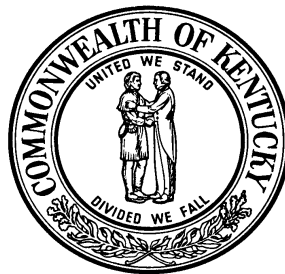


**REPORT OF THE AUDIT OF THE
KENTUCKY HERITAGE LAND
CONSERVATION FUND**

**For The Year Ended
June 30, 2018**



**MIKE HARMON
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MIKE HARMON
AUDITOR OF PUBLIC ACCOUNTS

Charles G. Snavely, Secretary
Energy and Environment Cabinet
Zeb Weese, Chairman
Kentucky Heritage Land Conservation Fund Board

Independent Auditor's Report

Report on the Financial Statements

We have audited the accompanying modified cash basis financial statements of the Kentucky Heritage Land Conservation Fund (KHLCF), as of and for the year ended June 30, 2018, and the related notes to the financial statements, which collectively comprise KHLCF's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

KHLCF's management is responsible for the preparation and fair presentation of these financial statements in accordance with the modified cash basis of accounting described in Note 2; this includes determining that the modified cash basis of accounting is an acceptable basis for the preparation of the financial statements in the circumstances. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.



We believe the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective modified cash basis financial position of the KHLCF, as of June 30, 2018, and the respective changes in financial position – modified cash basis and, where applicable, cash flows, thereof for the year then ended on the basis of accounting described in Note 2.


Basis of Accounting

We draw attention to Note 2 of the financial statements, which describes the basis of accounting. The financial statements are prepared on a modified cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 22, 2018 on our consideration of KHLCF's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the KHLCF's internal control over financial reporting and compliance.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Mike Harmon", with a long horizontal line extending to the right.

Mike Harmon
Auditor of Public Accounts

October 22, 2018

FINANCIAL STATEMENTS

**KENTUCKY HERITAGE LAND CONSERVATION FUND
BALANCE SHEET - MODIFIED-CASH BASIS**

June 30, 2018

Assets:

Cash and Cash Equivalents	<u>\$ 9,020,597</u>
Total Assets	<u><u>\$ 9,020,597</u></u>

Fund Balance:

Restricted	<u>\$ 9,020,597</u>
Total Fund Balance	<u><u>\$ 9,020,597</u></u>

The accompanying notes are an integral part of the financial statements.

**KENTUCKY HERITAGE LAND CONSERVATION FUND
STATEMENT OF RECEIPTS, EXPENDITURES, AND CHANGES
IN FUND BALANCE - MODIFIED-CASH BASIS**

For the Year Ended June 30, 2018

Receipts:	
Unmined Minerals Tax	\$ 636,307
Environmental Fines	2,262,555
Nature License Plate Sales	365,590
Interest Income	100,261
Donations and Other Receipts	385
Total Receipts:	<u>3,365,098</u>
Expenditures:	
Land Acquisition and Management	504,257
Total Expenditures	<u>504,257</u>
Excess (Deficiency) of Receipts Over (Under) Expenditures	2,860,841
Other Financing Sources (Uses)	
Division of Fossil Fuels and Utility Services Transfer	(400,000)
Administrative Transfer	(270,200)
Environmental Education Council Transfer	(150,000)
Transfer to General Fund	(2,500,000)
Total Other Financing Sources (Uses)	<u>(3,320,200)</u>
Net Change in Fund Balance:	(459,359)
Fund Balance at July 1, 2017	<u>9,479,956</u>
Fund Balance at June 30, 2018	<u>\$ 9,020,597</u>

The accompanying notes are an integral part of the financial statements.

NOTES TO THE FINANCIAL STATEMENTS

KENTUCKY HERITAGE LAND CONSERVATION FUND
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2018

Note 1 - Background

The Kentucky Heritage Land Conservation Fund (KHLCF) is administered within the Energy and Environment Cabinet, by the Kentucky State Nature Preserve Commission. The fund was created on July 15, 1994 by KRS 146.570 in order to provide funding for the purchase and preservation of selected natural areas in the Commonwealth, protect rare and endangered species and migratory birds, save threatened areas of natural importance, and provide natural areas for public use, outdoor recreation, and education. The Kentucky Heritage Land Conservation Fund Board has been given the authority under KRS 146.560 to administer and oversee the fund. The Board is comprised of 12 members, consisting of the commissioner of the Department of Parks, the director of the Kentucky Nature Preserves Commission, the commissioner of the Kentucky Department for Natural Resources, the commissioner of the Department of Fish and Wildlife Resources, the chairperson of the Kentucky Environmental Education Council, and seven members appointed by the governor as nominated by various interest groups throughout the state.

Note 2 - Summary of Significant Accounting Policies

Basis of Presentation

The financial statements have been prepared on a cash basis of accounting modified by the application of KRS 45.229, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. This statute provides that for a period of 30 days after the close of any fiscal year, warrants may be drawn against available balances of appropriations made for that fiscal year, for the payment of expenditures incurred during the year or in fulfillment of contracts properly made during the year but for no other purpose.

Concentration of Revenues

KHLCF receipts are derived from the following sources:

- Special license plates, as authorized by KRS 186.164, are available for purchase at each of the Kentucky County Clerk's offices. The sale proceeds are submitted to the Kentucky Transportation Cabinet (KYTC) and a portion of the sales is transferred to KHLCF.
- Unmined minerals taxes are collected by the County Sheriff's Offices, submitted to the Kentucky Department of Revenue (DOR), and transferred to KHLCF.
- A portion of environmental fines, collected by the Department of Environmental Protection (DEP) as environmental civil penalties, is transferred to KHLCF.
- The Office of Financial Management (OFM), within the Kentucky Finance and Administration Cabinet (FAC), maintains the KHLCF cash account. OFM periodically transfers interest earned on the cash account to KHLCF.

KENTUCKY HERITAGE LAND CONSERVATION FUND
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2018
(Continued)

Note 2 - Summary of Significant Accounting Policies (Continued)

Commitments

KHLCF has outstanding commitments related to land acquisition and management. These commitments consist of outstanding projects, as approved by the KHLCF Board, with open memoranda of agreement in which KHLCF's obligation has not yet been completed. Refer to KHLCF for additional information and disclosure.

Functional Expenses

KHLCF provides grant funding to state agencies, state and local governments, and state colleges and universities, for the acquisition and management of lands of natural significance as established in KRS 146.560. In accordance with KRS 224.10-250, the first \$150,000 of civil penalties collected annually are required to be paid to the State Treasury and credited to the Kentucky Environmental Education Council, for the purpose of providing leadership and planning for environmental education in the Commonwealth.

In accordance with KRS 132.020, \$400,000 of the unmined minerals taxes collected annually are paid to the State Treasury and credited to the Department for Energy Development and Independence, for the purpose of public education of coal-related issues. In addition, during FY 2018, \$270,200 was provided to the Kentucky State Nature Preserves Commission, for the administration of KHLCF. The remaining funds are allocated per KRS 146.570 as follows:

- 10% Department of Fish & Wildlife
- 10% Department of Parks
- 10% Division of Forestry
- 10% Nature Preserves Commission
- 10% Wild Rivers Program
- 50% Local Governments, State Colleges and Universities, and Other Agencies

Fund Balance

Fund balance represents the difference between assets and liabilities reported on KHLCF's balance sheet. The fund balance does not lapse, and therefore is available for use in future periods. Fund balance is classified as restricted. GASB 54 identifies fund balance should be reported as restricted when constraints placed on the use of resources are either externally imposed by creditors, grantors, contributors, laws and or regulations of other governments, or are imposed by law through constitutional provisions or enabling legislation. As established in KRS 146.570, KHLCF revenue is restricted for use exclusively for the purposes of the acquisition and management of lands as defined in KRS 146.560.

KENTUCKY HERITAGE LAND CONSERVATION FUND
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2018
(Continued)

Note 3 - Cash and Cash Equivalents

Participation in the Commonwealth's Internal Cash and Investment Pool

Receipts are deposited in the Commonwealth's general depository administered by the State Treasurer, who has statutory responsibility and authority to safeguard the monies. KHLCF participates in the internal cash and investment pool of the Commonwealth of Kentucky. Therefore, it follows the policies established by the Commonwealth for all pooled cash and investments. The Commonwealth's internal investment pool offers same day liquidity with no limitations, fees or restrictions on withdrawals. The risk disclosures related to deposits and investments are reported in the Commonwealth of Kentucky's Comprehensive Annual Financial Report. Accordingly, the Commonwealth of Kentucky's Comprehensive Annual Financial Report should be referred to for disclosures required by the Governmental Accounting Standards Board. For the year ended June 30, 2018, KHLCF's position in the pool totaled \$9,020,597.

Note 4 - Cash Transfer

Previous legislation enacted by the General Assembly of the Commonwealth of Kentucky resulted in a \$15 million transfer of cash from KHLCF to the Commonwealth's General Fund in exchange for a capital appropriation from bond funds in fiscal year 2012. The intent of the General Assembly was not to impact any project the KHLCF Board has already approved. The impact will be felt on future revenues from which the KHLCF Board will have available to authorize new projects due to a reduction in interest revenues. KHLCF paid a total of \$593,913 in expenditures for land acquisition costs from bond funds during fiscal year 2018, leaving a balance of \$0 available as of June 30, 2018.

During fiscal year 2018, KHLCF transferred \$2,500,000 in a cash transfer to the General Fund as required by Budget Bill enacted by the 2018 General Assembly. Like the fund transfers in 2016 Budget Bill and 2014 Budget Bill, the transfer did not include an exchange for a capital appropriation from bond funds.

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND
ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
*GOVERNMENT AUDITING STANDARDS***



MIKE HARMON
AUDITOR OF PUBLIC ACCOUNTS

**Report On Internal Control Over Financial Reporting , And On Compliance
And Other Matters Based On An Audit Of Financial Statements Performed In
Accordance With *Government Auditing Standards***

Independent Auditor's Report

Charles G. Snavely, Secretary
Energy and Environment Cabinet
Zeb Weese, Chairman
Kentucky Heritage Land Conservation Fund Board

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Kentucky Heritage Land Conservation Fund (KHLCF) as of and for the year ended June 30, 2018, and the related notes to the financial statements, which collectively comprise KHLCF's basic financial statements, and have issued our report thereon dated October 22, 2018.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the KHLCF's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of KHLCF's internal control. Accordingly, we do not express an opinion on the effectiveness of KHLCF's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weakness or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying Schedule of Findings and Recommendations, we identified certain deficiencies in internal control that we consider to be material weaknesses.



Report On Internal Control Over Financial Reporting And
On Compliance And Other Matters Based On An Audit Of Financial Statements
Performed In Accordance With *Government Auditing Standards*
(Continued)

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the following deficiencies described in the accompanying Schedule of Findings and Recommendations to be material weaknesses: 2018-KHLCF-01 and 2018-KHLCF-02.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the KHLCF's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards*, and which is described in the accompanying Schedule of Findings and Recommendations as item 2018-KHLCF-01.

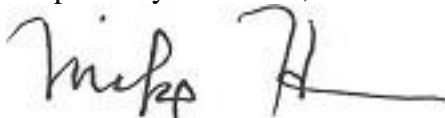
KHLCF's Response to Findings

KHLCF's response to the findings identified in our audit are described in the accompanying Schedule of Findings and Recommendations. KHLCF's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Respectfully submitted,



Mike Harmon
Auditor of Public Accounts

October 22, 2018

SCHEDULE OF FINDINGS AND RECOMMENDATIONS

**KENTUCKY HERITAGE LAND CONSERVATION FUND
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
For the Year Ended June 30, 2018**

2018-KHLCF-01: The General Fund Transfer From The Kentucky Heritage Land Conservation Fund Potentially Included License Plate Receipts In Violation Of Kentucky Revised Statutes

Kentucky Revised Statute (KRS) 186.164 requires funds received from the sale of the nature license plates be deposited to the Kentucky Heritage Land Conservation Fund (KHLCF) established under KRS 146.570. KRS 146.570 restricts KHLCF revenue, including license plate receipts, for the acquisition and management of lands as defined in KRS 146.560.

During fiscal year 2018 the General Assembly authorized a \$2.5 Million transfer from KHLCF to the Kentucky General Fund. While legislation specifically stated that this transfer shall not include any receipts derived from the sale of the nature license plate, \$50,492 of license plate revenues were potentially included within this transfer. This transfer resulted in a noncompliance with 16 RS HB 303, KRS 186.164, and KRS 146.570 as license plate receipts were transferred for purposes other than for the acquisition and management of lands. A summary of the fiscal year 2018 financial activity is provided below:

Total Non-License Plate Receipts	\$ 2,999,508
Transfer Required by KRS 132.020	(400,000)
Transfer Required by KRS 224.10-250	(150,000)
General Fund Transfer Per HB 303	<u>(2,500,000)</u>
*Excess Transfers Over Receipts	<u><u>\$ (50,492)</u></u>

*Represents license plate receipts necessary to cover statutorily required transfers.

KHLCF generates revenue from several sources including environmental fines and fees, interest, and license plate sales, which are identifiable by unique revenue source codes within KHCLF's accounting system. While the source of receipts can be identified, expenditures and transfers are not traceable to the specific revenue source, which has not been necessary since all expenditures within the fund are restricted for the same purpose. During fiscal year 2018, statutorily required transfers exceeded all non-license plate receipts by \$50,492, signifying that license plate receipts were potentially utilized. While KHLCF had an existing cash balance rolled forward from the prior year, there was no mechanism in the accounting system to identify the source and composition of this balance.

The transfer of license plate receipts to the general fund has resulted in non-compliances with state law, as funds were required to be expended solely for the acquisition and maintenance of land. Additionally, individuals purchasing nature license plates had their contributions used for purposes other than intended.

KRS 186.164 (14) states,

One hundred percent (100%) of the funds received by a group or organization under subsection (12) of this section shall be used for the express purpose identified by the group in subsection (13) of the section. Any group or organization that receives a mandatory EF fee under KRS 186.162 shall comply with the provisions of this subsection.

**KENTUCKY HERITAGE LAND CONSERVATION FUND
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
For the Year Ended June 30, 2018**

2018-KHLCF-01: The General Fund Transfer From The Kentucky Heritage Land Conservation Fund Potentially Included License Plate Receipts In Violation Of Kentucky Revised Statutes (Continued)

KRS 146.570 (3) states, “[m]oneys in the fund shall be used exclusively for the purpose of acquisition and management of land as defined in KRS 146.560.”

16 RS HB 303 states, “These funds transfers to the General Fund shall not include any receipts derived from the sale of the Nature License Plate.”

Recommendation

The KHLCF Board should consult with the Office of the State Budget Director to discuss mechanisms to prevent future non-compliances related to the transfer of restricted funds as well as to determine a possible resolution for the non-compliance identified during fiscal year 2018. Additionally, the KHLCF Board should consider using additional mechanisms within their accounting system for license plate activities so receipt and expenditure activity can be traced to funding source and purpose. The KHLCF board could consult with the Finance and Administration Cabinet (FAC) for further guidance on the tracking and reporting of license plate activity.

Management’s Response and Planned Corrective Action

EEC is of the opinion that it cannot be definitively determined that license plate funds were included in the transfer to the general fund. The carry-forward in the Heritage Land Conservation Fund 14BT into FY18 was \$9,479,956.43. This balance includes not only plate funds, but other receipts received by 14BT. Over the last 10 years, license plate receipts have accounted for under 11% of total KHLCF revenue. Pursuant to KRS 186.164 EEC has established a new fund (14GH) that is solely for the deposit of license plate funds from Kentucky Transportation Cabinet.

Auditor’s Reply

We agree that EEC cannot definitively determine that license plate funds were included in the transfer, which highlights the problem with the comingling of funds as noted in the finding. The finding provides the amount of license plate revenues potentially included in the transfer. Once the revenue sources were comingled, the funds lose their “source” identity. Additionally, the response poses additional concerns over the tracking of license plate activity. In setting up a new fund to track license plate activity, EEC should consult with KYTC to ensure compliance with license plate regulations as well as EEC general counsel to ensure all applicable legal requirements and statutes are met. KRS 186.162 identifies EEC’s portion of nature license plate sales should be deposited into the Kentucky Heritage Land Conservation Fund established under KRS 146.570.

**KENTUCKY HERITAGE LAND CONSERVATION FUND
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
For the Year Ended June 30, 2018**

2018-KHLCF-02: The Kentucky Heritage Land Conservation Fund Financial Statements And Financial Activity Reports Included Significant And Material Errors

The Kentucky Heritage Land Conservation Fund (KHLCF) is administratively attached to the Energy and Environment Cabinet's (EEC) Office of Kentucky Nature Preserves (Nature Preserves). EEC staff performs administrative, budgeting, capital planning, and reporting duties for KHLCF which includes drafting and preparing financial statements. Review of prepared quarterly reports, financial tracking spreadsheets, and the provided financial statements for fiscal year 2018 revealed the following errors and omissions:

- Land acquisition and maintenance expenditures were overstated by \$541,173 on the prepared financial statements.
- The beginning fund balance on the prepared financial statements was overstated by \$137,011 when compared to the ending fund balance reported in fiscal year 2017.
- A \$142,380 transfer was incorrectly included on the summary of expenditures attached as support for KHLCF financial activity. The transaction was subsequently cancelled during processing and should not have been recognized as an expenditure.
- \$20,650 of acquisition and land maintenance expenditures were omitted from the summary of expenditures used in preparing the quarterly reports. This activity was appropriately reported and classified within eMARS, KHLCF's accounting system, and should have been included.
- \$11,058 of receipts were transferred to KHLCF in error, overstating the KHLCF cash balance in fiscal year 2018. While this transaction was not reported on the prepared financial statements, financial activity posted within eMARS was not adequately monitored to identify and correct errors and misstatements timely.
- KHLCF's tracking of available grant funds for participants included recording of approved projects that did not agree to the approved project amounts as documented in the board minutes.

Adequate internal controls over the preparation and subsequent review of the financial statements, quarterly financial reports, and prepared financial tracking spreadsheets were not adequate in order to detect and correct material misstatements and inaccuracies. Financial information was not reconciled back to eMARS with discrepancies and potential errors being investigated timely. Failure to accurately record, classify, and report all financial activity resulted in misstatements on KHLCF financial statements which also impacted the tracking of available grant funds for future projects. Inaccurate financial statements and other tracking spreadsheets could negatively impact operational decisions by management or provide incorrect information to interested external parties reviewing the financial data.

Accounting standards require financial statements be complete and accurate to ensure information reported can be relied on and utilized by internal and external parties. Sound internal controls further dictate adequate policies and procedures be in place to ensure accuracy in the financial reporting process. This includes that all transactions recorded are complete, accurate, properly classified, and agree to the underlying records within the entities accounting system. Unidentified or unexpected amounts should be researched and corrected to ensure that financial reports are accurate. Additionally, any internal spreadsheets and quarterly reports utilized by management or those charged with governance should be verified for completeness and accuracy.

**KENTUCKY HERITAGE LAND CONSERVATION FUND
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
For the Year Ended June 30, 2018**

**2018-KHLCF-02: The Kentucky Heritage Land Conservation Fund Financial Statements And
Financial Activity Reports Included Significant And Material Errors (Continued)**

Recommendation

We recommend internal controls be implemented to ensure the accuracy and completeness of KHLCF financial statements as well as internal financial tracking spreadsheets utilized by management and the KHLCF board. Financial activity should be reconciled against the accounting system, with any unknown transactions being promptly reviewed and confirmed. Implemented internal controls over the review of the financial statements and related financial information should be adequately documented signifying review was completed. Additionally, a recalculation and review of the available funding allocations for entities as outlined in Kentucky Revised Statute (KRS) 146.570 should be completed due to the errors noted in financial reporting and the discrepancies noted with the project award amounts as reported in the board minutes.

Management's Response and Planned Corrective Action

Documents requested for audit purposes are prepared by Office of Kentucky Nature Preserves. In the future, these documents will be submitted to Division of Financial Management, Office Administrative Services for a final review, then forwarded on to auditors.