



Auditor of Public Accounts  
Mike Harmon

**FOR IMMEDIATE RELEASE**

Contact: **Michael Goins**  
[Michael.Goins@ky.gov](mailto:Michael.Goins@ky.gov)  
**502.564.5841**  
**502.209.2867**

**Harmon Releases Audit of McCreary County Fiscal Court**

**FRANKFORT, Ky.** – State Auditor Mike Harmon has released the audit of the financial statement of the McCreary 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 McCreary 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 the internal control over financial operations and reporting.

The audit contains the following comments:

**The fiscal court did not have proper purchase and procurement procedures.** The following deficiencies show a lack of proper purchase and procurement procedures:

- Six invoices that were bid did not have sufficient documentation attached to support the payment.
  - Four of these were for asphalt resurfacing - only one had a list of roads paved and none had signed haul tickets attached showing a fiscal court employee received materials. Additional information from the road supervisor had to be obtained to verify the invoices were valid.

- Although the net amount of difference was immaterial, all invoices for asphalt did not agree to the approved bid. The haul cost billed was rounded to the nearest one-tenth of a dollar (e.g., if the haul cost was calculated at \$9.57, it was billed at \$9.60, or if calculated at \$9.51, it was billed at \$9.50).
- One invoice stated ‘Balance of Construction Bid’ but there was no other supporting documentation, such as the approved bid or previous payments.
- Seven invoices totaling \$210,799 for the housing of inmates in other counties were paid from the statement amount without any reconciliation that the inmates listed belonged to McCreary County or that the number of days charged was accurate.
- Seven invoices were paid late (in excess of 30 days).
- 28 invoices tested did not have a purchase order attached, issued, or approved.
- One purchase order was approved after the date on the invoice.
- A payroll tax payment of \$15,984 was duplicated.
- The October retirement payments received from the sheriff and county attorney, which are included in the fiscal court’s retirement payment, did not agree to the reports submitted from those officials.
- Sixteen debt payments were not made by the scheduled date; with one being more than 30 days late. These payments were pre-approved and did not require waiting until the monthly fiscal court meeting before payment could be disbursed.
- A debt payment of \$2,145 was duplicated. Because the original invoice was not paid timely, the bank sent a second invoice which was paid along with the original invoice.

The above deficiencies are a direct result of the lack of adequate segregation of duties, improper accounting practices, and poor internal controls without sufficient management oversight.

The finance officer relies on the department heads to ensure that purchases are valid, meet bid requirements, and are calculated correctly. This could have resulted in significant overpayments, misappropriations, inaccurate financial reporting, and penalties being assessed. The authorized check signers rely on the finance officer to ensure disbursements are valid before submitting them for approval. This reliance negated the compensating controls instituted to offset the lack of segregation of duties. The fiscal court spent \$18,129 in error due to duplicate payments.

The State Local Finance Officer, given the authority by KRS 68.210, requires in the *County Budget Preparation and State Local Finance Officer Policy Manual* that all disbursements be accompanied by a purchase order and sufficiently documented. KRS 65.140(2) states, “Unless the purchaser and vendor otherwise contract, all bills for goods or 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[.]” In addition, good internal controls dictate that proper supporting documentation is maintained to validate disbursements.

We recommend the fiscal court maintain supporting documentation, such as haul tickets and approved bid specifications, with the original invoices and purchase orders. We recommend all invoices be accompanied by the signed haul ticket or packing slip showing receipt of the item purchased. Debt invoices should be accompanied by a payment or amortization schedule. We recommend the check signers ensure that all disbursements agree to the supporting

documentation attached before authorization. Furthermore, we recommend the fiscal court pay all expenditures within 30 working days in compliance with KRS 65.140.

*County Judge/Executive's response: Currently, all disbursements are reviewed and initialed by the Finance Officer, the Judge Executive, and the County Treasurer before authorization. We will ensure that all supporting documentation, such as haul tickets and amortization schedules, is attached to all invoices. Check signers will insure that all disbursements agree with the supporting documentation before authorization. Measures will be taken to correct all issues identified in this finding. Late payments are sometimes unavoidable due to our limited budget resources but every effort will be made to minimize them.*

**The payroll account was not properly reconciled.** The payroll revolving account did not reconcile to a zero balance as of June 30, 2016, and the remaining balance could not be readily explained. The remaining balance as of June 30, 2016, was \$77,819. Of this balance, the county had outstanding liabilities of \$51,448 and outstanding checks of \$464, leaving an unexplained balance of \$25,907 for Fiscal Year 2016. In addition, the payroll revolving account bank reconciliations were not reviewed by another employee to ensure accuracy.

The payroll account has not been properly reconciled since Fiscal Year 2011. In addition, the reconciliations are not being reviewed. Balances at fiscal year-end have carried forward each fiscal year without explanation. The unreconciled payroll account could cause the fiscal court to have insufficient funds to meet payroll requirements or it could cause the fiscal court's liabilities to not be properly paid or not to be paid in a timely manner.

Per KRS 68.210 the State Local Finance Officer has the authority to require a uniform system of accounts. The *County Budget Preparation and State Local Finance Officer Policy Manual* lists "monthly bank reconciliation" as a minimum requirement for all county officials. Since the payroll account is a "sweep account" only the funds necessary to pay employees and government agencies should be transferred from other county funds. Therefore, each month the account should reconcile to zero.

We recommend the fiscal court properly reconcile the payroll revolving account. Additionally, we recommend payroll revolving account bank reconciliations be reviewed by an independent employee to verify accuracy and completeness.

*County Judge/Executive's response: The payroll account has been out of balance for many years. We have made every attempt to reconcile but past records are limited. Will plan to balance the account to a zero balance during this fiscal year.*

**The fiscal court did not have sufficient internal controls over payroll.** The fiscal court did not have sufficient internal controls over payroll as shown by the following deficiencies:

- Of the 17 employees tested:
  - One employee did not have a timesheet to substantiate hours worked or health and retirement benefits received.
  - Two employees did not sign their timesheets to validate their hours worked.

- Seven employees had a timesheet listing hours worked, but no supervisor approval was evidenced.
- Magistrates received health insurance and retirement benefits but no timesheets or affidavits were found to justify the county paying these benefits.
- Constables received health insurance and retirement benefits but no timesheets or affidavits were found to justify the county paying these benefits.

The finance officer believed his authority to approve timesheets, as delegated to him by the county judge/executive, was sufficient. Additionally, the fiscal court believed magistrates and constables, as elected officials, were exempt from submitting timesheets.

The lack of properly designed controls creates the possibility that employees will receive wages or benefits not actually earned and that discrimination will occur, such as one individual working part-time hours receiving full-time benefits while other part-time individuals receive no benefits.

Internal control procedures that are properly designed and implemented allow employees to detect misstatements in a timely manner while preventing misappropriation of assets and inaccurate financial reporting. An individual who is independent of the recording and disbursement process should approve employee timesheets.

The county administrative code SECTION 5.9 Classification of Employees (A)(1) defines a full-time employee as “[a]n employee who works 40 hours per week on a regular scheduled basis.” SECTION 5.24 (b) requires timesheets to “be signed by employee and supervisor in order to be considered valid and compensation authorized.”

The county administrative code SECTION 5.37(a) also states “[a]ll full time employees of the County shall be provided with a health and hospitalization insurance coverage plan as provided by the Fiscal Court.” In addition, KRS 78.510(21) defines regular full-time positions as “all positions that average one hundred (100) or more hours per month, determined by using the number of hours actually worked in a calendar or fiscal year[.]”

We recommend the fiscal court strengthen their internal controls and ensure compliance with the county’s administrative code by requiring any individual receiving a paycheck from the fiscal court to submit a signed timesheet. Those timesheets should be approved by the employee’s supervisor, or by the county judge/executive. As elected officials, magistrates and constables are not required to maintain timesheets. However, we recommend they submit an affidavit of hours worked to ensure proper credit for retirement and to support county paid benefits.

*County Judge/Executive’s response: Time sheets and required signatures by both the employee and the supervisors are mandatory. Problems listed will be resolved. Magistrates and Constables are elected officials with set salaries with no time sheet requirements. They are elected as full-time and are therefore entitled to full-time benefits. They have been made aware of this.*

Auditor's Reply: The recommendation that magistrates and constables submit an affidavit of hours worked is not a statutory requirement, however it is a good practice to show they have met the full-time criteria for retirement benefits.

**The fiscal court did not have sufficient internal control procedures over credit card disbursements.** The fiscal court has not implemented proper internal control procedures over credit card disbursements. Credit card disbursements had the following deficiencies:

- Nine charges were paid without supporting documentation to explain what the charges were or which department head purchased them. Three of those paid the balance of the statement (after substantiated charges were accounted for) and four were to pay internet charges. Without proper documentation, it cannot be determined if these were business or personal charges.
- Two charges were coded to the wrong fund.
- Three food charges were based on a receipt with only a total instead of an itemized listing; without an itemized listing the purchases may have included unallowable items.
- Late fees were assessed five times.
- None of the disbursements were accompanied by a purchase order.

All credit card statements showed evidence of approval with initials by the county treasurer or the county judge/executive, even with the deficiencies noted above.

The deficiencies noted above stem from a lack of adequate segregation of duties, improper accounting practices, and poor internal controls without oversight. The county treasurer and county judge/executive are relying upon the finance officer to ensure all invoices are valid without proper review of the supporting documentation before authorizing disbursement.

The lack of proper segregation of duties, improper accounting practices, and lack of oversight could result in misappropriation of assets, inaccurate financial reporting, and payment for personal purchases with public funds.

The State Local Finance Officer, given the authority by KRS 68.210, requires in the *County Budget Preparation and State Local Finance Officer Policy Manual* that all disbursements be accompanied by a purchase order, within budgeted amounts and sufficiently documented. Additionally, good internal controls dictate that proper supporting documentation is maintained to support disbursements.

We recommend the fiscal court ensure proper accounting practices by implementing additional internal controls in the area of credit card disbursements, such as assigning an individual other than the finance officer to review all transactions to ensure they have proper documentation before being submitted for approval to the fiscal court. We further recommend the authorized check signers ensure credit card disbursements are properly supported before authorizing the disbursements.

*County Judge/Executive's response: We make every effort to maintain strong controls over credit card purchases, making sure all receipts are attached to statements. All credit card*

*purchases are made with the Judge/Executive's approval. The "internet charges" referenced in the audit comment were to [vendor name redacted], a website hosting site. We will make every effort to improve documentation to support all charges.*

**Penalties and interest were incurred due to late payment of invoices.** The fiscal court incurred penalties and interest on disbursements, debt, and payroll as follows:

- Finance charges totaling \$81 on three credit card invoices.
- Late payment fees totaling \$195 on five credit card invoices.
- Penalties and interest totaling \$242 as a result of nine out of eleven copier lease payments not paid by the date due. The June 2016 (12<sup>th</sup>) payment was paid using Fiscal Year 2017 funds.
- Out of 27 payments for payroll taxes, two were five to ten business days late, and 14 were 10 to 20 business days late. Also, the fiscal court did not file quarterly 941 tax reports to the Internal Revenue Service for the periods April through December. These noncompliances will likely result in penalties and interest, but as of audit report date, the amount is not known.
- Only two payments out of 36 health and other insurance invoices tested was paid on time by the date due, but no late fees were charged.

The payment of penalties and interest are due to invoices and payroll withholding not being remitted in a timely manner.

Since payments were not made before dates due, a total of \$512 of funds were used to pay penalties and interest, which could have been used for other purposes.

KRS 65.140(2) states, "[u]nless the purchaser and vendor otherwise contract, all bills for goods or 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."

We recommend the fiscal court comply with KRS 65.140 by ensuring all invoices are paid timely. We also recommend the fiscal court ensure payroll taxes and mandatory reports are submitted to the federal government in a timely manner to avoid unnecessary penalties and interest.

*County Judge/Executive's response: Every effort has been made to pay invoices in a timely manner. Due to limited budget resources, payments are not made until resources are available. This is especially difficult on recurring items that don't go through the normal approval processes. Every effort will be made to limit or eliminate these issues.*

**The fiscal court did not comply with the United State Department Of Agriculture (USDA) Grant Agreement.** Since 1994, the McCreary County Fiscal Court has utilized USDA grant funds to run a Rural Business Enterprise Grant (RBEG) program. The program is designed to encourage new employment opportunities within the county by providing low cost financing to new businesses.

The most recent USDA grant for this purpose was awarded to the McCreary County Fiscal Court during Fiscal Year 2013 in the amount of \$75,000. In accordance with the grant agreement, the fiscal court was required to provide \$20,000 in matching funds.

In June 2014, the fiscal court approved a new business loan in the amount of \$50,000. The loan was to be made from \$40,000 obtained from the USDA grant, and the remaining \$10,000 coming from county matching funds.

The fiscal court paid the matching \$10,000 from the county's Revolving Loan Fund, which is made up of prior revolving loan repayments. Due to poor accounting practices, the auditor was unable to determine if the prior repayments were from RBEG loans or from the earlier SMART loans.

Due to the fiscal court incorrectly considering any prior RBEG repayments as being unrestricted, the county's matching requirement for the grant was not met.

The grant agreement states, "It is clearly understood that matching Revolving Loan Funds (RLF) will remain in perpetuity along with Rural Business Enterprise Grant funds that are likewise designated and referred to as the fund. The fund will contain a Federal Interest equivalent to the dollar amount invested."

Additionally, a USDA official confirmed to the auditors that any prior revolving loan repayments are restricted, and thus should not be utilized by the county as a source for their matching requirements. Loan repayments should be used to provide additional revolving loans.

We recommend the fiscal court provide their match in compliance with the USDA grant agreement and reimburse the revolving loan fund for the matching funds previously expended.

*County Judge/Executive's response: We were told by officials at the USDA at the time of this loan that once payments recycle through and are paid back to the revolving loan fund, they lose their federal identity. Additionally, the money in the revolving loan account includes monies from other sources than the federal grants in the past. It was our understanding at the time that this was a proper use of that money since it was used for loans irrespective of whether there was a federal component or not. Our budget difficulties do not grant us the latitude to use money from the general fund to support the revolving loan program.*

Auditor's Reply: Due to the conflicting responses received by the USDA, we recommend you contact the USDA to discuss further and document conclusions reached.

**The fiscal court did not maintain accurate capital asset records.** The fiscal court did not maintain accurate capital asset records. The audit adjustments to the fiscal court's beginning balances are a result of adjustments made in the prior year audit not being made in the fiscal court's capital asset records. These adjustments along with audit adjustments to current year additions are a result of a lack of oversight in this area.

By not maintaining an accurate list of capital assets, assets could be improperly stated, increasing the risk of material misstatement to the capital asset schedule, and assets can be insured that are no longer owned. The beginning balances in the fiscal court's capital asset records had to be adjusted to match prior year audited amounts. These adjustments resulted in total decreases of beginning balances to buildings by \$467,863, vehicles by \$95,440, other equipment by \$305,235, and infrastructure by \$756,230. The adjustments also resulted in a total increase to the beginning balance of land by \$1,049,409. In addition, an adjustment to current year additions resulted in an increase to infrastructure by \$329,912.

KRS 68.210 gives the State Local Finance Officer the authority to prescribe a uniform system of accounts. Per the *County Budget Preparation and State Local Finance Officer Policy Manual*, capital asset records are necessary for proper valuation.

We recommend the employee(s) in charge of capital assets maintain accurate records throughout the year of any purchases and retirements of assets and provide periodic updates to the fiscal court. Records should also be changed for any audit adjustments agreed to by management. Purchases should be approved and records should include the date the asset was acquired, a description of the asset, the vendor name, the amount, salvage value, and useful life. Invoices and supporting documentation for asset acquisition should be kept on file in a manner that allows retrieval of the original invoice for review and verification as needed by management and auditors. If possible, an inventory count at June 30 of each fiscal year should be conducted. We recommend the fiscal court provide the necessary oversight needed to ensure accurate and complete records are maintained.

*County Judge/Executive's response: We are aware of this issue and plan to properly maintain capital asset records henceforth.*

**The fiscal court lacks segregation of duties over all accounting functions.** The following issues were noted:

- The county treasurer prepares and deposits receipts, posts to the ledgers, prepares financial reports, and prepares the bank reconciliations.
- Items returned from the bank are handled by the county treasurer.
- The finance officer prepares a list of bills for fiscal court's approval and prepares all checks.

A limited budget places restrictions on the number of employees the fiscal court can hire. When faced with a limited number of staff, strong compensating controls should have been implemented to offset the lack of segregation of duties.

The lack of oversight could result in undetected misappropriation of assets and inaccurate financial reporting to external agencies such as the Department for Local Government.

A segregation of duties over various accounting functions, such as opening mail, collecting receipts, preparing bank deposits, preparing reports and reconciliations, or the implementation of compensating controls, when needed because the number of staff is limited, 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.

To adequately protect against undetected misappropriation of assets and inaccurate financial reporting, we recommend the fiscal court separate the duties involving the opening of mail, collecting and depositing of receipts, and preparation of reports and reconciliations. If this is not feasible due to limited number of staff, strong oversight over these areas could occur and involve an employee that isn't currently performing any of those functions. Additionally, the county judge/executive could provide this oversight and document it on the appropriate source documents.

*County Judge/Executive's response: Our limited budget and resulting minimal workforce prevent us from hiring additional employees to enable optimal remediation of this issue. We will, however, continue to have oversight by multiple employees where possible. We are well aware of the need to have oversight in all transactions and will work diligently to ensure strong controls.*

**The fiscal court did not have sufficient monitoring or internal controls over the revolving loan program.** Since 1994, the McCreary County Fiscal Court has utilized United States Department of Agriculture (USDA) grants to run a Rural Business Enterprise Grant (RBEG) program. The program is designed to encourage new employment opportunities within the county by providing low cost financing to new businesses. The fiscal court has made 34 loans totaling \$1,586,345 from fiscal year 1994 through Fiscal Year 2016. The following issues were noted for Fiscal Year 2016 as a result of reviewing the program:

- The fiscal court made no attempt to collect payment on 21 loans totaling \$737,928. Due to the fiscal court not accurately reviewing credit risk during the application process, or continuing to monitor repayment activity, these loans have not been collected due to either bankruptcy, inactivity of loan payments, or litigation.
- The fiscal court maintained schedules reflecting repayment activity for the loans, but in some instances the breakdown of principal and interest is not correct.
- The grant agreement requires the fiscal court to report the status of the loans to the USDA semi-annually. However, the fiscal court did not submit a report during fiscal year 2016.

Due to weak controls and inadequate monitoring over the revolving loan program, the fiscal court has forgone the ability to support viable business within the county that could have produced additional jobs and revenue for the taxpayers.

Adequate monitoring and properly designed and implemented internal controls could allow early detection of possible non-paying borrowers. In addition, good internal controls dictate accurate records are maintained to support the activity of the program.

The grant application states, "Records will include an accurate accounting of any principal repayments, interest, or other proceeds generated by the loan fund and will document expenses paid for with interest, or other proceeds generated by the loan and will be documented for the grant audits."

We recommend the fiscal court properly monitor the activities of the revolving loan program. Additionally, we recommend the fiscal court comply with the requirements of the loan application and ensure that all loans are properly made, documented, collected, and reported.

*County Judge/Executive's response: This is a recurring audit finding and we are diligently working to remedy this issue. We have worked with our county attorney to identify collectable and uncollectable loans from the past. The Fiscal Court during 2016 authorized an option of refinancing any of the collectable loans, providing financial benefits to loan holders who complied. All but 3 of the collectable loan holders took advantage of the offer and refinanced to get their loans in compliance and up-to-date. The remainder will be pursued with legal action.*

**Fiscal court disbursements exceeded budgeted appropriations.** Emergency dispatch fund disbursements exceeded budgeted appropriations by \$82,724 because the protection to persons and property line items exceeded the budget appropriations by that amount.

Due to not properly monitoring budgeted to actual disbursements, the county treasurer exceeded budgeted appropriations.

When the fiscal court exceeds budgeted appropriations within line items, they are violating 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.”

We recommend the county treasurer present line item budget transfers to the fiscal court as necessary to ensure disbursements do not exceed budgeted appropriations.

*County Judge/Executive's response: The county treasurer will provide the line item budget transfers to the fiscal court as recommended.*

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

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