

**REPORT OF THE AUDIT OF THE
KNOX COUNTY
SHERIFF**

**For The Year Ended
December 31, 2016**



**MIKE HARMON
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MIKE HARMON
AUDITOR OF PUBLIC ACCOUNTS

The Honorable J.M. Hall, Knox County Judge/Executive
The Honorable Mike Smith, Knox County Sheriff
Members of the Knox County Fiscal Court

Independent Auditor's Report

Report on the Financial Statement

We have audited the accompanying Statement of Receipts, Disbursements, and Excess Fees - Regulatory Basis of the Sheriff of Knox County, Kentucky, for the year ended December 31, 2016, and the related notes to the financial statement.

Management's Responsibility for the Financial Statement

Management is responsible for the preparation and fair presentation of the financial statement in accordance with accounting practices prescribed or permitted by the laws of Kentucky to demonstrate compliance with the Commonwealth of Kentucky's regulatory basis of accounting and budget laws. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statement that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the financial statement based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and the *Audit Guide for County Fee Officials* issued by the Auditor of Public Accounts, Commonwealth of Kentucky. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statement is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statement. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statement, 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 statement 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 statement.

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



The Honorable J.M. Hall, Knox County Judge/Executive
 The Honorable Mike Smith, Knox County Sheriff
 Members of the Knox County Fiscal Court

Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles

As described in Note 1 of the financial statement, the financial statement is prepared by the Knox County Sheriff on the basis of the accounting practices prescribed or permitted by the laws of Kentucky to demonstrate compliance with the Commonwealth of Kentucky's regulatory basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America.

The effects on the financial statement of the variances between the regulatory basis of accounting described in Note 1 and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

Adverse Opinion on U.S. Generally Accepted Accounting Principles

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles paragraph, the financial statement referred to above does not present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position of each fund of the Knox County Sheriff, as of December 31, 2016, or changes in financial position or cash flows thereof for the year then ended.

Opinion on Regulatory Basis of Accounting

In our opinion, the financial statement referred to above presents fairly, in all material respects, the receipts, disbursements, and excess fees of the Knox County Sheriff for the year ended December 31, 2016, in accordance with the basis of accounting practices prescribed or permitted by the Commonwealth of Kentucky as described in Note 1.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated July 21, 2017, on our consideration of the Knox County Sheriff's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is solely 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 the internal control over financial reporting 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 over financial reporting and compliance.

Based on the results of our audit, we have presented the accompanying Schedule of Findings and Responses, included herein, which discusses the following report comments:

- 2016-001 The Sheriff's Receipts And Disbursements Ledgers Did Not Agree To His Annual Settlement Or To The Bank Records
- 2016-002 The Sheriff Did Not Segregate Accounting Duties

Respectfully submitted,



Mike Harmon
 Auditor of Public Accounts

July 21, 2017

KNOX COUNTY
MIKE SMITH, SHERIFF
STATEMENT OF RECEIPTS, DISBURSEMENTS, AND EXCESS FEES - REGULATORY BASIS

For The Year Ended December 31, 2016

Receipts

Federal Grants:

Unlawful Narcotics Investigation, Treatment & Education, Inc. (UNITE)	\$	14,863
United States Department of Agriculture (USDA)		44,390

State:

Kentucky Law Enforcement Foundation Program Fund (KLEFPF)		28,506
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State Fees For Services:

Finance and Administration Cabinet	\$	29,234
Sheriff Security Service		43,016
		13,782

Circuit Court Clerk:

Fines and Fees Collected		2,353
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Fiscal Court:

Contributions	283,727	
Matching Funds for USDA Grant	14,805	298,532

County Clerk - Delinquent Taxes

34,985

County Attorney

1,406

Commission On Taxes Collected

395,527

Fees Collected For Services:

Auto Inspections	27,005	
Accident and Police Reports	1,652	
Serving Papers	33,663	
Carrying Concealed Deadly Weapon Permits	11,780	
Transports	1,260	75,360

Other:

Add-On Fees	60,363	
Election Commission	1,000	
Miscellaneous	2,270	63,633

Interest Earned

822

The accompanying notes are an integral part of this financial statement.

KNOX COUNTY
MIKE SMITH, SHERIFF
STATEMENT OF RECEIPTS, DISBURSEMENTS, AND EXCESS FEES - REGULATORY BASIS
For The Year Ended December 31, 2016
(Continued)

Receipts (Continued)

Borrowed Money:		
State Advancement		<u>\$ 100,000</u>
Total Receipts		1,103,393

Disbursements

Operating Disbursements and Capital Outlay:

Personnel Services-		
Deputies' Salaries	\$ 309,135	
Other Salaries	104,007	
Overtime	32,337	
Employee Benefits-		
Employer's Share Social Security	39,044	
Employer's Share Retirement	81,269	
Employer Paid Health Insurance	111,493	
Employer's Unemployment - KACO	8,530	
Contracted Services-		
Advertising	124	
Office Support & Repair	6,737	
Accounting Services	1,500	
Materials and Supplies-		
Office Materials and Supplies	4,705	
Uniforms	1,975	
Auto Expense-		
Gasoline	44,170	
Maintenance and Repairs	19,013	
Other Charges-		
Bonds	1,476	
Conventions and Travel	885	
Dues	181	
Postage	11,175	
Utilities	11,909	
Miscellaneous	1,332	
Capital Outlay-		
Office Equipment	495	
Vehicles	<u>88,429</u>	\$ 879,921

The accompanying notes are an integral part of this financial statement.

KNOX COUNTY
MIKE SMITH, SHERIFF
STATEMENT OF RECEIPTS, DISBURSEMENTS, AND EXCESS FEES - REGULATORY BASIS
For The Year Ended December 31, 2016
(Continued)

Disbursements (Continued)

Debt Service:	
State Advancement	<u>\$ 100,000</u>
Total Disbursements	<u>\$ 979,921</u>
Net Receipts	123,472
Less: Statutory Maximum	<u>89,310</u>
Excess Fees	34,162
Less: Training Incentive Benefit	<u>1,984</u>
Excess Fees Due County for 2016	32,178
Payment to Fiscal Court - December 9, 2016	232
Payment to Fiscal Court - March 15, 2017	<u>31,946</u>
Balance Due Fiscal Court at Completion of Audit	<u><u>\$ 0</u></u>

The accompanying notes are an integral part of this financial statement.

KNOX COUNTY
NOTES TO FINANCIAL STATEMENT

December 31, 2016

Note 1. Summary of Significant Accounting Policies

A. Fund Accounting

A fee official uses a fund to report on the results of operations. A fund is a separate accounting entity with a self-balancing set of accounts. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities.

A fee official uses a fund for fees to account for activities for which the government desires periodic determination of the excess of receipts over disbursements to facilitate management control, accountability, and compliance with laws.

B. Basis of Accounting

KRS 64.820 directs the fiscal court to collect any amount, including excess fees, due from the sheriff as determined by the audit. KRS 134.192 requires the sheriff to settle excess fees with the fiscal court at the time he files his annual settlement with the fiscal court on or before September 1 of each year. KRS 64.830 requires an outgoing sheriff to settle excess fees with the fiscal court of his county by March 15 immediately following the expiration of his term of office.

The financial statement has been prepared on a regulatory basis of accounting, which demonstrates compliance with the laws of Kentucky and is a special purpose framework. Under this regulatory basis of accounting, receipts and disbursements are generally recognized when cash is received or disbursed, with the exception of accrual of the following items (not all-inclusive) at December 31 that may be included in the excess fees calculation:

- Interest receivable
- Collection on accounts due from others for 2016 services
- Reimbursements for 2016 activities
- Tax commissions due from December tax collections
- Payments due other governmental entities for payroll
- Payments due vendors for goods or services provided in 2016

The measurement focus of a fee official is upon excess fees. Remittance of excess fees is due to the county treasurer in the subsequent year.

C. Cash and Investments

KRS 66.480 authorizes the sheriff's office to invest in obligations of the United States and of its agencies and instrumentalities, obligations and contracts for future delivery or purchase of obligations backed by the full faith and credit of the United States, obligations of any corporation of the United States government, bonds or certificates of indebtedness of this state, and 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 (FDIC) or which are collateralized, to the extent uninsured, by any obligation permitted by KRS 41.240(4).

KNOX COUNTY
NOTES TO FINANCIAL STATEMENT
December 31, 2016
(Continued)

Note 2. Employee Retirement System and Other Post-Employment Benefits

The county official and employees have elected to participate, pursuant to KRS 78.530, in the County Employees Retirement System (CERS), which is administered by the Board of Trustees of the Kentucky Retirement Systems (KRS). This is a cost-sharing, multiple-employer, defined benefit pension plan, which covers all eligible full-time employees and provides for retirement, disability, and death benefits to plan members. Benefit contributions and provisions are established by statute.

The sheriff's contribution for calendar year 2014 was \$84,171, calendar year 2015 was \$81,703, and calendar year 2016 was \$81,269.

Nonhazardous

Nonhazardous covered employees are required to contribute five percent of their salary to the plan. Nonhazardous covered employees who begin participation on or after September 1, 2008, are required to contribute six percent of their salary to be allocated as follows: five percent will go to the member's account and one percent will go to the KRS insurance fund.

In accordance with Senate Bill 2, signed by the Governor on April 4, 2013, plan members who began participating on, or after, January 1, 2014, were required to contribute to the Cash Balance Plan. The Cash Balance Plan is known as a hybrid plan because it has characteristics of both a defined benefit plan and a defined contribution plan. Members in the plan contribute a set percentage of their salary each month to their own accounts. Nonhazardous covered employees contribute five percent of their annual creditable compensation. Nonhazardous members also contribute one percent to the health insurance fund which is not credited to the member's account and is not refundable. The employer contribution rate is set annually by the Board based on an actuarial valuation. The employer contributes a set percentage of the member's salary. Each month, when employer contributions are received, an employer pay credit is deposited to the member's account. A member's account is credited with a four percent employer pay credit. The employer pay credit represents a portion of the employer contribution.

Benefits fully vest on reaching five years of service for nonhazardous employees. Aspects of benefits for nonhazardous employees include retirement after 27 years of service or age 65. Nonhazardous employees who begin participation on or after September 1, 2008, must meet the rule of 87 (member's age plus years of service credit must equal 87, and the member must be a minimum of 57 years of age) or the member is age 65, with a minimum of 60 months service credit.

The county's contribution rate for nonhazardous employees was 17.06 percent for the first six months and 18.68 percent for the last six months.

Health Insurance Coverage

CERS also provides post-retirement health care coverage as follows:

For members participating prior to July 1, 2003, years of service and respective percentages of the maximum contribution are as follows:

KNOX COUNTY
 NOTES TO FINANCIAL STATEMENT
 December 31, 2016
 (Continued)

Note 2. Employee Retirement System and Other Post-Employment Benefits (Continued)

Health Insurance Coverage (Continued)

Years of Service	% Paid by Insurance Fund	% Paid by Member through Payroll Deduction
20 or more	100%	0%
15-19	75%	25%
10-14	50%	50%
4-9	25%	75%
Less than 4	0%	100%

As a result of House Bill 290 (2004 General Assembly), medical insurance benefits are calculated differently for members who began participation on or after July 1, 2003. Once members reach a minimum vesting period of ten years, non-hazardous employees whose participation began on or after July 1, 2003, earn ten dollars per month for insurance benefits at retirement for every year of earned service without regard to a maximum dollar amount. This dollar amount is subject to adjustment annually based on the retiree cost of living adjustment, which is updated annually due to changes in the Consumer Price Index.

KRS issues a publicly available annual financial report that includes financial statements and required supplementary information on CERS. This report may be obtained by writing the Kentucky Retirement Systems, 1260 Louisville Road, Frankfort, KY 40601-6124, or by telephone at (502) 564-4646.

Note 3. Deposits

The Knox County Sheriff maintained deposits of public funds with depository institutions insured by the Federal Deposit Insurance Corporation (FDIC) as required by KRS 66.480(1)(d). According to KRS 41.240, the depository institution should pledge or provide sufficient collateral which, together with FDIC insurance, equals or exceeds the amount of public funds on deposit at all times. In order to be valid against the FDIC in the event of failure or insolvency of the depository institution, this pledge or provision of collateral should be evidenced by an agreement between the sheriff and the depository institution, signed by both parties, that is (a) in writing, (b) approved by the board of directors of the depository institution or its loan committee, which approval must be reflected in the minutes of the board or committee, and (c) an official record of the depository institution.

Custodial Credit Risk - Deposits

Custodial credit risk is the risk that in the event of a depository institution failure, the sheriff's deposits may not be returned. The Knox County Sheriff does not have a deposit policy for custodial credit risk but rather follows the requirements of KRS 66.480(1)(d) and KRS 41.240. As of December 31, 2016, all deposits were covered by FDIC insurance or a properly executed collateral security agreement.

Note 4. Cash Drawer

The Knox County Sheriff maintains \$800 for making change to customers. This money was supplied by the Knox County Fiscal Court at the beginning of this term in January 2015 and will be returned to the fiscal court at the end of the sheriff's term in office.

KNOX COUNTY
NOTES TO FINANCIAL STATEMENT
December 31, 2016
(Continued)

Note 5. Drug Confiscation Funds

On January 5, 2015, the sheriff established a separate account for drug funds received from the former sheriff. The balance as of January 1, 2016 was \$13,527. During calendar year 2016, the sheriff received deposits totaling \$8,509, of which \$9 was accrued interest, and the sheriff expended \$18,932. The balance as of December 31, 2016 was \$3,104.

Note 6. Federal Grants

- A. The Knox County Sheriff's office received an UNITE grant from the Unlawful Narcotics Investigation, Treatment, and Education, Inc. in the amount of \$14,863 as reimbursement for the amount paid to one law enforcement officer to serve as the UNITE intelligence analyst. The grant began on October 1, 2015, and continues to June 30, 2017.
- B. The Knox County Sheriff's office received an equipment grant from the United States Department of Agriculture in the amount of \$44,390. The Knox County Fiscal Court agreed to contribute matching funds of \$14,805, and the account accrued \$4 of interest. Funds totaling \$59,199 were expended during the year. The unexpended grant balance was \$0 as of December 31, 2016.

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



MIKE HARMON
AUDITOR OF PUBLIC ACCOUNTS

The Honorable J.M. Hall, Knox County Judge/Executive
The Honorable Mike Smith, Knox County Sheriff
Members of the Knox County Fiscal Court

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

Independent Auditor's Report

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 Statement of Receipts, Disbursements, and Excess Fees - Regulatory Basis of the Knox County Sheriff for the year ended December 31, 2016, and the related notes to the financial statement and have issued our report thereon dated July 21, 2017. The Knox County Sheriff's financial statement is prepared on a regulatory basis of accounting, which demonstrates compliance with the Commonwealth of Kentucky's regulatory basis of accounting and budget laws, which is a basis of accounting other than accounting principles generally accepted in the United States of America.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statement, we considered the Knox County Sheriff'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 statement, but not for the purpose of expressing an opinion on the effectiveness of the Knox County Sheriff's internal control. Accordingly, we do not express an opinion on the effectiveness of the Knox County Sheriff'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 weaknesses 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 Responses, we identified a certain deficiency in internal control that we consider to be a material weakness.

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 statement will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described in the accompanying Schedule of Findings and Responses as item 2016-002 to be a material weakness.



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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Knox County Sheriff's financial statement is 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 Responses as item 2016-001.

Views of Responsible Official and Planned Corrective Action

The Knox County Sheriff's views and planned corrective action to the findings identified in our audit are described in the accompanying Schedule of Findings and Responses. The sheriff's responses were not subjected to the auditing procedures applied in the audit of the financial statement and, accordingly, we express no opinion on them.

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,

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

July 21, 2017

SCHEDULE OF FINDINGS AND RESPONSES

KNOX COUNTY
MIKE SMITH, SHERIFF
SCHEDULE OF FINDINGS AND RESPONSES

For The Year Ended December 31, 2016

STATE LAWS AND REGULATIONS:

2016-001 The Sheriff's Receipts And Disbursements Ledgers Did Not Agree To His Annual Settlement Or To The Bank Records

The sheriff's computerized receipts and disbursements ledgers did not agree to the fourth quarter report/annual settlement submitted to the Department for Local Government (DLG) and to the fiscal court. The sheriff's ledgers showed receipts of \$1,062,844, disbursements of \$1,058,474, and excess fees of \$4,371. The settlement submitted showed receipts of \$1,021,306, disbursements of \$1,029,141, with a deficit of \$7,835. In addition, neither the computerized ledgers nor annual settlement agreed to the bank records because the bank showed a balance of \$31,946 (submitted to the fiscal court on March 15, 2017).

The accounting software was not set up properly, which caused tax liabilities to be duplicated and the 2016 receivables not to be posted. The amount of revenues and expenses reported to the regulating bodies and to the public were not accurate. Inaccurate reporting results in lack of government transparency and may lead to further errors.

KRS 68.210 gives the State Local Finance Officer the authority to require a uniform system of accounts. And KRS 43.075(3) states "an audit shall determine whether the fiscal court or county official is complying with the requirements of the uniform system of accounts adopted under KRS 68.210, whether there is accurate recording of receipts by source and expenditures by payee[.]"

We recommend the sheriff comply with KRS 68.210 by ensuring his quarterly reports and annual financial statement agree to his receipts and disbursements ledgers.

Sheriff's Response: Due to a computer glitch with Quick Books Software the profit and loss report did not match bank reconciliation. CPA was consulted to correct the problem with Quick Book set up. All reports now match bank reconciliation and have been submitted to fiscal court.

INTERNAL CONTROL - MATERIAL WEAKNESS:

2016-002 The Sheriff Did Not Segregate Accounting Duties

The sheriff's office manager collects payments from customers, prepares bank deposits, issues checks and posts to the receipts and disbursements ledgers. The sheriff's part-time bookkeeper prepares bank reconciliations, prepares payroll and occasionally collects payments from customers. Front line office personnel prepare their own deposits but the office manager takes them to the bank. Neither the office manager nor the part-time bookkeeper are authorized check signers, but both are responsible for preparing monthly and quarterly reports. The sheriff or another employee did not provide oversight of any of these activities.

This condition is the result of a limited budget which restricts the number of employees the sheriff can hire or delegate duties to. The lack of oversight resulted in inaccurate financial reporting to the Department for Local Government and to the Knox County Fiscal Court.

Proper segregation of duties over various accounting functions such as opening mail, preparing deposits, recording receipts and disbursements, and preparing monthly reports, or the implementation of compensating controls, is essential for providing protection from asset misappropriation and inaccurate financial reporting. Additionally, proper segregation of duties protects employees in the normal course of performing their daily responsibilities.

KNOX COUNTY
MIKE SMITH, SHERIFF
SCHEDULE OF FINDINGS AND RESPONSES
For The Year Ended December 31, 2016
(Continued)

INTERNAL CONTROL - MATERIAL WEAKNESS: (Continued)

2016-002 The Sheriff Did Not Segregate Accounting Duties (Continued)

We recommend the sheriff further separate the duties involved in receiving cash, posting to ledgers, and preparing reports. If this is not feasible due to a limited budget, cross checking procedures should be implemented and documented by the individual performing the procedure. For example, the sheriff could instruct a person independent of receipts posting and bank reconciliation to compare bank deposit ticket to daily checkouts and show evidence of this review by initialing the deposit ticket and the daily checkout. Additionally, the sheriff or someone independent of report preparation could compare the monthly and quarterly reports to the supporting documentation to ensure accuracy and show evidence of review by initialing the documents reviewed.

Sheriff's Response: Due to budget constraints, additional administrative personnel are unable to be hired to assume accounting duties.

Auditor Reply: The sheriff should implement compensating controls using existing personnel as suggested.

