Auditor of Public Accounts
Mike Harmon

FOR IMMEDIATE RELEASE

Contact: Michael Goins
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, 2019. 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.

Finding 6 of the audit report will be referred to the U.S. Department of Agriculture (USDA).

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:

Transfers were made before approval by the fiscal court: This is a repeat finding and was included in the prior year audit report as Finding 2018-001. The county treasurer made 61 interfund transfers during Fiscal Year 2019. Of the 61 transfers, all 61 transfers received approval after the transfer was issued and made.

The county treasurer transferred funds before approval due to timing issues in an attempt to avoid late payment fees and penalties that would have incurred if she had waited until the next upcoming fiscal court meeting. By transferring funds before approval is received, the county treasurer circumvented the fiscal court's authority to decide how county funds are to be used.

KRS 68.290 states, "[t]he fiscal court may transfer money from one (1) budget fund to another to provide for emergencies or increases or decreases in county employment pursuant to KRS 64.530(4). The order of the fiscal court making the transfer shall show the nature of the emergency or personnel increase or decrease and the reason for making the transfer. The fiscal court shall not have any power to transfer money from any sinking fund or special fund raised for a specific purpose until the obligation or purpose for which the fund was raised has been satisfied."

According to page 73 of the Department for Local Government's (DLG) *County Budget Preparation and State Local Finance Officer Policy Manual*, "[a]ll transfers require a court order." Additionally, the McCreary County Fiscal Court's Administrative Code Section 4.4(H) states, in part, "[t]he original appropriation and all amendments and transfers authorized by order of the Fiscal Court shall be entered."

We recommend that all transfers be approved by the fiscal court before the transfer is made. The approval should be clearly reflected within the fiscal court minutes.

County Judge/Executive's Response: County Treasurer has started doing an anticipated interfund cash transfer report to be approved by Fiscal Court.

The payroll revolving account was not properly reconciled: This is a repeat finding and was included in the prior year audit report as Finding 2018-002. The payroll revolving account did not reconcile to zero as of June 30, 2019, and the remaining balance could not be readily explained. According to the information available to auditors, the account balance as of June 30, 2019, was $71,507. Of this balance, the county had receivables of $4,094, outstanding checks of $833, and outstanding liabilities of $58,641, leaving an unexplained balance of $16,127 for fiscal year 2019.

In addition, the employee benefits account, which primarily receives funds from the payroll account, did not reconcile to zero. According to the information available to auditors, as of June 30, 2019, the account had a balance of $573. There were $2,279 of deposits-in-transit, $2,955 of receivables, and $5,425 of outstanding liabilities, leaving an unexplained balance of $382 for fiscal year 2019. Auditors noted the finance officer verified that funds were deposited and checks or electronic withdrawals had cleared but no evidence of a monthly bank reconciliation was found for these accounts. In addition, the account was overdrawn three times during the fiscal year which indicates a lack of oversight.

According to the finance officer, a new payroll account was opened in July 2018 and he thought this corrected the prior year issue since he transfers payroll funds according to the summary produced by the computer software.

The unreconciled payroll account could cause the fiscal court to have insufficient funds to meet payroll requirements, cause the fiscal court's liabilities to not be properly paid, or cause liabilities to not be paid timely.

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* includes monthly bank reconciliations as a minimum requirement for all county officials. Since the payroll and employee benefits accounts are revolving accounts, 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 a zero balance.

Good internal controls dictate that revolving accounts be reconciled to a zero balance. In addition, monthly bank reconciliations should be prepared and reviewed by someone independent of the reconciliation process.

We recommend the fiscal court properly reconcile the payroll revolving account and the employee benefits account to a zero balance monthly. Additionally, we recommend the bank reconciliations be reviewed by an employee independent of the reconciliation process. These reviews should be dated and initialed by both the preparer and the reviewer to document evidence of oversight, accuracy, and completeness.

County Judge/Executive's Response: The official did not provide a response.

The fiscal court did not have proper purchase and procurement procedures: This is a repeat finding and was included in the prior year audit report as Finding 2018-004. The fiscal court did not have proper purchase and procurement procedures as noted by the following deficiencies:

Of the 69 invoices tested:

- Fiscal court did not bid out one disbursement for $20,000 to purchase materials for the construction of the Aerospace Academy building.
- Forty-eight invoices tested did not have purchase orders.
- Five invoices tested had purchase orders dated after receipt.
- Two invoices tested had cancelled checks with only one signature.
- Three invoices tested did not have original supporting receipts.
- Two invoices tested did not have any supporting receipts.
- One invoice did not get properly approved by the fiscal court.

The deficiencies are a direct result of the lack of adequate segregation of duties, improper accounting practices, and poor internal controls without sufficient management oversight. These deficiencies could have resulted in significant overpayments, misappropriations, inaccurate financial reporting, or penalties being assessed.

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 to be accompanied by a purchase order assigned in advance of the purchase to a fund with each disbursement to be sufficiently documented In addition, good internal controls dictate that proper supporting documentation be maintained to validate disbursements.

The McCreary County Administrative Code Section 9.2 (C) states, “[a]ny expenditure or contract for materials, supplies (except perishable meat, fish, and vegetables), equipment, or for contractual services other than professional, involving an expenditure of more than Twenty Thousand Dollars ($20,000) shall be subject to competitive bidding.”

We recommend the fiscal court take the steps necessary to ensure they are in compliance with the state local finance officer and the McCreary County Administrative Code. We recommend all disbursements be assigned a purchase order before the purchase is made and supporting documentation, such as approved bid specifications and purchase orders, be maintained with the original invoices. We also recommend two check signers ensure supporting documentation is reviewed for correct billing (such as accepted bid price), that all disbursements agree to the supporting documentation attached, and the fiscal court approve the disbursement before authorizing the checks. The authorized signers could document evidence of a review by initialing the invoices as well as the supporting documents (bid sheets, purchase order, invoice, fiscal court approval, etc.).

County Judge/Executive’s Response: We have instituted new procedures and all employees are aware of these procedures.

The fiscal court did not have sufficient internal control procedures over credit card disbursements: This is a repeat finding included in the prior year audit report as Finding 2018-005. The fiscal court has not implemented proper internal control procedures over credit card disbursements. Credit card disbursements had the following deficiencies:

- Three charges were based on a receipt with only a total instead of an itemized listing. Without an itemized listing the purchase may have included unallowable items.
- Twenty-eight of 36 credit card charges were not supported with a purchase order.
- One item was paid for using a purchase order dated after receipt.
- Three statements were paid in excess of 30 days incurring a total of $117 in penalties.

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 the disbursement.

The lack of proper segregation of duties, improper accounting practices, and lack of oversight could result in misappropriation of assets, inaccurate financial reporting, or 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, sufficiently documented, and paid within 30 working days. KRS 65.140(2) states in part, “[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[.]” Additionally, good internal controls dictate that proper supporting documentation is maintained to support disbursements and the fiscal court should not pay sales tax since they are a tax exempt entity.

We recommend the fiscal court take the steps necessary to ensure compliance with applicable statutes and proper accounting practices, by implementing additional internal controls in the area of credit card disbursements. This could be accomplished by assigning an individual other than the finance officer to review all transactions to ensure that they have proper documentation (such as a purchase order, itemized receipts, etc.) before being submitted for approval to the fiscal court. We further recommend that the authorized check signers ensure credit card disbursements are properly supported before authorizing the checks.

County Judge/Executive's Response: Several months ago we established an online account to alleviate this matter.

The fiscal court did not segregate duties over accounting functions: This is a repeat finding and was included in the prior year audit report as Finding 2018-006. A lack of segregation of duties exists over accounting functions. The following issues were noted:

- The county treasurer prepares and deposits receipts, posts to the ledgers, prepares financial reports, and prepares the monthly bank reconciliations.
- Items returned from the bank are handled by the county treasurer.
- The finance officer picks up mail from the post office then distributes to the proper department. He prepares a list of bills for the fiscal court's approval, prepares all checks, and makes adjustments to the appropriations ledger. The finance officer submits the financial statement electronically to the Department for Local Government (DLG). Also, the finance officer maintains timesheets, prepares payroll, posts payroll to the ledgers and transfers funds from the appropriate accounts to the revolving payroll account. In addition, the finance officer is responsible for employee benefits payments (health insurance, life insurance and payments to the employee benefit bank account).

According to the county judge/executive, a limited budget places restrictions on the number of employees the fiscal court can hire. The lack of oversight could have resulted in undetected misappropriation of assets and inaccurate financial reporting to external agencies such as DLG.

A segregation of duties over various accounting functions, collecting receipts, preparing bank deposits, and 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 segregate the duties involving collecting and depositing receipts and preparation of reports and reconciliations. If this is not feasible due to limited staff, strong oversight over these areas could occur and involve an employee that is not currently performing any of those functions. For example, the county judge/executive could provide this oversight and document his oversight by initialing the source documents.

County Judge/Executive's Response: Only by hiring more staff could we be in compliance.

The fiscal court did not have sufficient monitoring or internal controls over the revolving loan program: This is a repeat finding and was included in the prior year audit report as Finding 2018-007. 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 38 loans, totaling $1,666,345 from fiscal year 1994 through fiscal year 2019. The following issues were noted for fiscal year 2019 as a result of reviewing the program:

- In Fiscal Years 2017 and 2018, the fiscal court made an attempt to collect payment on an inactive loans originally made totaling $593,082 by way of refinancing. The loans were refinanced to a 1 percent interest rate and had their principal balances lowered dependent on their payment history. According to the former county judge/executive, the prior payments made on these loans were converted to all principal. Due to records the fiscal court maintained in regards to payment history not being complete, the new beginning balances could not be verified for accuracy.
- According to the former county judge/executive, the decision to refinance the inactive loans were discussed and approved by the USDA. However, the auditor was informed the approval was not in writing and the official at the USDA involved with the discussion is now retired.
- 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 2019.

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.

Section 52 of the Kentucky Constitution prohibits the fiscal court from forgiving debt in which the amount can be precisely determined and which is not in dispute.

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 USDA Application For Federal Assistance SF-424 states, "[r]ecords 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 USDA Application for Federal Assistance SF-424 and ensure that all loans are properly made, documented, collected, and reported. This matter will be referred to the United States Department of Agriculture.

County Judge/Executive's Response: The official did not provide a response.

The fiscal court did not have sufficient internal controls over payroll: This is a repeat finding included in the prior year audit report as Finding 2018-008. The fiscal court lacked sufficient internal controls over payroll as shown by the following deficiencies:

- Of the 33 employees tested:

    - The former treasurer did not have a timesheet to substantiate hours worked or health and retirement benefits received. The former treasurer did not meet the four criteria to be exempted as an executive or salaried employee per Kentucky Administrative Regulations (KAR).
    - The current treasurer was hired at 30 hours per week which fulfills the 100 hour per month requirement for retirement benefits per the Kentucky Retirement System but this is not sufficient hours for full time health, vacation, sick or holiday benefits per the county's administrative code. The current treasurer did not meet the four criteria to be exempted as an executive or salaried employee per Kentucky Administrative Regulations (KAR).
    - Four employees had timesheets listing hours worked, but no supervisor approval was evidenced. All were jail employees.

- Magistrates and constables received health insurance and retirement benefits but no timesheets or affidavits were found to justify the county paying these benefits.

According to the former county judge/executive, he believed he had instituted sufficient controls to prevent the deficiency. He also stated that he believed the former treasurer met the qualifications to be considered salaried.

The lack of properly designed internal controls increased the possibility of employees receiving wages or benefits not actually earned, such as an 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 or inaccurate financial reporting. An individual who is independent of the recording and disbursement process should approve employee timesheets.

McCreary 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.

McCreary County Administrative Code Section 5.37(A) 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[.]"

Furthermore, according to OAG 79-448, "Section 3 of the Kentucky Constitution is unequivocal on the point that public emolument to any person must be based on the consideration of public services. By the strongest implication this means 'public services actually rendered.'" Therefore, without timesheets it cannot be determined if services were actually rendered.

803 KAR 1:070 Section 2 states, in part, "General Rule for Executive Employees. (1) The term 'individual employed in a bona fide executive capacity' in KRS 337.010(2)(a)2 shall mean an employee: (a) Compensated on a salary basis at a rate of not less than $455 per week, exclusive of board, lodging, or other facilities; (b) Whose primary duty is management of the enterprise in which the employee is employed or of a customarily recognized department or subdivision thereof; (c) Who customarily and regularly directs the work of two (2) or more other employees; and (d) Who has the authority to hire or fire other employees[.]"

We recommend the fiscal court strengthen their internal controls and ensure compliance with the county's administrative code, Kentucky Administrative Regulations, and the Kentucky Constitution by making sure all classifications of employee pay are approved by fiscal court and by requiring any individual receiving a paycheck from the fiscal court to submit a signed timesheet to substantiate payment received. 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: The official did not provide a response.

Debt was materially misstated on the quarterly financial report: The fourth quarterly financial report listed liabilities (debt) as of June 30, 2019, with a combined principal balance of $1,188,140 but the actual amount was $669,172 and combined interest was listed as $48,741 but was actually $24,402. This reported $518,968 and $24,339 of combined principal and interest, respectively, in excess of the amount the county owed.

The county treasurer relied upon the computer software to reduce the liabilities listed without verifying the debt balances were reduced by the payments made. The largest payment being the 2009 bond issue paid during the fiscal year by the Administrative Offices of the Courts (AOC).

The lack of oversight resulted in an inaccurate financial report to the Department for Local Government (DLG) and to the citizens of the county.

The proper implementation of internal controls is essential for providing protection from inaccurate financial reporting.

Additionally, KRS 68.210 states, in part, "[t]he administration of the county uniform budget system shall be under the supervision of the state local finance officer who may inspect and shall supervise the administration of accounts and financial operations and shall prescribe . . . a system of uniform system of accounts[.]" Good internal controls dictate reports be accurate.

We recommend the fiscal court implement internal controls such as reviews of financial statements by an individual independent of the reporting process to ensure that all reporting is accurate.

County Judge/Executive's Response: The official did not provide a response.

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

###

The Auditor of Public Accounts ensures that public resources are protected, accurately valued, properly accounted for, and effectively employed to raise the quality of life of Kentuckians.

Call 1-800-KY-ALERT or visit our website to report suspected waste and abuse.