Auditor of Public Accounts
Mike Harmon

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Contact: Michael Goins
Michael.Goins@ky.gov
502.564.5841
502.209.2867

Harmon Releases Audit of Grant County Fiscal Court

FRANKFORT, Ky. – State Auditor Mike Harmon has released the audit of the financial statement of the Grant County Fiscal Court for the fiscal year ended June 30, 2016. State law requires annual audits of county fiscal courts.

Auditing standards require the auditor's letter to communicate whether the financial statement presents fairly the receipts, disbursements, and changes in fund balances of the Grant County Fiscal Court in accordance with accounting principles generally accepted in the United States of America. The fiscal court's financial statement did not follow this format. However, the fiscal court's financial statement is fairly presented in conformity with the regulatory basis of accounting, which is an acceptable reporting methodology. This reporting methodology is followed for 115 of 120 fiscal court audits in Kentucky.

As part of the audit process, the auditor must comment on noncompliance with laws, regulations, contracts, and grants. The auditor must also comment on material weaknesses involving internal control over financial operations and reporting.

The audit contains the following comments:

The Grant County Fiscal Court materially misstated the Public Properties Corporation (PPC) debt on the liabilities section of the quarterly report: The Grant County Fiscal Court has PPC debt for the judicial center. This debt was materially misstated on the liabilities section of the quarterly report. The principal ending balance was understated by $565,000 and the interest ending balance was overstated by $1,197,838.

The amounts reported were from an old amortization schedule. During Fiscal Year 2016, the Administrative Office of the Courts established a revenue refunding bond with a portion of the original debt. This created two loans, but the debt schedule change was not reflected on the county's report.

By not accurately reporting debt, the county is not in compliance with KRS 68.210. In addition, the county is not providing a complete overview of their outstanding debt.

According to the Department for Local Government's (DLG) *County Budget Preparation and State Local Finance Officer Policy Manual*, all county money is to be reported on the financial statement whether it is included in the budget or not. Documentation of the county's liabilities must be submitted to the State Local Finance Officer.

We recommend the county ensure accuracy when reporting the county's liabilities on the fourth quarter report submitted to DLG.

County Judge Executive's Response: The debt was reported as one liability, but going forward it will be reported separate.

The Grant County Fiscal Court's master capital assets listing was materially misstated: The county did not maintain an accurate capital asset listing. Our review of the fiscal court minutes and the county's disbursements ledger disclosed $1,280,863 of capital asset purchases during Fiscal Year 2016 that were not included on the county's capital asset listing. In addition, $314,052 of prior year deletions and $216,415 of prior year additions were not accounted for on the County's Master Capital Asset Listing.

The county did not have proper controls in place to ensure that the capital asset listing was updated as required. The county updated an older version of the capital asset listing that did not include additions or deletions from the prior fiscal year. This resulted in the capital asset listing being materially misstated. Furthermore, the risk of undetected misappropriation of assets increases with material misstatements.

Capital asset records are necessary for proper asset valuation, adequate and accurate insurance coverage, internal control, and long range planning for property replacement. Strong controls reduce the risk of asset misappropriation.

In order to strengthen the county's internal controls over capital assets, we recommend the county establish a detailed inventory system. This system should include a detailed description of the asset, an inventory control number or serial number, the date acquired, location, date destroyed or sold as surplus, and a brief description as to why the asset was discarded. The inventory of county assets should be updated as new assets are purchased or sold. We also recommend the county reconcile asset purchases and disposals with the disbursements ledger and receipts ledger. The county should also conduct a physical inspection of county assets at the end of each year and make comparisons to the county's list of inventoried assets and insurance policy.

County Judge Executive's Response: The county will maintain a detailed list of all Capital Assets and conduct a physical inspection of county assets annually and compare that to the list of inventoried assets and insurance policy.

The Grant County Fiscal Court did not prepare a balanced budget: The Grant County Fiscal Court's Fiscal Year 2016 budget submitted to the Department for Local Government (DLG) did not balance in accordance with KRS 68.220. The general fund budgeted disbursements were $209,652 more than the budgeted receipts, road fund budgeted disbursements were $223,710 less than the budgeted receipts, jail fund budgeted disbursements were $6,048 more than budgeted receipts, and Local Government Economic Assistance (LGEA) fund budgeted disbursements were $8,000 more than the budgeted receipts.

The Grant County Fiscal Court did not have adequate management oversight to detect errors and omissions.

This could result in a noncompliance with KRS 68.300, which states, "[a]ny appropriation made or claim allowed by the fiscal court in excess of any budget fund, and any warrant or contract not within the budget appropriation, shall be void. No member of the fiscal court shall vote for any such illegal appropriation or claim. The county treasurer shall be liable on his official bond for the amount of any county warrant willfully or negligently signed or countersigned by him in excess of the budget fund out of which the warrant is payable." When a county fails to establish a balanced budget, this could result in funds being spent that are not available, leading to financial strains on the county due to the lack of funds to cover necessary expenditures. See finding 2016-004.

Per KRS 68.220, "[t]he county budget shall provide for all the funds to be expended by the county from current revenue for each fiscal year." In summary, the disbursements estimated for the county should not exceed the estimated receipts the county expects to receive for that fiscal year and should balance by fund.

We recommend the county strengthen management oversight with regard to the budgeting process to ensure a balanced and accurate budget is provided to DLG.

County Judge Executive's Response: The county has since placed responsible individuals in place to review any oversight that may have occurred in the past to ensure a balanced and accurate budget is provided to DLG.

The Grant County Fiscal Court had inadequate internal controls over disbursements and was not compliant with various statutes: The auditor noted the following issues when testing disbursements:

- Three disbursements did not have adequate supporting documentation for credit card transactions. Receipts are not required for credit cards used for gas purchases to ensure the billing statement's accuracy. Meal purchases on credit cards did not provide detail of the purchases, only showing the total of the meal with tip.
- Three instances where the fiscal court did not retain the state price contract information for their files for items purchased using the state price contract.
- Two instances where disbursements could not be verified because the check image was not available and could not be retrieved by the treasurer.

- Three disbursements were not able to be agreed to the claims list as there was no claims list in the fiscal court order book. The auditor was unable to ensure these were approved by the fiscal court.
- Three instances where disbursements were not paid within 30 days as required by statute.
- Fifty-two instances where the county did not adhere to purchase order guidance per the Department for Local Government's (DLG) *County Budget Preparation and State Local Finance Officer Policy Manual.* Purchase orders were not issued for utilities, payroll, and other disbursements covered under the standing order. There were instances where one purchase order was issued for a vendor and the same number was used for all purchases made with that vendor for the entire fiscal year. Purchase orders were not used in sequence as there was more than one person issuing and they would be logged when the finance officer would receive them. Credit card purchases were made by various departments without confirming that the funds were available.
- There were negative balances on the purchase order log, indicating that purchases were made without adequate appropriations.

The fiscal court lacks strong internal controls and oversight with regard to the purchase order process and fails to follow the procedures as established by DLG.

The lax internal controls and oversight led to three disbursement accounts having a negative balance at year end, meaning that funds were spent from the line item that were not available per the appropriations ledger. Numerous account codes had a negative balance at some point during the fiscal year. This is neither compliant with purchasing requirements for counties, nor an effective implementation of internal controls. Management is unable to determine where potential issues with spending are before the expense is already incurred, creating the opportunity for waste, fraud, and abuse. This could lead to financial strain on the county due to overspending and lack of funds to cover necessary expenses of the county.

KRS 68.210 requires the State Local Finance Officer to create a system of uniform accounts for all counties and county officials. The *County Budget Preparation and State Local Finance Officer Policy Manual* outlines requirements for handling of public funds, including required purchasing procedures for counties. These requirements prescribe that, "[p]urchase requests shall not be approved in an amount that exceeds the available line item appropriation unless the necessary and appropriate transfers have been made."

Good internal controls for purchase requests exceeding budget appropriations would lead to discussion with both the county treasurer and county judge/executive as to whether the purchase order will be issued, the necessity and appropriateness of a budget transfer to cover the expense, and if other issues need to be addressed related to spending. Purchase orders should be issued for all goods and services utilized by the fiscal court.

The Department for Local Government (DLG) issued a memorandum on August 4, 2016, in which it "highly recommends" implementation of issuing purchase orders for payroll and utilities. This control allows the fiscal court to ensure that sufficient budget allocation is available for all expenses.

Per KRS 68.300, "[a]ny appropriation made or claim allowed by the fiscal court in excess of any budget fund, and any warrant or contract not within the budget appropriation, shall be void. No member of the fiscal court shall vote for any such illegal appropriation or claim. The county treasurer shall be liable on his official bond for the amount of any county warrant willfully or negligently signed or countersigned by him in excess of the budget fund out of which the warrant is payable." See finding 2016-003.

Finally, KRS 65.140(2) states, "[u]nless the purchaser and vendor otherwise contract, all bills for goods and services shall be paid within thirty (30) working days of receipt of a vendor's invoice except when payment is delayed because the purchaser has made a written disapproval of improper performances or improper invoicing by the vendor or by the vendor's subcontractor." Without invoices with adequate information, there is not proper justification for the disbursement.

We recommend the fiscal court work to ensure they adhere with DLG's requirements and guidance for the purchase order procedures per the *County Budget Preparation and State Local Finance Officer Policy Manual.* Furthermore, we recommend the county strengthen controls over the disbursements process to ensure compliance with applicable statutes and to provide better oversight to ensure funds are available prior to issuing purchase orders.

County Judge Executive's Response: Going forward the fiscal court will work to ensure they adhere with DLG's requirements and guidance for the purchase order procedures.

The Grant County Detention Center does not have adequate controls over disbursements for the Jail Commissary and Inmate Trust Funds: During our testing of 30 jail disbursements, we noted the following issues:

- Six invoices totaling $24,027 had no supporting documentation.
- Three transactions to inmates for closeout did not have inmate or employee signatures.

The Grant County Detention Center did not comply with the State Local Finance Officer *County Budget Preparation and State Local Finance Officer Policy Manual* due to poorly designed policies and procedures, inconsistent, incomplete, and inaccurate implementation of controls, and lack of management oversight/involvement.

The cumulative effect of these control weaknesses increases the risk of material misstatement caused by error or fraud. This risk results in the need to alert management of the necessity to improve controls over the financial activities of the office.

Good internal controls dictate that proper controls be in place to eliminate errors in recordkeeping. Without adequate oversight, undetected errors and omissions can lead to inaccurate financial reporting.

We recommend that all disbursements be adequately documented and supported. All inmate release reports should be signed by the inmate and an employee.

County Jailer's Response: We will be in compliance; we have a deposit book for each account here at the Detention center that backs any money deposited into the commissary and trust as well as any funds that have been disbursed to the fiscal court or any other entity that we may utilize. The trust checks are not always signed by the inmates because they are usually sent to another detention center or the inmate would like them mailed. Anything we give to the fiscal court will now have sufficient backing and signed for by them as a receipt they received it from the commissary account going forward. After numerous of audits, I was told with separate deposit books and receipt books, that was adequate control for questions that may arise.

Auditor's Reply: This finding addresses deficiencies with the disbursements from the canteen account, not deposits and receipts into the canteen account. When testing disbursements from the jail canteen account, six checks were written from the canteen account that did not have supporting documentation for the disbursement amount. Every disbursement should have an invoice or other supporting documentation to verify that the disbursement amount is accurate.

The Grant County Detention Center lacks oversight and evidence of supervisory reviews: As reported in the prior year audit, auditors could find no evidence the jailer, or a designated employee, is reviewing key functions and activities of the Grant County Detention Center (e.g. bank reconciliations, ledgers, daily checkouts, deposits, etc.). These functions include commissary transactions that are handled by a third party vendor, including inmate purchase history reports, and produce financial data for the jail. These transactions are performed by a third party vendor and there is little oversight or review performed by the jailer. According to the jailer, information available to the jailer regarding inmate accounts is limited.

This condition is a result of a lack of management oversight and a lack of adequate documentation of supervisory reviews. According to the jailer, this is also a result of utilizing a vendor that is unable to provide the detail needed for account reconciliations and oversight.

A lack of proper accounting practices and internal controls increases the risk of undetected misstatements of financial activity and fraud. The failure to maintain accurate, detailed reports could result in an inaccurate picture of the activities within the jailer's accounts and increased risk of misstatements or omissions.

Management has a responsibility to design and implement internal controls that provide reasonable assurance regarding the reliability of financial reporting. Good internal controls further dictate that all decreases in inmate account balances are reviewed and signed by the inmate, and all supporting documentation is maintained.

In order to provide a reasonable assurance that assets are safeguarded and transactions are processed in accordance with applicable laws and regulations, we recommend the jailer implement sufficient supervisory reviews of key functions and activities. If he designates a manager to perform these reviews, he should ensure the employee understands their role in the supervisory process. All supervisory reviews should be evidenced in writing.

County Jailer's Response: Jailer Hankins does look over things here at the Detention center and will initial and proceed as your recommendation after speaking with you all in regards to this *matter, we will also get with the commissary and medical companies to assure all backing is there for supporting documentation.*

The Grant County Fiscal Court lacked adequate internal controls and oversight over processing of payroll: Lax internal controls and oversight led to the following payroll issues:

- Timesheets were pulled from December 14, 2015 through April 30, 2016 for an employee of the county. The timesheets showed the use of sick and vacation for 5.5 weeks, timesheet noted "worked in hospital" for 6 weeks, and "office" for another 5.5 weeks. There were only two days where actual hours were noted to show how much actual time was worked during this 4.5 months reviewed. Auditor also noted that hours were maintained and documented for this same employee in July 2015, indicating that prior to this situation hours were documented.
- Documentation for leave accumulation and balance was not available for the employee's timesheets above. The auditor was unable to determine if the employee had accumulated leave time for the timesheets documented and if there was leave time accumulated during this time period.
- Four instances were noted where timesheets did not have the supervisor's signature of approval and review prior to payment.
- Flexible spending and health reimbursement benefits were not accurately reported by the third-party administrator. All funds were showing as flexible spending when they were health reimbursement. Some participants had administrative fees deducted from their election amount while others did not. The fee was deducted for those accounts set up as a flexible spending account. Some funds were shown as employee deposits but were actually employer deposits.
- Payroll deduction authorization forms were not maintained in employee files for the portion of the cell phone bills that were covered by employees through deduction from their pay.
- Auditor was informed that some employees were considered exempt and did not receive overtime pay. Auditor was unable to find documentation that these employees met the criteria for an exempt employee.

The fiscal court lacked strong internal controls and oversight over the processing of payroll. Review procedures were in place, however, they were not adequately performed to eliminate or reduce errors. This is neither compliant with payroll requirements for counties, nor an effective implementation of internal control. The cause appears to be a lack of strong internal controls and oversight over the payroll process.

Management is unable to ensure employees are accurately reporting hours, using leave appropriately, and ensuring payroll expenses were actually incurred, creating the opportunity for waste, fraud, or abuse. This could lead to financial strains on the county due to erroneous payment for hours not worked and for lawsuits that could derive from failure to ensure accurate time is reported.

KRS 337.320(1) states "[e]very employer shall keep a record of: (a) [t]he amount paid each pay period to each employee; (b) [t]he hours worked each day and each week by each employee; and

(c) [s]uch other information as the commissioner requires." KRS 337.320(2) states, "[s]uch records shall be kept on file for at least one (1) year after entry. They shall be open to the inspection. . .at any reasonable time, and every employer shall furnish to the commissioner or the commissioner's authorized representative on demand a sworn statement of them."

Guidance by 803 KAR 1:070 defines what constitutes an individual employed in an executive, administrative, or supervisory position. This guidance will assist in determining if an employee is eligible for exemption.

Good internal controls dictate that adequate oversight and strong internal controls are essential for ensuring that payroll disbursements are properly reported and accounted for. These controls will assist in making sure that the county is compliant with applicable regulations, to protect the county from fraud or abuse, and to ensure employees are accurately compensated.

We recommend the county strengthen controls over the payroll process to ensure compliance with applicable statutes and to provide better oversight to ensure accuracy in payroll disbursements. All employees should be required to submit timesheets detailing hours worked per day, and appropriate review and approval should be documented. Furthermore, we recommend the county ensure all authorization forms are completed and maintained on file to support deductions authorized by the employees.

County Judge Executive's Response: The county will strengthen controls over payroll process making sure all employees have submitted timesheets detailing hours worked per day. Also retain all authorization forms on file to support deductions authorized by the employee.

The audit report can be found on the auditor's website.

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