

A REPORT

TO

HIS EXCELLENCY, AUGUSTUS E. WILLSON

GOVERNOR OF KENTUCKY

UPON THE

FINANCIAL CONDITION OF THE STATE

AND CONCERNING

IMPROVED METHODS OF ACCOUNTING

BY

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FRANKFORT, KENTUCKY,
December 23, 1909.

TO HIS EXCELLENCY, AUGUSTUS E. WILLSON,
GOVERNOR OF KENTUCKY,
STATE HOUSE, FRANKFORT:

Dear Sir,—In accordance with your instructions, we have made an examination of the methods of accounting in the office of the Auditor of Public Accounts and elsewhere, and have prepared a table showing the revenues and expenditures in the various funds of the State during the past five fiscal years. In this table we have separated the total revenues and expenditures into four principal funds, namely, General Expenditure Fund, School Fund, Sinking Fund, and State University Fund. In the books of the Auditor the latter fund is included in the figures of the General Expenditure Fund, but we have taken these items out from the General Expenditure Fund, so that the University Fund may be separately set up. Otherwise, the figures are identical with those on the Auditor's books. We have verified the results on this table by a series of proofs which exhibit the actual increases and decreases in the cash balances from year to year, and thereby verify the totals of all of the figures given.

GENERAL EXPENDITURE FUND.

We have further separated the General Expenditure Fund into two parts: "Ordinary," which includes only current expenses of the year which have been paid, and "Extraordinary," which includes only expenditures for the erection of the New Capitol, for the Normal Schools, and also the

exceptional expenditures on account of the employment of military force in aid of civil power, which occurred in 1908-09, and which amounted to over \$150,000.00.

Referring to the table, you will note that in each year, except the first year (1904-05), there has been a surplus of revenue receipts over ordinary expenses paid. This surplus, however, has been sufficient in none of the years to provide for the extraordinary expenditures (*i.e.*, for the New Capitol, for the Normal Schools, and for the Militia). When the extraordinary expenditures are contrasted with the receipts available to pay for them, we are confronted with a deficiency in each year.

TABLE I.

Surplus of Receipts over Ordinary Expenses, together with Deficits caused by Extraordinary Expenditures.

(Cents have been omitted to save space.)

Year.	Surplus of Receipts over Ordinary Expenses.	Extraordinary Expenditures.	Deficiencies of Re- ceipts caused by Extraordinary Expenditures.
1904-5 . . .	\$32,613.*	\$34,885.	\$67,498.
1905-6 . . .	25,954.	130,116.	104,162.
1906-7 . . .	363,508.	573,551.	210,043.
1907-8 . . .	198,439.	451,107.	252,668.
1908-9 . . .	120,545.	619,834.	499,289.
	\$675,833.	\$1,809,493.	\$1,133,660.

*Deficit.

On August 31, 1907, \$500,000. was transferred from the Sinking Fund to the General Expenditure Fund. This transfer was made for the reason, apparently, that the sinking fund did not need this money, as its annual revenue from taxation is more than enough to pay the interest charges (all outstanding bonds of the State having been

paid, except the irredeemable debt), while the General Expenditure Fund was badly in arrears.

If this transfer is included, the apparent deficiency of the General Expenditure Fund is reduced to \$633,660 for the five years.

The Auditor's report shows that at the beginning of the five years above summarized, there was a deficit in the General Expenditure Fund of \$98,103.97, to which we must add \$1,115.58 due to the University Fund, which is separately stated in the Auditor's report, making the deficit carried over at the beginning of the five-year period the sum of \$99,219.55, so that the total excess of expenditure over the total receipts of the General Expenditure Fund, beginning with the deficit carried over in 1904-5, is as follows:—

Deficit carried over 1904-5	\$99,219.
Excess of General Fund Expenditure over receipts during the five-years (Table 1)	1,133,660.
Other transfers and corrections	9,827.
Total Deficit in general fund June 30, 1909	\$1,242,706.
Transfer from sinking fund, August 31, 1907	500,000.
Net Deficit in general fund June 30, 1909	<u>\$742,706.</u>

Comparing this net deficit with the Auditor's statement as of June 30, 1909, the figures are the same, as follows:—

Auditor's statement of deficiency, page 252 his report	\$739,726.
Add: Balance due University Fund	2,980.
Total as above	<u>\$742,706.</u>

SCHOOL FUND, SINKING FUND AND STATE UNIVERSITY FUND.

The School Fund has had a surplus of revenue each year, except 1905-6, when there was a deficiency of revenue of \$18,790.

The Sinking Fund has had a surplus of revenue each year, except the first year (1904-5), when there was a deficiency of revenue of \$3,997. If the transfer of the \$500,000. be taken into consideration in 1907-8, the surplus revenue in the Sinking Fund of that year, which amounted to \$44., is transformed into a deficiency of revenue for that year of \$499,956.

In the State University Fund there has been a surplus every year, except the last two years, when the expenditures exceeded the revenues.

SCHOOL FUND.

On June 30, 1904, there was a deficiency in the School Fund of	\$98,324.
During the five years to June 30, 1909, there should have been a net surplus of receipts over expenditures of	534,074.
Leaving a net surplus on June 30, 1909, of . . .	\$435,750.

SINKING FUND.

On June 30, 1904, there was a surplus of	\$546,444.
During the five years there should have been a surplus of	62,726.
Total surplus	\$609,170.
Less transfer of August 31, 1907	500,000.
Leaving a net surplus June 30, 1909 . . .	109,170.

UNIVERSITY FUND.

On June 30, 1904, there was a	
surplus of	\$1,116.
During the five years there	
should have been a sur-	
plus of	1,864.
Leaving a net surplus on June 30, 1909 . .	\$2,980.

TOTAL DUE TO THESE FUNDS.

Total surplus which should have existed in	
these funds June 30, 1909	\$547,900.

The facts, however, were these: that if all outstanding warrants had been presented for payment on June 30, 1909, it would have required all of the money in the treasury and nearly two hundred thousand dollars more to have paid them. That is to say, all of the money supposed to exist in the above funds, rightfully, had been mortgaged by excessive expenditures in the General Fund and \$194,806. of warrants were outstanding without revenues having been provided to pay for them.

Adding the outstanding, unprovided-for	
warrants	194,806.
Leaves the deficiency the same as stated	
above, due the special funds and for out-	
standing warrants in excess of avail-	
able cash	\$742,706.

As has been explained above, this deficiency has been caused in great part by the erection of the New Capitol,

the amounts expended thereon during the five years having been as follows:—

1904-5	\$34,885.
1905-6	130,116.
1906-7	573,551.
1907-8	451,107.
1908-9	260,986.
Total to June 30, 1909	\$1,450,645.
Adding Militia expenses on active service	151,400.
And outlays for Normal School buildings, etc. in 1908-9	207,448.
Makes a grand total of extraordinary outlays during the five years	\$1,809,493.

The above tables make evident the fact that, on account of these extraordinary expenditures for New Capitol, Normal School, Militia, etc., during these five years, what under ordinary conditions would have been a surplus of revenue over current expenses amounting to \$675,833, has been converted into a deficiency of revenue during the five years of \$1,133,660, as shown above.

Viz.: Loss during five years	\$1,133,660.
Deficit at beginning	99,219.
Other transfers and corrections	9,827.
	\$1,242,706.
Less transfer from sinking fund!	500,000.
Deficit June 30, 1909	\$742,706.

It is plainly evident, of course, that the deficiencies in the special funds—School, Sinking, and University—have been caused by the use of these funds for General Expenditure purposes. These amounts must, therefore, be paid back to the special funds out of general revenue hereafter, and the question arises:—"From what source may additional revenue be obtained to repay these special funds?"

This question might be answered satisfactorily if the current expenses of the next few years could be curtailed so that there may be a considerable surplus of ordinary revenue each year, which should then be used to rehabilitate the special funds. It will be difficult, if not impossible, to provide sufficient revenue in this manner from present sources and therefore new sources of revenue must be found, sufficient to provide for the losses in these funds, or else bonds must be issued and the proceeds used to pay off outstanding warrants and to provide for the deficiencies.

It is evident also that in great part the monies which should now exist in the special funds have been used to build the new Capitol, owing to lack of revenue in the general fund from which to pay such heavy expenditures. Such lack of revenue should have been foreseen years ago, and if the Capitol was to be built, an issue of bonds of a million dollars or more should have been authorized and duly provided with sinking funds whose requirements should be met by additional taxation annually.

GENERAL BALANCE SHEETS.

It is evident from our examination that the books of the "Auditors of Public Accounts," past and present, have never attempted to exhibit balance sheets containing all of the assets and all of the liabilities of the State of Kentucky as a whole. Such balance sheets properly designed and accurately drawn off each month would provide true statements whereby the Governor, the State officials and the members of the legislature could understand the actual financial condition of the State, and could then exercise real administrative control over the finances.

Nothing is more important, in our estimation, than the immediate installation in the Auditor's office of a complete controlling ledger in which all of the assets, the liabilities, the revenues and expenditures should be set up in comprehensive form, easily understood, from which; at the close

of each month, trial balances should be drawn off which will display automatically the true financial condition of the State, as a whole. Without such monthly statements, your officials must necessarily be in the dark as to the actual conditions of the funds. The deficiencies which may be accumulating in them each month cannot be foreseen by the financial officers, or, if known to these officers, will be unknown to all others.

In this connection we quote from a recent report of ours to the Governor and Auditor of another State, where the conditions are much the same as in Kentucky:—

“Our experience has taught us that in very few States in this country is there a system of controlling accounts, so segregated and classified and brought into one general ledger that balance sheets may be drawn off therefrom monthly or oftener, which will provide a complete and comprehensive view of the resources and liabilities of the State as a whole. Such a statement should give the assets of the State properly classified, and the contrasting liabilities, the funds and the appropriation balances separated in such a manner as to clearly show the actual financial condition of the State at the date of the schedule.”

“As already explained to you, we found no provisions for such a balance sheet in your office or elsewhere at your State Capitol. In our opinion, such a monthly statement is fundamentally necessary in order to provide the administrative officials of the State government, from the Governor down, with the necessary information which will enable them to keep in constant touch with the progress of the expenditures and the corresponding revenues, and with the condition of the available assets as against the corresponding liabilities. Without such a comprehensive and accurate statement, it is practically impossible to properly administer and control the finances of any State.

In our opinion, the means for providing such a statement should be immediately installed in your office."

"The Auditor should be the general accounting officer for the State. He should have on his books controlling accounts covering all of the transactions of the State and should be able to draw off at any time, from such a general ledger as we propose, an accurate statement of the financial condition of the State as a whole."

BALANCE SHEET OF NOVEMBER 30, 1909. (TABLE II.)

We have attached a schedule exhibiting a balance sheet as of November 30, 1909, which contains the liabilities of the General Expenditure Fund (including the balances due to the special funds); the assets available for paying these liabilities; and the deficiencies of these assets

The total assets as shown by this balance	
sheet amount to	\$3,033,523.37
The total liabilities as shown by the balance.	
sheet amount to	4,237,478.00
The deficiency of assets amounts to	\$1,203,954.37

DEFICIENCY OF JUNE 30, 1910.

This deficiency of assets represents the financial condition of the General Expenditure Fund as it will be at the end of the present fiscal year (June 30, 1910) provided the appropriations already made by the General Assembly shall have been expended, including the special appropriations of 1908, and provided also that the revenues collected during the balance of the fiscal year shall prove to be about the same in amount as the actual collections of the previous fiscal year (1908-09).

This deficiency, as of June 30, 1910, will be augmented by whatever additional appropriations are passed by the General Assembly of 1910 and expended prior to the end of

the fiscal year, unless new revenues are provided by the General Assembly.

This deficiency, \$1,204,000, which these figures exhibit as probable on June 30, 1910, is just about the amount which a common sense view of the condition of the finances would establish. For instance, the deficiency at the beginning of the present fiscal year, June 30, 1909, as stated by the Auditor's books was \$739,726.

Adding amount due to University Fund 2,980.

Total deficit in general fund \$742,706.

The loss during the year 1908-09, as shown by the Auditor's report page 252, was \$500,206.

The corresponding loss in 1907-08 was about \$257,000. If the loss in the current year be

taken at a reasonable estimate, say 450,000.

The total deficit on June 30, 1910, would be \$1,192,706.

This result is just about the same as the figures given in the balance sheet, namely, \$1,200,000, in round numbers, as the probable deficiency on June 30, 1910, excluding additional appropriations by the General Assembly and excluding any new revenue which may be provided similarly.

This amount of deficit is practically the same as the first two appropriations made for the building of the new Capitol, *viz.*:

First appropriations \$1,000,000.

Second appropriations 250,000.

Total of these \$1,250,000.

If proper provisions had been made by the General Assembly—new revenues, or issues of bonds, or otherwise—for the new Capitol, there would now be no deficit in the funds.

It is evident, therefore, that the whole trouble has arisen from the attempt to build the new Capitol out of ordinary revenues which were wholly inadequate for that purpose.

Even before the first money was expended upon the Capitol the general fund was behindhand. There was a deficit on June 30, 1904, as we have shown, amounting to about \$100,000, and the total expenditures since that date—for the five years—have amounted to over \$1,100,000 more than the revenues for that period.

There would appear to be no escape—in our opinion—from the necessity of a bond issue, which should be authorized by the General Assembly of 1910. These bonds should run, say, twenty years or more, and have sinking fund provisions; or, better, they should be serial bonds, payable one-twentieth annually from the taxes of each year.

With this amount of money in the treasury, the outstanding warrants could then be paid and brought down to a reasonable limit; the credit of the State would be re-established in the minds of its small creditors; the special funds would be rehabilitated and the deficit in the general expenditure fund would be sufficiently provided for.

Then, with due economy in new appropriations and with reasonable increase of the state revenues, there should be no recurrence of the present unfortunate condition of the finances.

It should be remembered that an issue of bonds of one million dollars will only provide for immediate necessities: will merely put the ship of state on an even keel, so to speak. There will be no portion of this issue available for new appropriations. All such new appropriations must be provided for from new revenues—increased tax rates or otherwise—by the General Assembly. Moreover, some increase of revenue will be absolutely necessary in order to provide for the sinking funds and the interest requirements for the new issue of bonds.

Very respectfully,

HARVEY S. CHASE & COMPANY,

Certified Public Accountants.

TABLE II.

STATE OF KENTUCKY.

GENERAL EXPENDITURE FUND.

Balance Sheet.

November 30, 1909.

<i>Assets.</i>	<i>Liabilities.</i>
ACCOUNTS RECEIVABLE:	APPROPRIATIONS for 1909—
Taxes 1909 uncollected, \$2,319,457.85	10 \$3,712,466.66
Other Receipts (estimated same as last year) uncollected . . 2,584,000.00	Less Expenditures to November 30 . . . 1,525,616.87
\$4,903,457.85	To be expended . . . \$2,186,849.79
Deduct 45% payable to the special funds (same % as last year) 2,206,807.85	SCHOOL FUND 341,647.88
Available for General Fund \$2,696,650.00	SINKING FUND 167,670.86
CASH IN TREASURY . . . 336,873.37	UNIVERSITY FUND 7,862.80
TOTAL ASSETS available against liabilities, contra \$3,033,523.37	APPROPRIATIONS, SPECIAL, 1908, unexpended . . . 381,666.87
	COMMISSIONS AND SALARIES to Sheriffs of 119 counties 213,647.92
	OUTSTANDING WARRANTS unpaid November 30. . . 938,131.88
	TOTAL LIABILITIES . \$4,237,478.00
DEFICIENCY OF ASSETS . 1,203,954.63	
Total \$4,237,478.00	Total \$4,237,478.00

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STATE OF KENTUCKY.

RECEIPTS AND EXPENDITURES OF EACH OF THE FOUR STATE FUNDS.

	1904-05.	1905-06.	1906-07.	1907-08.	1908-09.	Total. Five Years.
GENERAL EXPENDITURE FUND. Ordinary.						
Revenue Receipts of the year, per Auditor's books	\$2,993,816	\$3,110,107	\$3,528,816	\$3,675,819	\$3,754,076	\$17,062,634
Less: University Fund receipts	59,689	60,061	62,851	69,457	75,508	327,566
Revenue available for current expenses	\$2,934,127	\$3,050,046	\$3,465,965	\$3,606,362	\$3,678,568	\$16,735,068
Ordinary expenses of the year, paid	2,966,740	3,024,092	3,102,457	3,407,923	3,558,023	16,059,235
Surplus of Revenue over current expenses	\$32,613 D.	\$25,954	\$363,508	\$198,439	\$120,545	\$675,833
Extraordinary.						
Extraordinary Expenditures, buildings, Capitol, militia	34,885	130,116	573,551	451,107	619,834	1,809,493
Deficiency of Revenue on account of Extraordinary Expenditures	\$67,498	\$104,162	\$210,043	\$252,668	\$499,289	\$1,133,660
SCHOOL FUND.						
Revenue Receipts, including transfer from Sinking Fund	\$2,373,264	\$2,394,715	\$2,616,077	\$2,641,927	\$3,037,037	\$13,063,020
Expenditures, including interest on debts	2,210,530	2,413,505	2,462,795	2,629,101	2,813,015	12,528,946
Surplus of Revenue over Expenditure	\$162,734	\$18,790 D.	\$153,282	\$12,826	\$224,022	\$534,074
SINKING FUND.						
Revenue Receipts at 2c. tax	\$156,098	\$158,121	\$170,282	\$175,310	\$186,505	\$846,316
Expenditures, including transfers to other funds	160,095	149,695	149,695	175,266	148,838	783,589
Surplus of Revenue over Expenditure	\$3,997 D.	\$8,426	\$20,587	\$44	\$37,667	\$62,727
STATE UNIVERSITY FUND.						
Revenue Receipts from 1/2c. tax; from United States Government, etc.	\$68,334	\$68,706	\$71,496	\$78,101	\$84,153	\$370,790
Expenditures, including interest	67,646	68,472	65,127	82,612	85,069	368,926
Surplus of Revenue over Expenditure	\$688	\$234	\$6,369	\$4,511 D.	\$916 D.	\$1,864

D. Deficit.