



Auditor of Public Accounts  
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**FOR IMMEDIATE RELEASE**

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

**FRANKFORT, Ky.** – State Auditor Mike Harmon has released the audit of the financial statement of the Shelby 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 financial statement presents fairly the receipts, disbursements, and changes in fund balances of the Shelby 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 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 comments:

**The Shelby County Fiscal Court lacks adequate segregation of duties and should improve internal controls over payroll.** During approximately the first half of Fiscal Year 2015, the fiscal court had a lack of segregation of duties and inadequate supervisory review over payroll processing. A former employee had the responsibility of recomputing hours paid from timesheets, calculating overtime and leave time, preparing supplemental payments and withholding payments, entering data into the retirement reporting system, inputting payroll information into the accounting system, preparing ACH files, preparing payroll checks, and identifying and correcting errors.

These actions were possible because management did not implement a strong system of internal controls such as segregating duties or supervisory review. Further, the former employee had unlimited access to the payroll system allowing her to manipulate data by posting additional hours worked, altering pay rates and adding employees without detection.

The lack of adequate controls could lead to the undetected misappropriation of assets, errors and fraud and possible inaccurate reporting to federal reporting agencies.

Good internal controls dictate segregating duties to ensure no one person has the ability to commit and conceal fraud or errors. Duties should be segregated between processing, posting, check-writing, and reconciliation. Further, strong management oversight and review is necessary to help deter, prevent and detect overpayments, payment for time not worked, and processing errors. Employee access should be limited in a computer system to only the functions necessary for that employee to complete job duties. The ability to set up new employees and change pay rates should be limited to someone who does not have the ability to process payroll or create checks.

We recommend the fiscal court implement a strong internal control system by segregating duties, limiting access in the payroll system, and reviewing payroll reports timely to ensure accuracy.

*Former County Judge/Executive Rob Rothenburger's Response: We have put in place a new review system for payroll entry and review. The department heads have an electronic spreadsheet they fill in from the time cards and submit to the payroll officer (finance officer). The finance officer reconciles and enters data into the computer; once this is complete, reports are run. County treasurer reviews payroll spreadsheets submitted by department heads and reconciles to the payroll reports entered by finance officer. County treasurer then signs off and payroll is submitted.*

**The Shelby County Fiscal Court did not implement a capital asset inventory policy or maintain a complete and accurate capital asset schedules.** The fiscal court has not put procedures in place to ensure asset additions or asset retirements and asset disposals are accurately documented during the fiscal year. During capital asset testing, we noted six assets not removed from the insurance policy after they were retired. The auditor also noted annual inventories are requested from the departments, but there is no review or reconciliation of the inventories to the capital asset schedule to ensure accuracy

This is a repeat comment from the prior year as this has been an ongoing issue with the county not taking action to ensure compliance with the Department for Local Government's policy documented in the *County Budget Preparation and State Local Finance Officer Policy Manual*. The Department for Local Government (DLG) requires counties to maintain records for fixed assets including infrastructure, buildings, land, vehicles, equipment and other items purchased or received exceeding capitalization threshold determined by the fiscal court.

Not maintaining an accurate list of assets could result in new assets not being insured and retired assets not being removed from insurance. Further, the capital asset schedule included in the financial statements could be materially incorrect.

Good internal controls over compliance dictate adequate supporting documentation be maintained for assets and the capital asset schedule be updated regularly throughout the year to ensure accurate information is recorded.

In order to strengthen controls over capital assets and infrastructure, we recommend the fiscal court implement a capital asset inventory policy, conduct annual inventories and require departments to submit completed inventory sheets to the county judge/executive's office. The submitted inventory should then be reconciled to the capital asset schedule. If the judge/executive's office finds that notifications of new or disposed capital assets are not submitted from departments timely, a compensating control could include review of the fiscal court minutes, as they typically document purchases and disposals.

*Former County Judge/Executive Rob Rothenburger's Response: Once the item is surplus and transferred, the human resource director will review copies. The human resource director will then turn into KACO to remove from inventory listing. A follow-up will be made with KACO to ensure it was taken off inventory, by the human resource director.*

**The Shelby County Fiscal Court lacks adequate segregation of duties and should improve internal controls over disbursements.** During Fiscal Year 2015, the fiscal court had a lack of segregation of duties and inadequate supervisory review in the disbursements process. One former employee had the ability to procure goods and services, write purchase orders, use credit cards, pay invoices, post transactions, and write checks with little management oversight or review. Further, this former employee could create and change vendor information in the accounting system. This former employee prepared, approved and wrote checks to herself and her spouse during Fiscal Year 2014 and the first half of Fiscal Year 2015. There was no valid supporting documentation for these payments. In addition, this former employee made numerous errors during disbursements processing that went undetected by the county's internal control system.

Management lacked established, consistent policies and procedures for internal controls over disbursements. No supervisory review was performed to ensure all payments made were for valid purchases. The purchase order system in use acted as more of a purchase documentation system. Purchases were made before purchase orders are written, as evidenced by the dates on receipts being earlier than the dates on the purchase orders. Purchase orders were not consistently used for every disbursement. There was no system of tracking checks to ensure checks were not used and signed between batches.

As a result of the weaknesses, auditors noted the following issues during disbursements testing:

- Purchase orders were often prepared, completed, issued, and approved by the former employee. Many of these appeared to have the county judge/executive's name or initials written on the approval line by someone other than him.
- Sufficient supporting documentation was not available for every purchase. Some payments were made from copies of invoices and some payments had no invoices or no purchase order attached.

- Invoices were paid over 30 days past the date of receipt, which could result in late charges, interest, and late fees.
- Management has a responsibility to design and implement internal controls that provide reasonable assurance of safeguarding resources against waste, fraud, and abuse. Good internal controls provide reasonable assurance that the recording, processing, and reporting of data is properly performed and that if errors or fraud occur, detective controls will bring these to management's attention.

Management should be sufficiently involved with day to day operations, by providing strong oversight and review, to mitigate the risks inherent in certain accounting areas. Incompatible duties should be segregated to assure that no one person has the ability to commit and conceal fraudulent activity or to process errors that go undetected.

Good internal controls dictate that adequate supporting documentation and purchase orders be maintained for all disbursements. All vendor invoices, receipts, and statements should be maintained and agree with corresponding purchase orders and reports. KRS 65.140(2) requires all bills for goods and services to be paid in full within thirty (30) working days of receiving a vendor invoice. KRS 424.260 states when the county purchases, makes a contract, lease, or other agreement involving an expenditure of more than \$20,000, they must advertise for bids.

KRS 68.210 gives the State Local Finance Officer the authority to prescribe a uniform system of accounts. In the *Instructional Guide for County Budget Preparation and State Local Finance Officer Policy Manual*, purchase guidelines are prescribed by the State Local Finance Officer, including:

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.

To improve internal controls over disbursements, we recommend the fiscal court take the following actions:

- Segregate duties to ensure no one person has the ability to create, approve, and process transactions without sufficient management oversight and review.
- Review and update the purchase order system in use to ensure state guideline are met.
- Update and communicate the purchase order and credit card policy to all staff.
- Require all original invoices, receipts, statements and other supporting documentation to be maintained and reconciled to corresponding purchase orders and bill lists for all disbursements.

- Pay only from original invoices, not estimates, quotes, copies, or email confirmations.
- Ensure all invoices are processed and paid within 30 days of receipt to avoid unnecessary late charges, interest, and finance charges.
- Update and communicate the policy to staff concerning reimbursement for excess charges during training events for spouses and other family members.
- Account for all checks in numerical sequence by maintaining a check register or other check log system for both the county judge/executive and treasurer that tracks the last check signed, to prevent signing of checks by unauthorized personnel.
- Limit vendor creation and vendor file changes to authorized personnel, provide the county's tax id information to all vendors to avoid paying sales tax.

*Former County Judge/Executive Rob Rothenburger's Response: No purchase orders are written by finance officer. Human resource director or department head issues all purchase orders. When stamped and received in county judge's office, the deputy judge reviews for approval and are then given to finance officer to be placed on bills list for court approval. After court approves, finance officer runs checks, county judge/executive signs, Treasurer approves each P.O. and signs.*

**The Shelby County Fiscal Court did not have adequate controls over credit card purchases, including:**

- Purchase orders without original receipts or invoices.
- Purchase orders without approval signatures from department heads.
- Purchase orders prepared from receipts after purchase.
- Purchase order was paid twice.
- Payments made from credit card statement balances not matched to purchase orders.
- Purchase orders not paid within 30 days of receipt.

Also, in several instances the supporting documentation, i.e. cash register receipts, was not maintained or reconciled to the statements and payment was made based on an outstanding statement balance.

The lack of consistent documentation increases the risk for fraud or error. By not consistently requiring purchase orders prior to using credit card for purchase and matching purchase receipts or invoices to purchase orders, the fiscal court's finance department cannot perform a complete, knowledgeable review of documentation before payment of the expense.

Documentation of all expenditures should be included in the overall payment package for approval by fiscal court. An annual review by the fiscal court of the administrative code is required by KRS 68.005 during the month of June. KRS 65.140(2) requires all bills for goods and services to be paid in full within thirty (30) working days of receiving a vendor invoice. The statute also states that if payment of invoices exceeds thirty (30) days, a 1% interest penalty should be added.

Strong internal controls dictate procedures be in place to reconcile monthly credit card receipts submitted by employees to the credit card statements.

We recommend the fiscal court implement control procedures to ensure purchase orders are prepared prior to purchases using a credit card, purchase receipts are matched to the purchase order, and credit card receipts are reconciled to the credit card statements on a monthly basis. We further recommend full documentation of credit card purchases be provided to fiscal court members with the list of expenditures to be approved.

*Former County Judge/Executive Rob Rothenburger's Response: New credit card use system has been implemented. There is a log at the front desk to check out all credit cards and return them with a P.O. and original receipt or purchase. Finance officer reviews all claims and immediately places on bill list for payment.*

**The Shelby County Fiscal Court had negative bank balances during the fiscal year.** The fiscal court had negative cash balances in the jail fund and road fund bank accounts during the fiscal year. The negative bank balance was noted for seven days for the jail fund and 17 days in the road fund.

The negative bank balances appear to be the result of lack of monitoring of fund balances when claims are paid to realize that a transfer was needed to cover the claims. This caused negative account balances and NSF fees to be incurred to the county for the checks issued.

Negative bank balances are indicative of cash flow problems and is a poor business practice. The negative account balances caused NSF fees to be incurred by the county for the checks issued.

Aside from being good business practice, maintaining positive bank balances are required by statutes. KRS 68.210 requires the State Local Finance officer to create a system of uniform accounts for all counties and county officials. The *County Budget Preparation and State Local Finance Officer Policy Manual* states that the county treasurer is only to sign checks if there is sufficient fund balance and adequate cash in the bank to cover the check.

We recommend the county be sure to verify that all bank accounts have sufficient balances to cover all checks written against them at all times. The county should request cash transfers as necessary from the fiscal court to avoid overdrawing the bank accounts.

*Former County Judge/Executive Rob Rothenburger's Response: Advanced requested cash transfers from the fiscal court have taken care of this issue.*

**The Shelby County Fiscal Court should resolve the negative payroll account balance.** The fiscal court uses a clearing bank account for payroll processing. Deposits are made into the bank account from the county's general, road, jail and EMS funds to pay for salaries, taxes, the county's matching portion of taxes, retirement, and health insurance, and other payments to benefit vendors. The account should reconcile to zero every month because the total amount deposited into the account should be completely paid out that same month. While the fiscal court has completed regular, accurate reconciliations for this bank account, a negative reconciled

balance existed at June 30, 2015 of (\$33,360). The balance is due to the cumulative effect of various errors made in payroll processing, including:

- Overpayment/underpayment of the county's retirement matching contribution to the county retirement system.
- Payment of the monthly health insurance invoice before completing a reconciliation, resulting in a difference between the amount due and the amount paid.
- Various other errors noted in calculations/payments.
- Good internal controls require timely, accurate reconciliations to ensure all funds are properly accounted for and to prevent misappropriation of funds and inaccurate financial reporting.

We recommend the fiscal court reconcile the payroll revolving bank account to zero every month. A reconciliation should also be performed of the health insurance invoice to withholdings and county match before the transfer is made to the clearing account. Differences noted in the reconciliation should be tracked as reconciling items. To address the current negative account balance, the fiscal court should complete a current month reconciliation and determine the ending balance in the account. If the balance is still negative, a cash transfer from the county's funds to the payroll revolving bank account should be made to bring the bank account balance to zero. The reconciliation should be performed by someone other than the person responsible for payroll processing, to ensure an adequate segregation of duties.

*Former County Judge/Executive Rob Rothenburger's Response: Bank account is now being reconciled by County Treasurer each month instead of Finance Officer.*

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

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