



Auditor of Public Accounts
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FOR IMMEDIATE RELEASE

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Harmon Releases Audit of Magoffin County Fiscal Court

FRANKFORT, Ky. – State Auditor Mike Harmon has released the audit of the financial statement of the Magoffin County Fiscal Court for the fiscal year ended June 30, 2018. 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 Magoffin 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 fiscal court’s administrative code does not address commuting mileage or the personal use of vehicles owned by the fiscal court: This is a repeat finding and was included in the prior year audit report as Finding 2017-002. Internal Revenue Service (IRS) Code Section 61(a) states that the commuting value of a vehicle owned or leased by a public entity represents taxable income to the employee. The fiscal court’s administrative code should address the use of vehicles and other assets owned by the fiscal court.

Fiscal court employees’ personal use (e.g. commuting mileage) of county vehicles or other assets owned by the fiscal court is not reported as compensation to the employees. The fiscal court’s administrative code does not address the use of vehicles or other assets owned by the fiscal court;

therefore, it is unclear as to whether personal use of the vehicles and other assets are authorized by the fiscal court. Personal use of public resources is permitted if the fiscal court has approved such use and should be reported as compensation to employees. Historically, the fiscal court has not maintained the appropriate documentation or complied with IRS Code Section 61(a).

The fiscal court understands the recommendations, but as of June 30, 2018, has not implemented the recommendations.

We recommend the fiscal court establish internal controls over vehicles by implementing the following:

- Report personal use and commuting mileage for vehicles as compensation/employee benefit on W-2 wage and tax statements in accordance with IRS regulations. Several methods can be used to determine the vehicle use that is taxable income to the employees, including the cents-per-mile rule, the lease value rule, and the commuting rule.
- Every employee and every department that has vehicles should maintain vehicle logs. The logs should include at a minimum, the date, destination, purpose, and mileage for all use of the vehicle.
- The fiscal court should amend the current administrative code to include a policy on the authorization and use of vehicles and other assets owned by the fiscal court. In addition, it should address the tax implications of using a vehicle for personal use or commuting travel.

County Judge/Executive's Response: The Fiscal Court adopted a new administrative code that addresses this issue and will ensure compliance with IRS regulations regarding accounting for the use of county owned vehicles.

The fiscal court did not consistently utilize the purchase order system: This is a repeat finding and was reported in the prior year as Finding 2017-007. The fiscal court is not consistently utilizing the purchase order system in accordance with the Department for Local Government (DLG) guidelines. Of the 81 items tested, 53 disbursements totaling \$2,206,441 did not have a purchase order. Failure to issue purchase orders for all disbursements increases the risk that adequate funds or sufficient budget appropriation will not be available to satisfy all financial obligations.

KRS 68.210 gives the state local finance officer the authority to prescribe a uniform system of accounts, which is set forth in the *DLG County Budget Preparation and State Local Finance Officer Policy Manual*. The manual states: “1. Purchases shall not be made without approval by the judge/executive (or designee), and/or a department head. 2. Purchase requests shall indicate the proper appropriation account number to which the claim will be posted. 3. Purchase requests shall not be approved in an amount that exceeds the available line item appropriation unless the necessary and appropriate transfers have been made. 4. Each department head issuing purchase requests shall keep an updated appropriation ledger and/or create a system of communication between the department head and the judge/executive or designee who is responsible for maintaining an updated, comprehensive appropriation ledger for the county.”

We recommend the fiscal court require purchase orders be obtained prior to items being ordered or services received to determine adequate funds and budget appropriations are available for the purchase. Purchase orders should be completely filled out at the time of issuance. Additionally, we recommend the fiscal court properly utilize the purchase order system in order to comply with DLG requirements.

County Judge/Executive's Response: The treasurer was not aware that purchase orders for reoccurring monthly services such as Utilities, Payroll and Debt were required. As of January 1, 2019, the finance officer began utilizing the purchase order system that is included in the accounting program and should eliminate this issue. In addition, the new administration is developing a "Standard Operating Manual" for all accounting functions to enhance internal controls and ensure compliance with all statutes, regulations and generally accepted accounting principles.

The fiscal court was not presented all claims for review before payment: The fiscal court was not presented all claims to review before payment was made. Of the 81 transactions tested, 19 transactions totaling \$705,662 were not presented to the fiscal court. Management did not have adequate controls in place to ensure all claims and disbursements were presented to the fiscal court for review before payment. In addition, KRS 68.275(2) states, "[t]he county judge/executive shall present all claims to the fiscal court for review prior to payment and the court, for good cause shown, may order that a claim not be paid." If the fiscal court does not have a chance to review all disbursements prior to payment, it increases the risk that undetected improper payments could be made. Furthermore, the fiscal court cannot provide proper oversight and make sound financial decisions if they are not adequately informed of the financial activity of the county. We recommend management implement adequate controls to ensure all claims and disbursements are presented to the fiscal court for review prior to payment.

County Judge/Executive's Response: During this audit year it was believed that all claims were presented to the Fiscal Court for review except for claims approved by the fiscal court on the standing order. The new administration is developing a "Standard Operating Manual" for all accounting functions to enhance internal controls and ensure compliance with all statutes, regulations and generally accepted accounting principles.

The fiscal court did not pay invoices timely: The Magoffin County Fiscal Court did not pay invoices within 30 days of receipt of invoice. Of the 81 items tested, 11 transactions, totaling \$514,393, were not paid timely. Insurance payments were not made timely, resulting in late fees of \$7,661. In addition, finance charges were noted for credit cards totaling \$355. Management did not have adequate controls in place to ensure that invoices were paid timely. KRS 65.140(2) states, "[a]ll bills for goods or services shall be paid within thirty (30) working days of receipt of 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." The fiscal court is in violation of the statute and paid late fees and finance charges, which are an inefficient use of taxpayer resources. We recommend the county comply with KRS 65.140(2) by paying invoices within 30 working days.

County Judge/Executive's Response: The Fiscal Court will ensure that invoices are entered on a claims list as they are received. Unless disputed, the bill will be paid according to the Department

for Local Government (DLG) County Budget Preparation and State Local Finance Officer Policy Manuel. In addition, the new administration is developing a “Standard Operating Manual” for all accounting functions to enhance internal controls and ensure compliance with all statutes, regulations and generally accepted accounting principles.

The fiscal court lacks adequate segregation of duties over payroll: This is a repeat finding and was included in the prior year audit report as Finding 2017-003. We noted inadequate segregation of duties over payroll. The treasurer is responsible for maintaining timesheets, entering payroll information into the computer system for processing, posting to the payroll ledgers, transferring funds to the revolving payroll account, administering health reimbursement and flex spending programs, preparing pay checks, preparing state and local withholding reports, and reconciling the payroll account. According to the fiscal court, they have a small accounting/payroll department and segregation of duties has been challenging to achieve.

By delegating all these duties to the same individual, the risk of undetected fraud and errors increases. Segregation of duties is an essential element of sustainable risk management and internal controls. The principle of segregation of duties is based on shared responsibilities of a key process that disperses the critical functions of that process to more than one person or department. A strong internal control system does not allow one person to perform processing, documentation, and reporting functions. We recommend the fiscal court find ways to segregate key duties related to payroll or implement other controls to compensate for these weaknesses (for example, designating an individual to review the payroll ledgers, reconciliations, and reports, and requiring the individual to document their review by initialing the documents that were reviewed).

County Judge/Executive’s Response: Changes were made after the FY2015 audit in an attempt to further improve the segregation of duties and internal controls. At that time the E.M. director reviewed and signed the timesheets. The finance officer then posted checks to the ledger and the secretary reviewed and distributed the checks. In addition, the new administration is developing a “Standard Operating Manual” for all accounting functions to enhance internal controls and ensure compliance with all statutes, regulations and generally accepted accounting principles.

The fiscal court did not comply with procurement procedures for competitive bidding: The fiscal court did not solicit competitive bids for all contracts exceeding \$20,000. KRS 45A.385, as effective during the relevant timeframe, allowed for use of small purchase procedures for contracts not exceeding \$20,000. We noted three instances in which competitive bids should have been solicited for purchases but were not. Additionally, we noted one instance in which the bid being used was obtained in 2015. Management did not have adequate controls in place to ensure competitive bidding procedures were followed. The fiscal court is in violation of procurement statutes and there is increased risk that the fiscal court did not receive goods and services at the best possible price.

KRS 45A.365 states,

(1) All contracts or purchases shall be awarded by competitive sealed bidding, which may include the use of a reverse auction, except as otherwise provided by KRS 45A.370 to 45A.385 and for the purchase of wholesale electric power by municipal utilities as provided in KRS 96.901(1).

(2) The invitation for bids shall state that the award shall be made on the basis of the lowest bid price or the lowest evaluated bid price. If the latter is used, the objective measurable criteria to be utilized shall be set forth in the invitation for bids. The invitation for bids shall include the reciprocal preference for resident bidders described in KRS 45A.494.

(3) Adequate public notice of the invitation for bids and any reverse auction shall be given prior to the date set forth for the opening of bids. The notice may include posting on the Internet or publication in a newspaper of general circulation in the local jurisdiction at least seven (7) days before the date set for the opening of the bids and any reverse auction. Nothing in this section shall prohibit additional notice, posting, or publication, nor shall additional notification, posting, or publication extend the required notice period. The public notice shall include the time and place the bids will be opened and the time and place where the specifications may be obtained.

(4) The bids shall be opened publicly or entered through a reverse auction at the time and place designated in the invitation for bids. Each written or reverse auction bid, together with the name of the bidder, shall be recorded and be open to public inspection. Electronic bid opening and posting of the required information for public viewing shall satisfy the requirements of this subsection.

We recommend management implement adequate controls to ensure all contracts and expenditures are properly procured in accordance with local model procurement code and the county's administrative code.

County Judge/Executive's Response: All items purchased will be procured in compliance with the Model Procurement Code and the county's Administrative Code. In addition, the new administration is developing a "Standard Operating Manual" for all accounting functions to enhance internal controls and ensure compliance with all statutes, regulations and generally accepted accounting principles.

The audit report can be found on the [auditor's website](#).

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