supervisory control over such corporation as may be deemed proper by the governmental agency in the administration of the corporation's activities as a constituted authority of such governmental agency, and as may be required from time to time by federal law in order to qualify the corporation to issue bonds, notes or other obligations on behalf of the governmental agency.

(5) It shall be provided, inter alia, in the articles of incorporation of any such corporation and constituted authority created to act as the agency and instrumentality of a governmental agency and to finance public projects for such governmental agency on its behalf and thereby accomplish a public purpose of such governmental agency, (i) that any net revenues of such corporation beyond those necessary for retirement of indebtedness, or implementation of the public purpose or purposes of the corporation and the governmental agency shall not inure to the benefit of any person other than the governmental agency; (ii) that upon dissolution of the corporation, title to all property owned by such corporation shall vest in the governmental agency; and (iii) that the corporation shall be created and operated solely and only to accomplish one or more of the public purposes of the governmental agency and for the acquisition and financing of public projects for and on behalf of such governmental agency.

(6) The governing body of such corporation shall consist solely and only of the following individuals:

- (a) Public officials of the governmental agency as ex officio members; or
- (b) Persons appointed by the governmental agency or by public officials of the governmental agency.

#### **61.190. Receiving profit on public funds - Penalty.**

Any public officer who shall receive, directly or indirectly, any interest, profits, or perquisites arising from the use or loan of public funds in his hands, or to be raised through his agency, shall be guilty of a Class D felony. The judgment of conviction shall recite that the offender is disqualified to hold any public office thereafter.

#### **64.850. Commingling of public and private funds prohibited.**

It shall be unlawful for any county official to deposit public funds with individual or private funds in any bank or other depository or for any such official to withdraw public funds for any purpose other than that for which they were received and deposited.

### **65.7719. Notification of prescribed note information to state local debt**

Without first notifying the state local debt officer in writing, no note shall be valid or obligatory. Notification shall contain the terms of the notes, including the interest rates or method of determining rates, the approximate date of issue, the maturity dates, the trustee or paying agent, if any, and shall include a copy of the certificate of the governmental agency as to taxes or revenues to be collected during the term of the notes. No approval of the state local debt officer shall be required.

66.045. Notice to state local debt officer required before bonds and obligations issued by political subdivision.

(1) It is the intent of this section to facilitate, through state technical and advisory assistance, the marketing of local government bonds and other long-term obligations at the lowest possible net interest costs.

(2) Without first notifying the state local debt officer in writing, no bonds or obligations may be issued by or on behalf of any issuer except as provided by KRS 65.940 to 65.956. The notification shall contain the maturity schedule, interest rate, date of issue, purpose, paying agent, and any other information the state local debt officer may require to provide a complete file on local government debt.

(3) The state local debt officer may provide technical and advisory assistance regarding the issuance of bonds and obligations to those issuers whose governing bodies request that assistance. The assistance shall include, but need not be limited to:

- (a) Advice on the marketing of bonds and obligations by issuers;
- (b) Conduct of training courses in debt management; and
- (c) Promotion of the use by local governments of such tools for sound financial management as adequate systems of budgeting, accounting, auditing, and reporting.

### **66.480. Investment of public funds - Limitations - Written investment policy - Duties of state local debt officer - Investment pool.**

(1) The governing body of a city, county, urban-county, charter county, school district (provided that its general procedure for action is approved by the Kentucky Board of Education), or other local governmental unit or political subdivision, may invest and reinvest money subject to its control and jurisdiction in:

(a) Obligations of the United States and of its agencies and instrumentalities, including obligations subject to repurchase agreements, if delivery of these obligations subject to repurchase agreements is taken either directly or through an authorized custodian. These investments may be accomplished through repurchase agreements reached with sources including, but not limited to, national or state banks chartered in Kentucky;

(b) Obligations and contracts for future delivery or purchase of obligations backed by the full faith and credit of the United States or a United States government agency, including but not limited to:

- 1. United States Treasury;
- 2. Export-Import Bank of the United States;
- 3. Farmers Home Administration;
- 4. Government National Mortgage Corporation; and
- 5. Merchant Marine bonds;

(c) Obligations of any corporation of the United States government, including but not limited to:

- 1. Federal Home Loan Mortgage Corporation;
- 2. Federal Farm Credit Banks;

3. Bank for Cooperatives;
  4. Federal Intermediate Credit Banks;
  5. Federal Land Banks;
  6. Federal Home Loan Banks;
  7. Federal National Mortgage Association; and
  8. Tennessee Valley Authority;
- (d) Certificates of deposit issued by or other interest-bearing accounts of any bank or savings and loan institution which are insured by the Federal Deposit Insurance Corporation or similar entity or which are collateralized, to the extent uninsured, by any obligations, including surety bonds, permitted by KRS 41.240(4);
- (e) Uncollateralized certificates of deposit issued by any bank or savings and loan institution rated in one (1) of the three (3) highest categories by a nationally recognized rating agency;
- (f) Bankers' acceptances for banks rated in one (1) of the three (3) highest categories by a nationally recognized rating agency;
- (g) Commercial paper rated in the highest category by a nationally recognized rating agency;
- (h) Bonds or certificates of indebtedness of this state and of its agencies and instrumentalities;
- (i) Securities issued by a state or local government, or any instrumentality of agency thereof, in the United States, and rated in one (1) of the three (3) highest categories by a nationally recognized rating agency; and
- (j) Shares of mutual funds, each of which shall have the following characteristics:
1. The mutual fund shall be an open-end diversified investment company registered under the Federal Investment Company Act of 1940, as amended;
  2. The management company of the investment company shall have been in operation for at least five (5) years; and
  3. All of the securities in the mutual fund shall be eligible investments pursuant to this section.
- (2) The investment authority provided by subsection (1) of this section shall be subject to the following limitations:
- (a) The amount of money invested at any time by a local government or political subdivision in one (1) or more of the categories of investments authorized by subsections (1)(e), (f), (g), and (i) of this section shall not exceed twenty percent (20%) of the total amount of money invested by the local government; and
- (b) No local government or political subdivision shall purchase any investment authorized by subsection (1) on a margin basis or through the use of any similar leveraging technique.
- (3) The governing body of every local government or political subdivision that invests or reinvests money subject to its control or jurisdiction according to the provisions of subsection (1) of this section shall by January 1, 1995, adopt a written investment policy that shall govern the investment of funds by the local government or political subdivision. The written investment policy shall include, but shall not be limited to the following:
- (a) A designation of the officer or officers of the local government or political subdivision who are authorized to invest and oversee the investment of funds;
  - (b) A list of the permitted types of investments;
  - (c) Procedures designed to secure the local government's or political subdivision's financial interest in the investments;
  - (d) Standards for written agreements pursuant to which investments are to be made;
  - (e) Procedures for monitoring, control, deposit, and retention of investments and collateral;
  - (f) Standards for the diversification of investments, including diversification with respect to the types of investments and firms with whom the local government or political subdivision transacts business;
  - (g) Standards for the qualification of investment agents which transact business with the local government, such as criteria covering creditworthiness, experience, capitalization, size, and any

other factors that make a firm capable and qualified to transact business with the local government or political subdivision; and

(h) Requirements for periodic reporting to the governing body on the status of invested funds.

(4) Sheriffs, county clerks, and jailers, who for the purposes of this section shall be known as county officials, may, and at the direction of the fiscal court shall, invest and reinvest money subject to their control and jurisdiction, including tax dollars subject to the provisions of KRS 134.300, 134.320, and 160.510, as permitted by this section.

(5) The provisions of this section are not intended to impair the power of a county official, city, county, urban-county, charter county, school district, or other local governmental unit or political subdivision to hold funds in deposit accounts with banking institutions as otherwise authorized by law.

(6) The governing body or county official may delegate the investment authority provided by this section to the treasurer or other financial officer or officers charged with custody of the funds of the local government, and the officer or officers shall thereafter assume full responsibility for all investment transactions until the delegation of authority terminates or is revoked.

(7) All county officials shall report the earnings of any investments at the time of their annual reports and settlements with the fiscal courts for excess income of their offices.

(8) The state local debt officer is authorized and directed to assist county officials and local governments (except school districts) in investing funds that are temporarily in excess of operating needs by:

(a) Explaining investment opportunities to county officials and local governments through publication and other appropriate means; and

(b) Providing technical assistance in investment of idle funds to county officials and local governments that request that assistance.

(9) (a) The state local debt officer may create an investment pool for local governments (except school districts) and county officials; and counties and county officials and cities may associate to create an investment pool. If counties and county officials and cities create a pool, each group may select a manager to administer their pool and invest the assets. Each county and each county official and each city may invest in a pool created pursuant to this subsection. Investments shall be limited to those investment instruments permitted by this section. The funds of each local government and county official shall be properly accounted for, and earnings and charges shall be assigned to each participant in a uniform manner according to the amount invested. Charges to any local government or county official shall not exceed one percent (1%) annually on the principal amount invested, and charges on investments of less than a year's duration shall be prorated. Any investment pool created pursuant to this subsection shall be audited each year by an independent certified public accountant, or by the Auditor of Public Accounts. A copy of the audit report shall be provided to each local government or county official participating in the pool. In the case of an audit by an independent certified public accountant, a copy of the audit report shall be provided to the Auditor of Public Accounts, and to the state local debt officer. The Auditor of Public Accounts may review the report of the independent certified public accountant. After preliminary review, should discrepancies be found, the Auditor of Public Accounts may make his own investigative report or audit to verify the findings of the independent certified public accountant's report.

(b) If the state local debt officer creates an investment pool, he shall establish an account in the Treasury for the pool. He shall also establish a separate trust and agency account for the purpose of covering management costs, and he shall deposit management charges in this account. The state local debt officer may issue regulations, pursuant to KRS Chapter 13A, governing the operation of the investment pool, including but not limited to provisions on minimum allowable investments and investment periods, and method and timing of investments, withdrawals, payment of earnings, and assignment of charges.

(c) Before investing in an investment pool created pursuant to this subsection, a local government or county official shall allow any savings and loan association or bank in the county, as described in subsection (1)(d) of this section, to bid for the deposits, but the local government or county official shall not be required to seek bids more often than once in each six (6) month period.

(10) (a) With the approval of the Kentucky Board of Education, local boards of education, or any of them that desire to do so, may associate to create an investment pool. Each local school board which associates itself with other local school boards for the purpose of creating the investment pool may invest its funds in the pool so created and so managed. Investments shall be limited to those investment instruments permitted by this section. The funds of each local school board shall be properly accounted for, and earnings and charges shall be assigned to each participant in a uniform manner according to the amount invested. Charges to any local school board shall not exceed one percent (1%) annually on the principal amount invested, and charges on investments of less than a year's duration shall be prorated. Any investment pool created pursuant to this subsection shall be audited each year by an independent certified public accountant, or by the Auditor of Public Accounts. A copy of the audit report shall be provided to each local school board participating in the pool. In the case of an audit by an independent certified public accountant, a copy of the audit report shall be provided to the Auditor of Public Accounts, and to the Kentucky Board of Education. The Auditor of Public Accounts may review the report of the independent certified public accountant. After preliminary review, should discrepancies be found, the Auditor of Public Accounts may make his own investigative report or audit to verify the findings of the independent certified public accountant's report.

(b) The Kentucky Board of Education may issue administrative regulations governing the operation of the investment pool including, but not limited to, provisions on minimum allowable investments and investment periods, and methods and timing of investments, withdrawals, payment of earnings, and assignment of charges.

### **83A.060. Enactment of ordinances.**

(1) Each ordinance shall embrace only one (1) subject and shall have a title that shall clearly state the subject.

(2) Each ordinance shall be introduced in writing and shall have an enacting clause styled "Be it ordained by the City of \_\_\_\_\_."

(3) No ordinance shall be amended by reference to its title only, and ordinances to amend shall set out in full the amended ordinance or section indicating any words being added by a single solid line drawn underneath them, and any words being deleted by a single broken line drawn through them.

(4) Except as provided in subsection (7) of this section, no ordinance shall be enacted until it has been read on two (2) separate days. The reading of an ordinance may be satisfied by stating the title and reading a summary rather than the full text.

(5) A city legislative body may adopt the provisions of any local, statewide, or nationally recognized standard code and codifications of entire bodies of local legislation by an ordinance that identifies the subject matter by title, source, and date and incorporates the adopted provisions by reference without setting them out in full, if a copy accompanies the adopting ordinance and is made a part of the permanent records of the city.

- (6) Unless otherwise provided by statute, a majority of a legislative body shall constitute a quorum and a vote of a majority of a quorum shall be sufficient to take action.
- (7) In an emergency, upon the affirmative vote of two-thirds (2/3) of the membership, a city legislative body may suspend the requirements of second reading and publication to provide for an ordinance to become effective by naming and describing the emergency in the ordinance. Publication requirements of subsection (9) of this section shall be complied with within ten (10) days of the enactment of the emergency ordinance.
- (8) Every action of the city legislative body shall be made a part of the permanent records of the city and on passage of an ordinance the vote of each member of the city legislative body shall be entered on the official record of the meeting. The legislative body shall provide by ordinance for the maintenance and safekeeping of the permanent records of the city. The person assigned this responsibility and the presiding officer shall sign the official record of each meeting. All ordinances adopted in a city shall, at the end of each month, be indexed and maintained in the following manner:
- (a) The city budget, appropriations of money, and tax levies shall be maintained and indexed so that each fiscal year is kept separate from other years.
- (b) All other city ordinances shall be kept in the minute book or an ordinance book in the order adopted and indexed in a composite index or maintained in a code of ordinances.
- (9) Except in cities of the first class, a charter county government, and as provided in subsection (7) of this section, no ordinance shall be effective until published pursuant to KRS Chapter 424. Ordinances may be published in full or in summary as designated by the legislative body. If the legislative body elects to publish an ordinance in summary, the summary shall be prepared and certified by an attorney licensed to practice law in the Commonwealth of Kentucky and shall include the following:
- (a) The title of the ordinance;
- (b) A brief narrative setting forth the main points of the ordinance in a way reasonably calculated to inform the public in a clear and understandable manner of the meaning of the ordinance; and
- (c) The full text of each section that imposes fines, penalties, forfeitures, taxes, or fees. Ordinances that include descriptions of real property may include a sketch, drawing, or map, including common landmarks, such as streets or roads in lieu of metes and bounds descriptions.
- (10) A city may specify by ordinance additional requirements for adoption of ordinances in greater detail than contained herein, but a city shall not lessen or reduce the substantial requirements of this section or any other statute relating to adoption of ordinances.
- (11) At least once every five (5) years, each city shall cause all ordinances in the composite index or code of ordinances to be examined for consistency with state law and with one another and to be revised to eliminate redundant, obsolete, inconsistent, and invalid provisions.
- (12) The legislative body may adopt municipal orders. Orders shall be in writing and may be adopted only at an official meeting. Orders may be amended by a subsequent municipal order or ordinance. All orders adopted shall be maintained in an official order book.
- (13) In lieu of an ordinance, a municipal order may be used for matters relating to the internal operation and functions of the municipality and to appoint or remove or approve appointment or removal of members of boards, commissions, and other agencies over which the city has control.
- (14) All ordinances, and orders of the city may be proved by the signature of the city clerk; and when the ordinances are placed in a printed composite index or code of ordinances by authority of the city, the printed copy shall be received in evidence by any state court without further proof of the ordinances.
- (15) For anything said in debate, legislative body members shall be entitled to the same immunities and protections allowed to members of the General Assembly.

### **83A.130. Mayor-council plan - Powers and duties of mayor and council.**

- (1) The form of government provided in this section shall be known as the mayor-council plan and this section shall together with KRS 83A.010 to 83A.120 govern any city declared to be under the mayor-council plan by KRS 83A.020 or which has adopted the mayor-council plan pursuant to KRS 83A.160.
- (2) Each city under this section shall be governed by an elected executive who shall be called mayor and by an elected legislative body which shall be called the city council, and by such other officers and employees as may be provided for by statute or city ordinance.
- (3) The executive authority of the city shall be vested in and exercised by the mayor. The mayor shall enforce the mayor-council plan, city ordinances and orders and all applicable statutes. He shall supervise all departments of city government and the conduct of all city officers and employees under his jurisdiction and shall require each department to make reports to him required by ordinance or as he deems desirable. The mayor shall maintain liaison with related units of local government respecting interlocal contracting and joint activities. The mayor shall report to the council and to the public on the condition and needs of city government as he finds appropriate or as required by ordinance, but not less than annually. He shall make any recommendations for actions by the council he finds in the public interest.
- (4) Subject to disapproval of the council, the mayor shall promulgate procedures to insure orderly administration of the functions of city government and compliance with statute or ordinance. Upon promulgation or upon revision or rescission of the procedures, copies shall be filed with the person responsible for maintaining city records as provided under KRS 83A.060.
- (5) The mayor shall preside at meetings of the council. The council may set by ordinance the manner in which one of its number may be selected to preside at meetings of the council in place of the mayor. The mayor may participate in council proceedings, but shall not have a vote, except that he may cast the deciding vote in case of a tie.
- (6) All ordinances adopted by the council shall be submitted to the mayor who shall within ten (10) days after submission either approve the ordinance by affixing his signature or disapprove it by returning it to the council together with a statement of his objections. No ordinance shall take effect without the mayor's approval unless he fails to return it to the legislative body within ten (10) days after receiving it or unless the council votes to override the mayor's veto, upon reconsideration of the ordinance not later than the second regular meeting following its return, by the affirmative vote of one (1) more than a majority of the membership.
- (7) Any delegation of the mayor's power, duties or responsibilities to subordinate officers and employees and any expression of his official authority to fulfill executive functions shall be made by executive order. Executive orders shall be sequentially numbered by years and shall be kept in a permanent file.
- (8) All bonds, notes, contracts and written obligations of the city shall be made and executed by the mayor or his agent designated by executive order.
- (9) The mayor shall be the appointing authority with power to appoint and remove all city employees, including police officers, except as tenure and terms of employment are protected by statute, ordinance or contract and except for employees of the council.
- (10) The mayor shall provide for the orderly continuation of the functions of city government at any time he is unable to attend to the duties of his office by delegating responsibility for any function to be performed in accordance with subsection (7) of this section, provided that the mayor shall not delegate the responsibility of presiding at meetings of the council and that approving ordinances or promulgating administrative procedures may only be delegated to an elected officer. With approval of the council, the mayor may rescind any action taken in his absence under this subsection within thirty (30) days of such action. If for any reason the disability of the mayor to attend to his duties persists for sixty (60) consecutive days, the office

of mayor may be declared vacant by a majority vote of the council and the provisions of KRS 83A.040 shall apply.

(11) The legislative authority of the city shall be vested in and exercised by the elected council of the city. The council shall not perform any executive functions except those functions assigned to it by statute. Regular meetings of the council shall be held at least once each month at such times and places as are fixed by ordinance. Special meetings of the council may be called by the mayor or upon written request of a majority of the council. In the call, the mayor or council shall designate the purpose, time and place of the special meeting with sufficient notice for the attendance of council members and for compliance with KRS Chapter 61. At a special meeting no business may be considered other than that set forth in the designation of purpose. The minutes of every meeting shall be signed by the person responsible for maintaining city records provided under KRS 83A.060 and by the officer presiding at the meeting.

(12) The council shall by ordinance establish all appointive offices and the duties and responsibilities of those offices and codes, rules and regulations for the public health, safety and welfare. The council shall by ordinance provide for sufficient revenue to operate city government and shall appropriate the funds of the city in a budget which shall provide for the orderly management of city resources.

(13) The council shall have the right to investigate all activities of city government. The council may require any city officer or employee to prepare and submit to it sworn statements regarding his performance of his official duties. Any statement required by the council to be submitted or any investigation undertaken by the council, if any office, department or agency under the jurisdiction of the mayor is involved, shall not be submitted or undertaken unless and until written notice of the council's action is given to the mayor. The mayor shall have the right to review any statement before submission to the council and to appear personally or through his designee on behalf of any department, office or agency in the course of any investigation.

#### **83A.140. Commission plan - Duties of mayor and commission.**

(1) The form of government provided in this section shall be known as the commission plan and this section shall together with KRS 83A.010 to 83A.120 govern any city declared to be under the commission plan by KRS 83A.020 or which has adopted the commission plan pursuant to KRS 83A.160.

(2) Each city under this section shall be governed by an elected officer who shall be called mayor and by elected legislative body members who shall be called city commissioners and which together shall be known as the city commission and by such other officers and employees as may be provided for by statute or city ordinance.

(3) All legislative, executive and administrative authority of the city shall be vested in and exercised by the commission. The commission shall enforce the commission plan, ordinances and orders of the city and all applicable statutes. The commission shall maintain liaison with related units of local government respecting interlocal contracting and joint activities. The commission shall supervise all departments of city government and the conduct of all city officers and employees under its jurisdiction and may require each department to make such reports to it as it finds necessary. The commission shall report to the public on the condition and needs of the city government as provided by ordinance, but not less than annually.

(4) The mayor shall preside at all meetings of the commission and may vote in all proceedings. All bonds, notes, contracts and written obligations of the city authorized by ordinance or resolution shall be executed by the mayor on behalf of the city. The commission shall designate one (1) city commissioner to serve as mayor pro tem. The mayor pro tem shall act for the mayor whenever the mayor is unable to attend to the duties of his office and he shall then possess all rights, powers and duties of mayor. If the disability of the mayor to attend to his duties continues

for sixty (60) consecutive days, the office of mayor may be declared vacant by a majority vote of the commission membership, and the provisions of KRS 83A.040 shall apply.

(5) In carrying out its duty to supervise the departments of city government and the conduct of all city officers and employees under its jurisdiction, the commission may require any city officer or employee to prepare and submit to it sworn statements regarding the performance of his official duties.

(6) All administrative and service functions of the city shall be classified under departments created by ordinance which shall prescribe the functions of the department and the duties and responsibilities of the department head and his employees. The commission shall at its first regular meeting in each year designate the commission member to have superintendence over each department established under this subsection, except the commission may delegate responsibility for overall supervision of any or all departments to a city administrative officer established pursuant to KRS 83A.090.

(7) Regular meetings of the commission shall be held at least once a month at such times and places as are fixed by ordinance. Special meetings may be called by the mayor or a majority of the city commissioners. In the call, the mayor or city commissioners shall designate the purpose, time and place of the special meeting with sufficient notice for the attendance of commission members and for compliance with KRS Chapter 61. At a special meeting no business may be considered other than that set forth in the designation of purpose. The minutes of every meeting shall be signed by the person responsible for maintaining city records provided under KRS 83A.060 and by the officer presiding at the meeting.

(8) The commission shall by ordinance establish all appointive offices and the duties and responsibilities of those offices and codes, rules and regulations for the public health, safety and welfare. The commission shall by ordinance provide for sufficient revenue to operate city government and shall appropriate such funds in a budget which shall provide for the orderly management of the city's resources. The commission shall promulgate procedures to insure orderly administration of the functions of city government and compliance with statute, ordinance or order.

### **83A.150. City manager plan - Powers and duties of mayor, board of commissioners, and city manager.**

(1) The form of government provided in this section shall be known as the city manager plan and this section shall together with KRS 83A.010 to 83A.120 govern any city declared to be under the city manager plan by KRS 83A.020 or which has adopted the city manager plan pursuant to KRS 83A.160.

(2) Each city under this section shall be governed by an elected officer who shall be called mayor and by elected legislative body members who shall be called city commissioners and which together shall be known as the board of commissioners and by such other officers and employees as may be provided for by statute or city ordinance.

(3) All legislative and executive authority of the city shall be vested in and exercised by the board. The mayor shall preside at all meetings of the board and may vote in all proceedings. The mayor shall be recognized as the head of the city government by the Governor for purposes of military law, but shall have no regular administrative duties. The board shall designate one (1) city commissioner to serve as mayor pro tem. The mayor pro tem shall act for the mayor whenever the mayor is unable to attend to the duties of his office and he shall then possess all rights, powers and duties of mayor. If the disability of the mayor to attend his duties continues for sixty (60) consecutive days, the office of mayor may be declared vacant by a majority vote of the board membership and the provisions of KRS 83A.040 shall apply.

(4) Regular meetings of the board shall be held at least once each month at such times and places as are fixed by ordinance. Special meetings of the board may be called by the mayor or

upon written request of a majority of the city commissioners. In the call, the mayor or commissioners shall designate the purpose, time and place of the special meeting with sufficient notice for the attendance of board members and for compliance with KRS Chapter 61. At a special meeting no business shall be considered other than that set forth in the designation of purpose. The minutes of every meeting shall be signed by the person responsible for maintaining city records provided under KRS 83A.060 and the officer presiding at the meeting.

(5) The board shall by ordinance establish all appointive offices and the duties and responsibilities of those offices and codes, rules, and regulations for the public health, safety, and welfare. The board shall by ordinance provide for sufficient revenue to operate city government and shall appropriate the funds of a city budget which shall provide for the orderly management of city resources.

(6) The board may require any city officer or employee to prepare and submit to it sworn statements regarding his performance of his official duties and may otherwise inquire into the conduct of duties of any department, office, or agency of the city.

(7) The board shall in accordance with KRS 83A.080 create the office of city manager and set qualifications for the office, which shall include, but not be limited to professional training or administrative qualifications with special reference to actual experience in or knowledge of accepted practice regarding duties of the office and list duties and responsibilities of the office which shall include, but not be limited to:

(a) Being responsible to the board for the proper administration of all duties imposed upon him by ordinance;

(b) Recommending to the board, subject to any statute, ordinance, or contract which relates to the appointment, tenure, or removal of any employee, the appointment, and when necessary for the good of the service, the removal of subordinate employees and officers of the city. No officer or employee of the city shall be appointed or removed except through action by the board, except that the city manager may fill vacancies in the classified service pending the appointment by the board and may employ personnel for temporary positions subject to such conditions as may be imposed by the board;

(c) Preparing the budget and submitting it to the board and being responsible for its administration after adoption;

(d) Preparing and submitting to the board as of the end of each fiscal year a complete report on the finances and administrative activities of the city for the preceding year;

(e) Keeping the board advised of the financial condition and future needs of the city and making recommendations as he deems desirable;

(f) Maintaining liaison with related units of local government respecting interlocal contracting and joint activities;

(g) Supervising all departments of city government and the conduct of all city officers and employees under his jurisdiction and requiring each department to make reports to him required by ordinance or as he deems desirable; and

(h) Performing other duties required of city executive authorities by statute or required of him by the board not inconsistent with this section.

(8) The board shall appoint a city manager by a majority vote of all its members. The city manager shall be appointed for an indefinite term and may be removed only by a majority vote of all board members. At least thirty (30) days before such removal shall become effective, the board shall by a majority vote of all its members adopt a preliminary resolution stating the reasons for his removal. The city manager may reply in writing and may request a public hearing which shall be held not earlier than twenty (20) days nor later than thirty (30) days after the filing of the request. After the public hearing, if requested, and after full consideration, the board by majority vote of all its members may adopt a final resolution of removal. By the preliminary resolution, the board may suspend the city manager from duty, but shall in any

event cause to be paid to him any unpaid balance of his compensation and compensation for the next calendar month following adoption of the preliminary resolution.

(9) The city manager shall be the chief administrative officer and exercise those executive powers and duties delegated to him by ordinance and statute. He shall enforce the city manager plan, city ordinances and all applicable statutes. Subject to approval of the board, the city manager shall promulgate procedures to insure orderly administration of the functions of city government and compliance with statute or ordinance. Any delegation of the city manager's duties or responsibilities to subordinate officers and employees shall be made by municipal order except that all bonds, notes, contracts, and written obligations of the city according to ordinance or resolution shall be made and executed by the mayor on behalf of the city.

#### **91A.010. Definitions for KRS 91A.010 to 91A.060.**

As used in KRS 91A.010 to 91A.060, unless the context otherwise requires:

(1) "Budget" means a proposed plan for raising and spending money for specified programs, functions, activities, or objectives during a fiscal year.

(2) "Debt service" means the sum of money required to pay installments of principal and interest on bonds, notes, and other evidences of debt accruing within a fiscal year and to maintain sinking funds.

(3) "Encumbrances" means obligations in the form of purchase orders or contracts that are chargeable to an appropriation. An obligation ceases to be an encumbrance when paid or when the actual liability is recorded.

(4) "Executive authority" means the mayor in any city organized under the mayor-council plan or mayor-aldermen plan, the commission in any city organized under the commission plan, or the board in any city organized under the city manager plan.

(5) "Fiscal year" means the accounting period for the administration of fiscal operations.

(6) "Generally accepted governmental auditing standards" means those standards for audit of governmental organizations, programs, activities, and functions issued by the Comptroller General of the United States.

(7) "Generally accepted principles of governmental accounting" mean those standards and procedures promulgated and recognized by the Governmental Accounting Standards Board.

(8) "Legislative body" means the council in cities organized under the mayor-council plan, the board of aldermen in cities of the first class organized under the mayor-aldermen plan, the commission in cities organized under the commission plan and the board of commissioners in cities organized under the city manager plan.

#### **91A.020. Accounting records.**

(1) Each city shall keep its accounting records and render financial reports in such a way as to:

(a) Determine compliance with statutory provisions; and

(b) Determine fairly and with full disclosure the financial operations of constituent funds and account groups of the city in conformity with generally accepted governmental accounting principles.

(2) Municipal accounting systems shall be organized and operated on a fund basis.

### **91A.030. Annual budget.**

- (1) Each city shall operate under an annual budget ordinance adopted and administered in accordance with the provisions of this section. Notwithstanding any other provision of law, no city shall expend any moneys from any governmental or proprietary fund, except in accordance with a budget ordinance adopted pursuant to this section.
- (2) Moneys held by a city as a trustee or agent for individuals, private organizations, or other governmental units need not be included in the budget ordinance.
- (3) If, in any fiscal year subsequent to a fiscal year in which a city has adopted a budget ordinance in accordance with this section, no budget ordinance is adopted, the budget ordinance of the previous fiscal year shall have full force and effect as if readopted.
- (4) The budget ordinance of a city shall cover one (1) fiscal year.
- (5) Preparation of the budget proposal shall be the responsibility of the executive authority of the city in cities operating pursuant to KRS Chapter 83, KRS 83A.130 or 83A.140 or the city manager in cities operating pursuant to KRS 83A.150.
- (6) The budget proposal shall be prepared in the form and detail as is prescribed by ordinance.
- (7) The budget proposal together with a budget message shall be submitted to the legislative body not later than thirty (30) days prior to the beginning of the fiscal year it covers. The budget message shall contain an explanation of the governmental goals fixed by the budget for the coming fiscal year; explain important features of the activities anticipated in the budget; set forth the reasons for stated changes from the previous year in program goals, programs, and appropriation levels; and explain any major changes in fiscal policy.
- (8) (a) The legislative body shall adopt a budget ordinance making appropriations for the fiscal year in such sums as the legislative body finds sufficient and proper, whether greater or less than the sums recommended in the budget proposal. The budget ordinance may be in any form that the legislative body finds most efficient in enabling it to make the necessary fiscal policy decisions.  
(b) No budget ordinance shall be adopted which provides for appropriations to exceed revenues in any one (1) fiscal year in violation of Section 157 of the Kentucky Constitution.
- (9) The full amount estimated to be required for debt service during the budget year shall be appropriated for all governmental fund types.
- (10) The city legislative body may amend the budget ordinance after the ordinance's adoption, if the amended ordinance continues to satisfy the requirements of this section.
- (11) Administration and implementation of an adopted budget ordinance shall be the responsibility of the executive authority of the city. That responsibility shall include the preparation and submission to the legislative body of operating statements which shall include budgetary comparisons of each governmental fund for which an annual budget has been adopted. These reports shall be submitted not less than once every three (3) months in each fiscal year.
- (12) To the extent practical, the system utilized in the administration and implementation of the adopted budget ordinance shall be consistent in form with the accounting system called for in KRS 91A.020.
- (13) No city agency, or member, director, officer, or employee of a city agency, may bind the city in any way to any extent beyond the amount of money at that time appropriated for the purpose of the agency. All contracts, agreements, and obligations, express or implied, beyond existing appropriations are void; nor shall any city officer issue any bond, certificate, or warrant for the payment of money by the city in any way to any extent beyond the unexpended balance of any appropriation made for the purpose.

#### **91A.040. Annual city audits - Exception.**

(1) Each city of the first through fifth class shall, after the close of each fiscal year, cause each fund of the city to be audited by the Auditor of Public Accounts or a certified public accountant. The audits shall be completed by February 1 immediately following the fiscal year being audited. Within ten (10) days of the completion of the audit and its presentation to the city legislative body, in accordance with subsection (4)(f) of this section, each city shall forward three (3) copies of the audit report to the Kentucky Department for Local Government for information purposes. The department shall forward one (1) copy of the audit report to the Legislative Research Commission to be used for the purposes of KRS 6.955 to 6.975.

(2) Except as provided in subsection (3) of this section, each city of the sixth class shall, after the close of each odd-numbered fiscal year, cause each fund of the city to be audited by the Auditor of Public Accounts or a certified public accountant. The audits shall be completed by February 1 immediately following the fiscal year to be audited. Within ten (10) days of the completion of the audit and its presentation to the city legislative body, in accordance with subsection (4)(f) of this section, each sixth class city shall forward three (3) copies of the audit report to the Kentucky Department for Local Government for information purposes. The department shall forward one (1) copy of the audit report to the Legislative Research Commission to be used for the purposes of KRS 6.955 to 6.975. After the close of each even-numbered fiscal year, each sixth class city shall prepare a financial statement in accordance with KRS 424.220 and immediately forward one (1) copy to the Kentucky Department for Local Government. The department shall forward one (1) copy of the financial statement to the Legislative Research Commission.

(3) Any city of the sixth class, which for any fiscal year receives and expends, from all sources and for all purposes, less than seventy-five thousand dollars (\$75,000), and which has no long-term debt, whether general obligation or revenue debt, shall not be required to audit each fund of the city for that particular fiscal year. Each city shall annually prepare a financial statement in accordance with KRS 424.220 and immediately forward one (1) copy to the Kentucky Department for Local Government for information purposes. The department shall be responsible for forwarding one (1) copy of the financial statement to the Legislative Research Commission to be used for the purposes of KRS 6.955 to 6.975.

(4) Each city required by this section to conduct an annual or biannual audit shall enter into a written contract with the selected auditor. The contract shall set forth all terms and conditions of the agreement which shall include, but not be limited to, requirements that:

(a) The auditor be employed to examine the general purpose financial statements of all governmental, proprietary, and fiduciary funds of the city;

(b) The auditor shall include in the annual city audit report an examination of local government economic assistance funds granted to the city under KRS 42.450 to 42.495. The auditor shall include a certification with the annual audit report that the funds were expended for the purpose intended;

(c) All audit information be prepared in accordance with generally accepted governmental auditing standards which include tests of the accounting records and auditing procedures considered necessary in the circumstances. Where the audit is to cover the use of state or federal funds, appropriate state or federal guidelines shall be utilized;

(d) The auditor prepare a typewritten or printed report embodying the general purpose financial statements and his opinion and statements relating to those statements;

(e) The auditor express an overall opinion as to whether the general purpose financial statements present fairly the financial condition of the city or state the reasons why an overall opinion cannot be expressed;

(f) The completed audit and all accompanying documentation shall be presented to the city legislative body at a regular or special meeting; and

(g) Any contract with a certified public accountant for an audit shall require the accountant to forward a copy of the audit report and management letters to the Auditor of Public Accounts upon request of the city or the Auditor of Public Accounts, and the Auditor of Public Accounts shall have the right to review the certified public accountant's work papers upon request.

(5) A copy of an audit report which meets the requirements of this section shall be considered satisfactory and final in meeting any official request to a city for financial data, except for statutory or judicial requirements, or requirements of the Legislative Research Commission necessary to carry out the purposes of KRS 6.955 to 6.975.

(6) Upon completion of an audit, each city may elect to publish the auditor's report in accordance with subsection (7) of this section, or publish a financial statement in accordance with subsection (8) of this section. Notwithstanding the election of subsection (7) or (8) of this section, the city shall, within ninety (90) days after the close of the fiscal year, cause to be published in a newspaper qualified under KRS 424.120 a legal display advertisement of not less than eight (8) column inches that the statement required by KRS 424.220 has been prepared and that copies have been provided to each local newspaper of general circulation, each news service, and each local radio or television station which has on file with the city a written request to be provided a statement.

(7) If the city elects to publish the auditor's report prepared in accordance with this section in lieu of the financial statement required by KRS 424.220, it shall publish the auditor's cover letter to the city council, the combined balance sheet showing all fund types and account groups, the combined statement of revenues, expenditures, and changes in fund balance for all governmental fund types, the combined statement of revenues, expenses, and changes in retained earnings/fund balances for all proprietary fund types and similar trust funds, and the combined statement of changes in financial position for all proprietary fund types and similar trust funds in accordance with KRS Chapter 424. The advertisement shall contain a statement that a copy of the complete auditor's report, including financial statements and supplemental information, are on file at city hall and are available for public inspection during normal business hours. The advertisement shall also contain a statement that any citizen may obtain from city hall a copy of the complete auditor's report, including financial statements and supplemental information, for his personal use. The statement shall notify citizens requesting a personal copy of the city audit report that they will be charged for duplication costs at a rate that shall not exceed twenty five cents (\$0.25) per page. In addition, the advertisement shall contain a statement that copies of the financial statement prepared in accordance with KRS 424.220 are available to the public at no cost at the business address of the officer responsible for preparation of the statement.

(8) If the city, other than a city of the first or second class or urban-county government, elects to publish the financial statement prepared in accordance with KRS 424.220 in lieu of publishing the auditor's report, it shall, within sixty (60) days after the completion of the audit, publish the statement in accordance with KRS Chapter 424.

(9) Any city of the fifth or sixth class may utilize the alternative publication methods authorized by KRS 424.190(2) to comply with the provisions of this section.

(10) Any person who violates any provision of this section shall be fined not less than fifty dollars (\$50) nor more than five hundred dollars (\$500). In addition, any officer who fails to comply with any of the provisions of this section shall, for each failure, be subject to a forfeiture of not less than fifty dollars (\$50) nor more than five hundred dollars (\$500), in the discretion of the court, which may be recovered only once in a civil action brought by any resident of the city. The costs of all proceedings, including a reasonable fee for the attorney of the resident bringing the action, shall be assessed against the unsuccessful party.

### **91A.060. Official depositories.**

(1) The executive authority shall designate as the city's official depositories one (1) or more banks, federally insured savings and loan companies or trust companies within the Commonwealth. The amount of funds on deposit in an official depository shall be fully insured by deposit insurance or collateralized in accordance with 12 U.S.C. sec. 1823, to the extent uninsured, by any obligations, including surety bonds permitted by KRS 41.240(4).

(2) All receipts from any source of city money or money for which the city is responsible, which has not been otherwise invested or deposited in a manner authorized by law, shall be deposited in official depositories. All city funds shall be disbursed by written authorization approved by the executive authority which shall state the name of the person to whom funds are payable, the purpose of the payment and the fund out of which the funds are payable. Each authorization shall be numbered and recorded.

### **424.110. Definitions.**

As used in KRS 424.110 to 424.370:

(1) "Publication area" means the city, county, district, or other local area for which an advertisement is required by law to be made. An advertisement shall be deemed to be for a particular city, county, district, or other local area if it concerns an official activity of the city, county, district, or other area or of any governing body, board, commission, officer, agency, or court thereof, or if the subject of the advertisement concerns particularly the people of the city, county, district, or other area;

(2) "Advertisement" means any matter required by law to be published.

(3) "Zoned edition" means a newspaper edition published at least once a week, distributed in a specific geographic region of the newspaper's circulation area, and containing reporting and advertising of interest to subscribers in that geographic region.

### **424.120. Qualifications of newspapers.**

(1) Except as provided in subsection (2) of this section, if an advertisement for a publication area is required by law to be published in a newspaper, the publication shall be made in a newspaper that meets the following requirements:

(a) It shall be published in the publication area. A newspaper shall be deemed to be published in the area if it maintains its principal office in the area for the purpose of gathering news and soliciting advertisements and other general business of newspaper publications, and has a second-class mailing permit issued for that office. A newspaper published outside of Kentucky shall not be eligible to carry advertisements for any county or publication area within the county, other than for the city in which its main office is located, if there is a newspaper published in the county that has a substantial general circulation throughout the county and that otherwise meets the requirements of this section; and

(b) It shall be of regular issue and have a bona fide circulation in the publication area. A newspaper shall be deemed to be of regular issue if it is published regularly, as frequently as once a week, for at least fifty (50) weeks during the calendar year as prescribed by its mailing permit, and has been so published in the area for the immediately preceding two-year period. A newspaper meeting all the criteria to be of regular issue, except publication in the area for the immediately preceding two-year period, shall be deemed to be of regular issue if it is the only paper in the publication area and has a paid circulation equal to at least ten percent (10%) of the population of the publication area. A newspaper shall be deemed to be of bona fide circulation in the publication area if it is circulated generally in the area, and maintains a definite price or consideration not less than fifty percent (50%) of its published price, and is paid for by not less than fifty percent (50%) of those to whom distribution is made; and

(c) It shall bear a title or name, consist of not less than four (4) pages without a cover, and be of a type to which the general public resorts for passing events of a political, religious, commercial, and social nature, and for current happenings, announcements, miscellaneous reading matter, advertisements, and other notices. The news content shall be at least twenty-five percent (25%) of the total column space in more than one-half (1/2) of its issues during any twelve-month period.

(d) If, in a publication area there is more than one (1) newspaper which meets the above requirements, the newspaper having the largest bona fide paid circulation as shown by the average number of paid copies of each issue as shown in its published statement of ownership as filed on October 1 for the publication area shall be the newspaper where advertisements required by law to be published shall be carried.

(e) For the purposes of KRS Chapter 424, publishing shall be considered as the total recurring processes of producing the newspaper, embracing all of the included contents of reading matter, illustrations, and advertising enumerated in paragraphs (a) through (d) of this subsection. A newspaper shall not be excluded from qualifying for the purposes of legal publications as provided in this chapter if its printing or reproduction processes take place outside the publication area.

(2) (a) If, in the case of a publication area smaller than the county in which it is located, there is no newspaper published in the area, the publication shall be made in a newspaper published in the county that is qualified under this section to publish advertisements for the county. If the qualified newspaper publishes a zoned edition which is distributed to regular subscribers within the publication area, any advertisement required by law to be published in the publication area may be published in the zoned edition distributed in that area.

(b) If, in any county there is no newspaper meeting the requirements of this section for publishing advertisements for that county, any advertisements required to be published for the county or for any publication area within the county shall be published in a newspaper of the largest bona fide circulation in that county published in and qualified to publish advertisements for an adjoining county in Kentucky. This subsection is intended to supersede any statute that provides or contemplates that newspaper publication may be dispensed with if there is no newspaper printed or published or of general circulation in the particular publication area.

(3) If a publication area consists of a district, other than a city, which extends into more than one (1) county, the part of the district in each county shall be considered to be a separate publication area for the purposes of this section, and an advertisement for each separate publication area shall be published in a newspaper qualified under this section to publish advertisements for the area.

#### **424.130. Times and periods of publication.**

(1) Except as otherwise provided in KRS 424.110 to 424.370 and notwithstanding any provision of existing law providing for different times or periods of publication, the times and periods of publications of advertisements required by law to be made in a newspaper shall be as follows:

(a) When an advertisement is of a completed act, such as an ordinance, resolution, regulation, order, rule, report, statement, or certificate and the purpose of the publication is not to inform the public or the members of any class of persons that they may or shall do an act or exercise a right within a designated period or upon or by a designated date, the advertisement shall be published one time only and within thirty (30) days after completion of the act. However, a failure to comply with this paragraph shall not subject a person to any of the penalties provided by KRS 424.990 unless such failure continues for a period of ten (10) days after notice to comply has been given him by registered letter.

(b) When an advertisement is for the purpose of informing the public or the members of any class of persons that on or before a certain day they may or shall file a petition or exceptions or

a remonstrance or protest or objection, or resist the granting of an application or petition, or present or file a claim, or submit a bid, the advertisement shall be published at least once, but may be published two (2) or more times, provided that one (1) publication occurs not less than seven (7) days nor more than twenty-one (21) days before the occurrence of the act or event.

(c) Excepting counties with a city of the first class, when an advertisement is for the purpose of informing the public and the advertisement is of a sale of property or is a notice of delinquent taxes, the advertisement shall be published once a week for three (3) successive weeks. For counties containing a city of the first class, when an advertisement is for the purpose of informing the public and the advertisement is a notice of delinquent taxes, or notice of the sale of tax claims, the advertisement shall be published once, preceded by a one-half (1/2) page notice of advertisement the preceding week. The provisions of this paragraph shall not be construed to require the advertisement of notice of delinquent state taxes which are collected by the State.

(d) Any advertisement not coming within the scope of paragraph (a), (b) or (c) of this subsection, such as one (1) for the purpose of informing the public or the members of any class of persons of the holding of an election, or of a public hearing, or of an examination, or of an opportunity for inspection, or of the due date of a tax or special assessment, shall be published at least once but may be published two (2) or more times, provided that one (1) publication occurs not less than seven (7) days nor more than twenty-one (21) days before the occurrence of the act or event, or in the case of an inspection period, the inspection period commences.

(e) If the particular statute requiring that an advertisement be published provides that the day upon or by which, or the period within which, an act may or shall be done or a right exercised, or an event may or shall take place, is to be determined by computing time for the day of publication of an advertisement, the advertisement shall be published at least once, promptly, in accordance with the statute, and the computation of time shall be from the day of initial publication.

(2) This section is not intended to supersede or affect any statute providing for notice of the fact that an adversary action in court has been commenced.

#### **424.140. Contents or form of advertisements.**

(1) Any advertisement of a hearing, meeting or examination shall state the time, place and purpose of the same.

(2) Any advertisement of an election shall state the time and purpose of the election, and if the election is upon a public question the advertisement shall state the substance of the question.

(3) Any advertisement for bids or of a sale shall describe what is to be bid for or sold, the time and place of the sale or for the receipt of bids, and any special terms of the sale.

(4) Where any statute provides that, within a specified period of time after action by any governmental agency, unit or body, members of the public or anyone interested in or affected by such action shall or may act, and it is provided by statute that notice of such governmental action be published, the advertisement shall state the time and place when and where action may be taken.

#### **424.150. Person responsible for publishing.**

When any statute providing for newspaper publication of an advertisement does not designate the person responsible for causing the publication to be made, the responsible person shall be:

(1) Where the advertisement is of the filing of a petition or application, the person by whom the same is filed;

(2) Where the advertisement is of an activity or action of:

(a) An individual public officer, the officer himself;

(b) A city, the city clerk if there be one; if not, the mayor;

- (c) A county, the county clerk;
- (d) A district, or a board, commission or agency of a city, county or district, the chief administrative or executive officer or agent thereof;
- (e) A court, the clerk thereof;
- (f) A state department or agency, the head thereof.

#### **424.160. Rates.**

- (1) For all newspaper advertising required by law, the publisher is entitled to receive payment for each insertion at a rate per column inch, computed as or published no larger than nine (9) point type on ten (10) point leading. The rate shall not exceed the lowest rate paid by advertisers for comparable matter in the same publication.
- (2) If by law or by the nature of the matter to be published, a display form of advertisement is required, or if the person or officer responsible for causing an advertisement to be published determines in his discretion that a display form is practicable or feasible, and so directs the newspaper, the advertisement shall be published in display form and the newspaper shall be entitled to receive its established display rate.
- (3) If it is provided by statute that an advertisement shall be published of the filing of a petition or application seeking official action, the filing, if required by other than a governmental official or agency, shall not be deemed complete unless there is deposited with the petition or application an amount sufficient to pay the cost of publication.
- (4) The expense of advertisements in judicial proceedings shall be taxed as costs by the clerk of the court.

#### **424.170. Proof of publication.**

- (1) The affidavit of the publisher or proprietor of a newspaper, stating that an advertisement has been published in his newspaper and the times it was published, attached to a copy of the advertisement, constitutes prima facie evidence that the publication was made as stated in the affidavit.
- (2) The affidavit of the person responsible for publishing as described in KRS 424.150, stating that an advertisement has been delivered by first class mail to each residence within the publication area, attached to a copy of the advertisement, constitutes prima facie evidence that the publication was made as stated in the affidavit and that the expenditure for the cost of postage, all supplies, and reproduction of the advertisement did not exceed the cost of newspaper publication of the advertisement.

#### **424.220. Financial statements**

- (1) Excepting officers of a city of the first class, a county containing such a city, a public agency of such a city or county, or a joint agency of such a city and county, or of a school district of such a city or county, and excepting officers of a city of the second class or an urban-county government, every public officer of any school district, city, county, or subdivision, or district less than a county, whose duty it is to collect, receive, have the custody, control, or disbursement of public funds, and every officer of any board or commission of a city, county or district whose duty it is to collect, receive, have the custody, control, or disbursement of funds collected from the public in the form of rates, charges, or assessments for services or benefits, shall at the expiration of each fiscal year prepare an itemized, sworn statement of the funds collected, received, held, or disbursed by him during the fiscal year just closed, unless he has

complied with KRS 424.230. Pursuant to subsections (2) and (3) of KRS 91A.040, each city of the sixth class shall prepare an itemized, sworn statement of the funds collected, received, held, or disbursed by the city which complies with the provisions of this section.

(2) The statement shall show:

(a) The total amount of funds collected and received during the fiscal year from each individual source; and

(b) The total amount of funds disbursed during the fiscal year to each individual payee and the purpose for which the funds were expended.

(3) Only the totals of amounts paid to each individual as salary or commission and public utility bills shall be shown. The amount of salaries paid to all nonelected county employees shall be shown as lump-sum expenditures by category, including, but not limited to, road department, jails, solid waste, public safety, and administrative personnel.

(4) The amount of salaries paid to all teachers shall be shown as a lump-sum instructional expenditure for the school district and not by amount paid to individual teachers. The amount of salaries paid to all other employees of the board shall be shown as lump-sum expenditures by category, including, but not limited to, administrative, maintenance, transportation, and food service. The local board of education and the fiscal court shall have accessible a factual list of individual salaries for public scrutiny and the local board and the fiscal court shall furnish by mail a factual list of individual salaries of its employees to a newspaper qualified under KRS 424.120 to publish advertisements for the district, which newspaper may then publish as a news item the individual salaries of school or county employees.

(5) The officer shall procure and include in or attach to the financial statement, as a part thereof, a certificate from the cashier or other proper officer of the banks in which the funds are or have been deposited during the past year, showing the balance, if any, of funds to the credit of the officer making the statement.

(6) The officer shall, except in a city electing to publish its audit in lieu of the financial statement in accordance with KRS 91A.040(6), within sixty (60) days after the close of the fiscal year cause the financial statement to be published in full in a newspaper qualified under KRS 424.120 to publish advertisements for the city, county, or district, as the case may be. Promptly after the publication is made, the officer shall file a written or printed copy of the advertisement with proof of publication, in the office of the county clerk of the county and with the Auditor of Public Accounts. Promptly after the publication is made, the officer shall also file one (1) copy of the financial statement with the Kentucky Department for Local Government.

(7) In lieu of the publication requirements of subsection (6) of this section, the appropriate officer of any municipally-owned electric, gas, or water system may elect to satisfy the requirements of subsection (6) of this section by:

(a) Preparation of a certified audit by a certified public accountant, performed in accordance with generally accepted principles of accounting, for the fiscal year;

(b) Publishing in a newspaper qualified under KRS 424.120 to publish advertisements for the city, county, or district as the case may be, the statement of revenue and expenditures from such audit, together with the statement that the audit report is available for inspection at the offices of the utility; and

(c) Making such audit available for inspection on request of anyone during normal working hours of the utility.

(8) In lieu of the publication requirements of subsection (6) of this section, the appropriate officer of a county may elect to satisfy the requirements of subsection (6) of this section by publishing an audit, prepared in accordance with KRS 43.070 or 64.810, in the same manner that city audits are published in accordance with KRS 91A.040(7).

#### **424.240. County or city budget**

Immediately following the adoption of an annual budget by any county or city other than one of the first class, the county or city clerk shall cause a summary of the budget or the text of the budget ordinance to be advertised for the county or city by publication in a newspaper.

#### **424.260. Bids for materials, supplies, equipment, or services**

(1) Except where a statute specifically fixes a larger sum as the minimum for a requirement of advertisement for bids, no city, county, or district, or board or commission of a city or county, or sheriff or county clerk, may make a contract, lease, or other agreement for materials, supplies except perishable meat, fish, and vegetables, equipment, or for contractual services other than professional, involving an expenditure of more than twenty thousand dollars (\$20,000) without first making newspaper advertisement for bids.

(2) If the fiscal court requires that the sheriff or county clerk advertise for bids on expenditures of less than twenty thousand dollars (\$20,000), the fiscal court requirement shall prevail.

(3) (a) Nothing in this statute shall limit or restrict the ability of a local school district to acquire supplies and equipment outside of the bidding procedure if those supplies and equipment meet the specifications of the contracts awarded by the Division of Material and Procurement Services or a federal, local, or cooperative agency and are available for purchase elsewhere at a lower price. A board of education may purchase those supplies and equipment without advertising for bids if, prior to making the purchases, the board of education obtains certification from the district's finance or purchasing officer that the items to be purchased meet the standards and specifications fixed by state price contract, federal (GSA) price contract, or the bid of another school district whose bid specifications allow other districts to utilize their bids, and that the sales price is lower than that established by the various price contract agreements or available through the bid of another school district whose bid specifications would allow the district to utilize their bid.

(b) The procedures set forth in paragraph (a) of this subsection shall not be available to the district for any specific item once the bidding procedure has been initiated by an invitation to bid and a publication of specifications for that specific item has been published. In the event that all bids are rejected, the district may again avail itself of the provisions of paragraph (a) of this subsection.

(4) This requirement shall not apply in an emergency if the chief executive officer of the city, county, or district has duly certified that an emergency exists, and has filed a copy of the certificate with the chief financial officer of the city, county, or district, or if the sheriff or the county clerk has certified that an emergency exists, and has filed a copy of the certificate with the clerk of the court where his necessary office expenses are fixed pursuant to KRS 64.345 or 64.530, or if the superintendent of the board of education has duly certified that an emergency exists, and has filed a copy of the certificate with the chief state school officer.

(5) The provisions of subsection (1) of this section shall not apply for the purchase of wholesale electric power for resale to the ultimate customers of a municipal utility organized under KRS 96.550 to 96.900.

**OFFICE OF THE ATTORNEY GENERAL OF THE STATE OF KENTUCKY**

**OAG 81-331**

September 14, 1981

Honorable Daugh K. White  
Mayor  
City Hall  
Manchester, Kentucky 40962

**OPINIONBY:**

Steven L. Beshear, Attorney General; By: Walter C. Herdman, Assistant Deputy Attorney General

**OPINION:**

This is in response to your letter of September 1, in which you raise the question as to whether or not the City of Manchester, a city of the fourth class, has the right to sell city-owned property to a city employee and if so, what procedures are to be followed.

KRS 82.081 authorizes cities of all classes to dispose of its property, and reads as follows:

"Each city shall constitute a corporation, with capacity to sue and be sued, to contract and be contracted with, to acquire and dispose of property, and to have a common seal and change it at pleasure or act without a seal."

KRS 61.270 reads as follows:

"If any officer of a city of the fourth class becomes directly or indirectly interested as agent, principal or surety in any contract with the city, he shall thereby vacate his office, and the contract, if entered into while he is in office, shall be void."

The above statute prohibits any municipal officer in cities of the fourth class from becoming interested, directly or indirectly, in any contract with the city. This statute would prohibit an officer of the city from purchasing city property. See OAG 76-264. However, KRS 61.270 would not prohibit an employee from contracting with a city for the purchase of city property authorized to be disposed of by KRS 82.081. Therefore, we see no legal objection to a city employee purchasing city property provided such sale is openly and fairly conducted, which is a fundamental rule with respect to the sale of public property generally. Referring to McQuillin, Municipal Corporations, Volume 10, § 28.45, this general principle is so stated. In addition, it is pointed out that unless a municipal corporation is required to sell its property on a competitive bid basis, which it is not, under Kentucky law, a competitive bidding procedure need not be used. Nevertheless, we have suggested that all public property be disposed of either by competitive bidding or at public auction to the highest bidder in order to comply with the fundamental rule referred to above. See OAG 70-126, copy attached.

OFFICE OF THE ATTORNEY GENERAL OF THE STATE OF  
KENTUCKY

OAG 82-41

January 15, 1982

Mr. O. J. Simpson  
City Coordinator  
402 W. Main Street  
Cumberland, Kentucky 40823

OPINIONBY:

Steven L. Beshear, Attorney General; By: Walter C. Herdman, Assistant Deputy Attorney General

OPINION:

This is in response to your letter of January 6, in which you relate that the City of Cumberland has closed an alley in the city pursuant to KRS 82.405 and declared it to be excess property. You enclosed a copy of the circuit court judgment closing said alley. In disposing of this property you relate the following facts and question:

"Sealed bids were advertised for and two bids were received, one for \$2,500.00 and one for \$809.00. The city council determined the bid of \$2,500.00 was too high and requested of the two defendants, the only ones who bid, get together and submit a common bid to divide the property. The two property owners did submit a joint bid which was accepted by the council unanimously.

QUESTION: Was the joint bid, a legal bid, as the property was not advertised a second time."

Every city is authorized to sell surplus real and personal property pursuant to KRS 82.081 and 82.082. There is no statute detailing the procedure for the sale of municipal property as is the case with the purchase of material, equipment, supplies, services, etc., under KRS 424.260. In other words, there is no requirement that the sale of the property must be on a bid basis. Referring to McQuillin Municipal Corporations, Vol. 10, § 28.44, we find the following statement:

"If no provision is made by statute as to the procedure for disposing of municipal property, and the conditions of the conveyance, such matters are within the reasonable discretion of the appropriate municipal authorities."

Next referring to § 28.45, we quote the following excerpts:

". . . It is fundamental that sales of public property must be openly and fairly conducted, . . ."

\* \* \*

. . . Unless, however, the applicable laws expressly so provide, a municipal corporation is not required to use competitive bidding or otherwise seek the highest obtainable price in selling its property. . . ."

It is clear from the above that the city may sell its property in any feasible manner that is in the best interest of the city, and we have suggested that such sale be either by auction or by bidding, though neither mode is required. As a matter of fact, there is law to the effect that in

the absence of a competitive bid requirement but where the public authority voluntarily advertises the bids, they may reject all bids as they see fit and enter into private negotiations with one of the bidders in order to secure the best possible price, whether it be in connection with the purchase of property or the sale of property. See 43 Am.Jur., Public Works and Contracts, § 49, and OAG 67-119.

The factual situation you have presented appears to be rather unusual, in that the city has rejected the high bid simply because they thought it was too high, which raises the question of whether or not the public interest of the city was sufficiently considered, that being to obtain the highest possible price for the property. On the other hand, there is no question that the bids could normally be rejected for a valid reason and either new bids requested or the city enter into private negotiation in order to get the best possible price for the property. However, the fact that the city rejected the high bid and requested a common bid between the two original bidders would appear to this office to have been improper; first, because it failed to seek new bids through appropriate advertisement which is normally required if the city is going to utilize the bidding process, and, secondly, by rejecting the high bid, the city turned down the sale price that would have most benefited the city's interest.

Under the circumstances, we believe that the joint bidding procedure described should be rejected and either new bids requested pursuant to appropriate advertisement, or the property be sold at public auction.

**OFFICE OF THE ATTORNEY GENERAL OF THE STATE OF  
KENTUCKY**

**OAG 82-530**

**September 24, 1982**

Mr. Andy Meadors  
Public Administration Specialist  
Cumberland Valley  
Area Development District, Inc.  
Cumberland Valley ADD Building  
London, Kentucky 40741

**OPINIONBY:**

Steven L. Beshear, Attorney General; Walter C. Herdman, Asst. Deputy Attorney General

**OPINION:**

This is in response to your letter of September 17 in which you raise the following question:

"The City of Barbourville has a street sweeper, which the City of McKee wants to acquire. It is the City's understanding that it is not necessary for cities to advertize for bids in connection with purchases from the federal government. In this case could a city purchase from another city without advertising for bids."

In response to your question, we first wish to point out that the city of Barbourville, which owns the street sweeper desired by the city of McKee, may sell any of its property no longer needed for public purpose pursuant to the terms of KRS 82.081 and 82.082 in any manner that

it desires. However, we have pointed out in numerous opinions, including OAG 82-41, copy attached, that such sale though not required by statute to be on a bid basis, should be sold either at a public auction or by competitive bids. If, of course, the city of Barbourville wishes to sell the sweeper by competitive bidding, the city of McKee will have to bid on the property. On the other hand, if it is sold at auction, then the city of McKee can acquire it by participating in the auction sale.

It is true that every city in order to acquire property must generally do so by utilizing the bidding procedure provided in KRS 424.260 assuming it has not adopted the state procurement code. However, there are exceptions to the competitive bidding requirements where, for example, bidding would be undesirable, impractical, or impossible as pointed out in *McQuillin Municipal Corporations*, Vol. 10, Section 29.36. We also refer you to the case of *Bennett v. City of Mayfield, Ky.*, 329 S.W.2d 573 (1959) in which the court declared and we quote:

". . . There are many special transactions of such character as to make it impractical or unwise to apply the policy of competitive bidding, such, for example, as buying a particular property by contract or acquiring it by condemnation or contracting for professional services. . ." (Emphasis added.)

It is thus possible that the use of competitive bidding would be impractical and useless in acquiring the property in question. In any event, however, the facts related are insufficient to determine this.

We trust the above response to your question will be of assistance to the city of McKee's acquisition of the street sweeper owned by the city of Barbourville. Incidentally, we know of no statutory exemption with respect to purchases between cities under the terms of KRS 424.260. If, however, the city is operating under the Kentucky Model Procurement Code, we call your attention to KRS 45A.425 and particularly subsection 3 which reads as follows:

"Surplus or excess personal property as described in this section may be transferred, with or without compensation, to another governmental agency; or it may be sold at public auction or by sealed bids in accordance with KRS 45A.365."