



Auditor of Public Accounts
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Harmon Releases Audit of Owsley County Fiscal Court

FRANKFORT, Ky. – State Auditor Mike Harmon has released the audit of the fourth quarter report of the Owsley County Fiscal Court for the fiscal year ended June 30, 2015. State law requires annual audits of county fiscal courts.

Auditing standards require the auditor’s letter to communicate whether the fourth quarter report presents fairly the receipts, disbursements and changes in fund balances of the Owsley County Fiscal Court in accordance with accounting principles generally accepted in the United States of America. The fiscal court’s fourth quarter report did not follow this format. The fiscal court may also present its fourth quarter report in conformity with the regulatory basis of accounting, which is the reporting methodology followed for 115 of 120 fiscal court audits in Kentucky.

Auditors were not able to obtain sufficient and appropriate evidence to provide a basis for an audit opinion on the Owsley County Fiscal Court fourth quarter report for the fiscal year ended June 30, 2015, and the audit report therefore presents a disclaimer of opinion.

As part of the audit process, the auditor must comment on non-compliance 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 comment:

Poor financial management practices for the first half of the fiscal year have resulted in a disclaimed opinion on the fourth quarter report. Numerous deficiencies were noted in the county’s internal control structure and in financial management practices which made it impossible for auditors to issue an opinion on the fourth quarter report. Management override of established control procedures and failure to adhere to sufficient financial management procedures, resulted in numerous and pervasive audit comments:

- The county does not have adequate internal controls.
- The county lacks adequate segregation of duties for receipts and payroll.
- Management override of internal controls regarding dual signatures on checks.)
- The county did not record and deposit receipts timely.
- The county did not follow proper procedures for disbursements.
- The county incurred penalties and overdraft fees.
- The county did not follow proper procedures for payroll.
- The county failed to submit timely, complete, and accurate quarterly reports.
- The county did not maintain proper documentation of fiscal court meetings.

These internal control deficiencies and non-compliance issues affect the entity and the internal control structure as a whole. These issues have severely limited the entity's ability to provide financial information that is complete, accurate, adequately documented, and free of material misstatement. We recommend the fiscal court review the deficiencies and noncompliance issues as noted and take appropriate action to correct each finding.

County Judge/Executive's response: From January 1, 2015 until present, we have worked diligently to correct any deficiencies or improper procedures to maintain a more compliance local government entity.

The county does not have adequate internal controls over cash, receipts, disbursements, payroll, and capital assets. Several deficiencies were noted regarding the control procedures for cash, receipts, disbursements, payroll, and capital assets. These deficiencies resulted in the numerous compliance issues noted in the following comments. The following control issues inhibits the county's ability to properly record, classify, and report transactions for cash, receipts, disbursements, payroll, and capital assets:

- Cash balances were not adequately monitored and were not accurately reported.
- Bank reconciliations were not completed timely for all accounts.
- Receipts were not recorded and deposited timely.
- Adequate supporting documentation was not maintained for all disbursement transactions.
- Proper procedures were not in place to ensure proper calculation and documentation of payroll items.
- Adequate schedules were not maintained for capital assets.
- Proper procedures were not in place to ensure proper recording of certain disbursements.
- Proper approval was not obtained for certain transactions.
- Several items were not paid timely.

In order for the county's fourth quarter report to be free of material misstatement, it is essential that procedures are in place to ensure the accuracy, validity, and completeness of all transactions, including maintaining adequate supporting documentation for all transactions. We recommend the county implement the following procedures to strengthen controls and to limit the amount of noncompliance issues noted in the future:

- Review cash balances and bank reconciliations.
- Record and deposit receipts timely.
- Retain adequate supporting documentation for all transactions.
- Recalculate payroll items to ensure accuracy.
- Maintain adequate capital asset documentation and information.
- Record all transactions accurately and in the appropriate fund, account code, line item, etc.
- Present all transactions to fiscal court for approval.
- Pay invoices/obligations timely and in compliance with all statutes and regulations.

County Judge/Executive's response: From January 1, 2015 until present, we have maintained current cash balances and up-to-date bank reconciliations, record and deposits timely, retain adequate supporting documentation for all transactions, maintain adequate capital asset documentation and information as of July 1, 2015, record all transactions accurately in the appropriate fund, account code, line item, etc.; present all transactions to fiscal court for approval, and pay invoices/obligations timely and in compliance with all statutes and regulations.

The county lacks adequate segregation of duties for receipts and payroll. The county lacks adequate segregation of duties for receipts and payroll. During receipts testing, we noted the former treasurer received all monies except solid waste receipts, made deposits, posted to the receipts ledger, and prepared bank reconciliations. In order for adequate segregation of duties to occur, the functions of receiving, posting, and reconciling receipts should be delegated to separate individuals when possible. Adequate segregation of duties increases the ability of the entity to recognize and correct errors timely. The receipt issues noted in Comment 2015-005 could have been prevented, detected, and/or corrected timely had proper controls and segregation of duties existed.

Likewise, we noted inadequate segregation of duties for payroll. The former treasurer was 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, preparing pay checks, preparing state and local withholding reports, and reconciling the payroll account. By delegating all these duties to the same individual, it increases the risk that fraud or errors will occur and go undetected for a significant time. The payroll issues noted in Comments 2015-008 and 2015-009 could have been prevented, detected, and corrected timely had proper controls and segregation of duties existed.

The current administration has made improvements. However, in order to further strengthen internal controls, we recommend the county adequately segregate duties in receipts and payroll or implement other controls to compensate for these weaknesses. For example, designate an individual to review the receipts and payroll ledgers, reconciliations, and reports. This individual can document their review by initialing the documents that were reviewed.

County Judge/Executive's response: We plan on having the finance officer as well as county treasurer review the receipts and payroll ledgers, reconciliations, and reports; we already have been reviewing bank reconciliations each month and both initializing and dating.

Management disregarded internal controls regarding dual signatures on checks. For the first six months of Fiscal Year 2015, auditors questioned numerous cancelled checks as to whether they contained the authentic signature of the former county judge/executive. It was revealed to auditors that the former county judge/executive regularly allowed the former treasurer to sign his name on checks.

The county's internal control system requires the signature of both the treasurer and the county judge/executive for all checks. In addition, KRS 68.020(1) reads, in part, "All warrants for the payment of funds from the county treasury shall be co-signed by the county treasurer and the county judge/executive." It is never an acceptable practice for a person to sign another person's name. The county judge/executive can choose a person to sign checks in his absence, but the designated person must be properly bonded, approved by the fiscal court, sign his/her own name to the check, and be independent from the treasurer's office.

Overriding the internal controls related to check processing increases the risk that errors or fraud can occur and go undetected. Good management oversight and adhering to established internal controls can decrease this risk. However, beginning in January 2015, it appears both the current county judge/executive and the treasurer sign all checks for payment to ensure compliance with internal control procedures and adherence to the applicable statute.

County Judge/Executive's response: We continue to each sign all checks by hand to ensure compliance with internal control procedures and adherence to the applicable statute.

The county did not record and deposit receipts timely. During Fiscal Year 2015, we noted numerous instances in which funds were not recorded and deposited timely. We noted delays in checks being recorded and deposited from several weeks up to several months. For example, three checks from the state in the amount of \$5,000, \$7,669 and \$178 were received in July 2014, but have not been recorded and deposited as of audit date.

An essential component of a strong internal control system is to record and deposit funds immediately after they are received in order to decrease the risk that the funds will be lost, stolen, or otherwise misappropriated. We recommend the fiscal court implement stronger internal controls over receipts to ensure that all funds received are recorded and deposited timely.

County Judge/Executive's response: To ensure a strong internal control system, all mail (checks) initially received by finance officer is endorsed and copied – recorded in her deposit log, then forwarded to county treasurer for deposit. We will compare deposit logs monthly to ensure accuracy and sufficiency.

The county did not follow proper procedures for disbursements. Numerous deficiencies were noted in the county's internal control structure as it relates to disbursements. Procedures regarding the documentation, preparation, and authorization of disbursements were not adequate for 71 transactions tested and resulted in the following findings:

- 32 instances totaling \$1,393,168 were noted in which proper documentation (i.e. invoices) for disbursements could not be located.
- 49 instances totaling \$1,292,147 were noted in which the county did not properly approve the transaction as documented on the claims list.
- 10 instances totaling \$81,213 were noted in which the county did not pay the vendor within 30 days of receipt of invoice.
- 32 instances were noted in which the disbursements did not contain an account code.

Basic internal control procedures require the county to maintain documentation for every disbursement. This documentation should include, but is not limited to, invoices, purchase orders, packing/receiving slips, etc. Guidance regarding fiscal court approval is outlined in KRS 68.275(2), which states, “The county judge/executive shall present all claims to the fiscal court for review prior to payment...” In addition, KRS 65.140(2) requires local governments to pay for goods and services within 30 working days of receiving an invoice. The Department for Local Government (DLG) Budget Manual provides a chart of accounts counties are supposed to use to code and record disbursements.

Failure to adhere to the guidelines outlined above increases the risk that the county’s disbursements will be materially misstated or funds will be misappropriated. We recommend the county immediately implement procedures to ensure that all disbursements are properly documented, approved by the fiscal court, recorded correctly, and paid timely.

County Judge/Executive’s response: As of January 1, 2015, we have worked diligently to keep all bills paid on time and any past due bills paid from previous years, when we will receive all bills – we will stamp when received and pay within time allotments.

The county incurred penalties and overdraft fees. During Fiscal Year 2015, the county incurred penalties and overdraft fees for the following reasons:

- Failure to make retirement contributions by the 10th of each month, which led to penalties totaling \$9,000.
- Failure to maintain sufficient balances in bank accounts, which led to fees totaling \$705.

The county participates in County Employees Retirement Systems (CERS). KRS 61.675 and KRS 78.625 require retirement withholding and matching funds be paid to CERS by the 10th of each month or a \$1,000 penalty is applied. During fiscal year 2015, the county incurred \$4,000 of retirement penalties for failure to file and remit payments timely. A total of \$9,000 in penalties was paid in fiscal year 2015, of which \$5,000 was related to fiscal year 2014.

The general, jail, LGEA funds, and payroll account were overdrawn on multiple occasions resulting in overdraft fees of \$705. The Department for Local Government (DLG) Budget Manual outlines the duties of a county treasurer, one of which is to sign a check only if sufficient fund balance and adequate cash balance exists to cover the check.

Poor financial management practices and weak internal controls cause errors to occur and go undetected for a significant time period and may result in financial ramifications such as these.

Additionally, penalties and overdraft fees are unnecessary expenses that are avoidable and a wasteful use of taxpayer resources. We recommend the fiscal court ensure that all withholding and matching payments are made timely, and ensure all bank accounts have sufficient cash balances to cover any checks in order to avoid unnecessary costs in the future.

County Judge/Executive's response: As of January 1, 2015, we have worked diligently to pay any penalties or late fees incurred, and worked diligently to keep all required reports and payments made and sent in in a timely manner.

The county did not follow proper procedures for payroll. During our testing of payroll, we noted numerous deficiencies related to the preparation and calculation of payroll:

- The fiscal court did not approve a salary schedule.
- Overtime was not calculated correctly.

KRS 64.530(1) states, "[T]he fiscal court of each county shall fix the compensation of every county officer and employee...." The county failed to do this for fiscal year 2015.

KRS 337.285 outlines overtime provisions and requires that employees be paid at one and a half times their hourly pay rate for all hours worked in excess of 40 hours in one week. Salaried employees are not exempt from overtime provisions, unless all the requirements outlined in the Fair Labor Standards Act (FLSA) are met. The failure to calculate overtime correctly could result in employees being overpaid or underpaid.

The deficiencies noted above may have caused the county to improperly compensate employees for time worked. Compliance with the aforementioned statutes is essential in order for the county to properly prepare and calculate payroll.

We recommend the county do the following regarding payroll to ensure compliance with applicable statutes and to ensure proper payroll practices and controls are in place:

- Approve a salary schedule listing each employee's rate of pay.
- Ensure proper time and a half/overtime payments are made in accordance with the county administrative code and state and federal regulations.

County Judge/Executive's response: We will approve a salary schedule listing each employee's rate of pay, already maintain properly executed timesheets for all non-exempt employees, and already ensure proper time and half/overtime payments in accordance with the county administrative code and state and federal regulations.

The county did not calculate FICA and Medicare withholdings correctly or file 941 forms timely. The county did not calculate FICA and Medicare withholdings correctly for the first six months of Fiscal Year 2015. FICA and Medicare withholdings are based on gross wages less any allowable retirement contribution and any other allowable pre-tax items. The former treasurer based the deduction calculation on gross wages only and did not account for County Employees Retirement System (CERS) contributions. Internal Revenue Service (IRS)

Publication 15 outlines employment taxes and the federal guidelines employers are to follow regarding calculations of FICA and Medicare taxes. This miscalculation for FICA and Medicare withholdings results in employees paying more FICA and Medicare tax than necessary, thus decreasing their net pay. Furthermore, this miscalculation increased the amount of the county's required matching funds causing the county to remit more matching funds than necessary.

In addition, we noted the county did not file a timely Form 941 for the third quarter of calendar 2014 with the Internal Revenue Service as required by IRS Publication 15. Form 941 is used to summarize and reconcile all FICA, Medicare, and federal tax withholdings based on the entity's payroll records. The failure to file these forms timely will likely result in penalties from the IRS and is indicative of improper payroll procedures and poor financial management practices. We recommend the county immediately correct the FICA and Medicare calculations for all employees. Finally, we recommend the treasurer ensure that FICA and Medicare deductions are calculated correctly and ensure complete, accurate and timely 941 Forms are filed quarterly with the Internal Revenue Service.

County Judge/Executive's response: As of January 1, 2015, we have corrected the FICA and Medicare withholdings, by obtaining new accounting software and monitoring in a timely basis, as well as updated all quarterly 941s and kept all 941s and quarterly 941s sent in a timely manner.

The county failed to submit timely, complete, and accurate quarterly reports to the department for local government. The Uniform System of Accounts requires counties to submit quarterly reports to their regulatory agency, the Department for Local Government (DLG). These reports should include all funds of the county, should include all activity within the funds, and should agree to the county's reconciled cash balances. The quarterly report for Owsley County was not filed timely with DLG. In addition to the report not being filed timely, we noted the following:

- Receipts and disbursements listed in the quarterly report were incorrect.
- Emergency Planning Fund activity was not included on the report at all.

Timely, complete, and accurate quarterly reports are essential for the regulatory agency to be informed of the financial activity of a county. Quarterly reports also provide valuable information to the fiscal court regarding receipts, disbursements, and cash balances and are an essential component of sound financial management practices. Without this valuable information, the fiscal court's decision making capabilities may be adversely affected. We recommend the treasurer prepare timely, complete, and accurate quarterly reports to submit to DLG as required.

County Judge/Executive's response: As of January 1, 2015, we have worked diligently to send in any lacking quarterly reports from the past, and prepare and send in all quarterly reports in a timely manner to DLG.

The county did not maintain proper documentation of fiscal court meetings. During our review of the fiscal court minutes, we noted that no minutes of meetings for the audit period

were recorded in the fiscal court minutes book and made available for public inspection at the county clerk's office. KRS 67.100 outlines the requirements for fiscal court records regarding minutes of meetings and requires the minutes to be indexed and filed within 30 days of any action or ordinance. Without complete and accurate minutes available, interested parties are not fully informed of the actions taken by the fiscal court.

We recommend that the fiscal court require the fiscal court clerk to keep up to date minutes indexed and filed in the fiscal court minutes book so they're available for public inspection at the county clerk's office.

County Judge/Executive's response: As of around March 2015, the County Judge/Executive has the finance officer attend all fiscal court meetings and take and later transcribe into hard document format.

Improper payments totaling \$4,200 were made from the road fund. During Fiscal Year 2015, the county paid the sheriff's office a total of \$4,200 out of the Road Fund for transporting prisoners. Road monies are restricted by KRS 177.320. Disbursements from the Road Fund should be for secondary and rural road maintenance, repairs, and related activities. The county is allowed to pay the sheriff for transporting inmates; however, these payments should be made from the Jail Fund, the General Fund, or the LGEA Fund. It is not appropriate to pay the sheriff's office out of restricted road monies. By doing this, the county has reduced the amount of funds available to spend on road repairs and maintenance, and has created a situation in which another fund must pay back the improper payments. In June 2015, the fiscal court reimbursed the Road Fund \$11,200 (\$7,000 from Fiscal Year 2014 and \$4,200 for Fiscal Year 2015) from the General Fund. We recommend that only proper payments for allowable activities are made in the future from restricted Road Fund monies.

County Judge/Executive's response: We corrected this issue on June 10, 2015, by reimbursing the Road Fund from the General Fund \$7,000 and an additional transfer to the Road Fund from the General Fund \$4,200. Total of transfers from General Fund to Road Fund - \$11,200.

The county did not comply with regulations for local government economic assistance coal producing funds. The county did not comply with KRS 42.455 regarding coal producing funds received through the Local Government Economic Assistance (LGEA) program. KRS 42.455 states that 30% of all coal producing funds received must be spent on the county coal haul road system. The county received \$156,063 in coal producing funds, of which \$46,819 was required to be spent on the coal haul road system. The county did not spend any coal producing funds on road repairs/maintenance. Failure to spend the allotted amount as designated is a direct violation of KRS 42.455. We recommend the fiscal court monitor the amounts received and expended in the LGEA Fund to ensure compliance with LGEA regulations in the future.

County Judge/Executive's response: We will monitor closely the LGEA Funds to ensure that 30% of all coal producing funds received must be spent on county coal haul road system through the road fund.

The county did not maintain capital asset schedules in accordance with regulatory requirements. The county did not maintain a complete and accurate capital asset schedule for the fiscal year ending June 30, 2015. Lack of a well maintained and updated capital asset schedule increases the risk of loss or misappropriation of capital asset items. The Department for Local Government (DLG) requires counties to track capital assets (i.e. land, buildings, equipment, vehicles, infrastructure, etc.) and maintain a listing of capital assets to be provided to auditors for inclusion in the audit report. This list should include all current year additions/purchases, retirements, disposals/sale of assets, etc. Any related documentation for capital asset additions, retirements, and disposals in the form of invoices, deeds, purchase orders, sales records, titles, liens, etc. should be maintained in a manner that facilitates easy access, retrieval, and verification of capital asset amounts recorded. We recommend the county implement procedures to identify and track capital asset additions, retirements, and disposals in order for capital asset schedules to be complete and accurate. Additionally, we recommend the county perform physical inventories periodically to further ensure the accuracy and completeness of capital asset schedules.

County Judge/Executive's response: Beginning July 1, 2015, we have an updated capital asset schedule on file.

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

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