Auditor of Public Accounts
Mike Harmon

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Contact: Michael Goins
Michael.Goins@ky.gov
502.564.5841
502.209.2867

Harmon Releases Audit of Wolfe County Fiscal Court

FRANKFORT, Ky. – State Auditor Mike Harmon has released the audit of the financial statement of the Wolfe 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 Wolfe County Fiscal Court in accordance with accounting principles generally accepted in the United States of America. The fiscal court's financial statement did not follow this format. However, the fiscal court's financial statement is fairly presented in conformity with the regulatory basis of accounting, which is an acceptable reporting methodology. This reporting methodology is followed for 115 of 120 fiscal court audits in Kentucky.

As part of the audit process, the auditor must comment on noncompliance with laws, regulations, contracts, and grants. The auditor must also comment on material weaknesses involving internal control over financial operations and reporting.

The audit contains the following comments:

A Schedule of Expenditures of Federal Awards (SEFA) was not prepared: This is a repeat finding and was included in the prior year audit report as Finding 2018-005. The fiscal court received and expended federal grant funds during Fiscal Year 2019. A Schedule of Expenditures of Federal Awards (SEFA) detailing these federal grants was not prepared.

The fiscal court was aware of the requirement but failed to prepare the SEFA. Failure to prepare the SEFA increases the risk that a required separate audit of federal funds will not occur when federal expenditures exceed $750,000. Not properly reporting federal funds increases the possibility of undetected errors or misappropriation and potential loss of future federal grant funding.

KRS 68.210 gives the state local finance officer the authority to prescribe a uniform system of accounts. Pursuant to KRS 68.210, the state local finance officer has prescribed minimum accounting and reporting standards in the Department for Local Government's (DLG) *County Budget Preparation and State Local Finance Officer Policy Manual*, which on page 54 states that a Schedule of Expenditures of Federal Awards is required to be maintained under the uniform system of accounts.

We recommend the fiscal court maintain accurate and complete records for all federal grants and prepare a SEFA at the end of each fiscal year.

County Judge Executive's Response: February 2019 new Treasurer was appointed. Fiscal Court had not received any federal money due to prior errors of former administration. This report had not been completed for the past 2 years therefore we had nothing to reference, along with the unknown of Federal Awards prior to January. We plan to ensure required reports on submitted correctly in the future.

The fiscal court lacks adequate controls over interfund transfers: This is a repeat finding and was included in the prior year audit report as Finding 2018-012. The fiscal court minutes indicate transfers are presented to the court monthly. However, the fiscal court appears to give a blanket approval for transfers each month without reviewing a list of individual transfer amounts.

The fiscal court lacks adequate controls and oversight for interfund transfers. As a result, transfers may be made without the specific approval of the fiscal court, which increases the risk of undetected errors, fraud, misstatements, or other non-compliance issues. As a result of undetected errors in interfund transfers, we noted interfund liabilities and receivables that will increase the interfund liabilities and receivable amounts reported in the prior year audit report. The road fund transferred $20,000 to the payroll revolving account that did not get returned by year end. Since the revolving payroll account does not have a revenue source other than transfers from other funds, this repayment will have to be made from the general fund and will be reported as a liability of the general fund.

KRS 68.210 gives the state local finance officer the authority to prescribe a uniform system of accounts. Pursuant to KRS 68.210, the state local finance officer has prescribed minimum accounting and reporting standards in the Department for Local Government's (DLG) *County Budget Preparation and State Local Finance Officer Policy Manual*, which requires a court order for all transfers. The funds and amount for each individual transfer should be recorded in the official minutes of the fiscal court.

In addition, strong internal controls prohibit the transfer of monies from restricted funds since this increases the risk of inappropriate use. Under the regulatory basis of accounting, fund balances on the financial statement are not adjusted for the unpaid liabilities and receivables, however, the liability amounts are still owed.

We recommend the fiscal court implement adequate controls over transfers to ensure all specific amounts are approved and that all transfers from restricted funds are used for appropriate purposes to prevent interfund liabilities. We further recommend the amounts due to the road fund be repaid as funds become available.

County Judge Executive's Response: This issue has been corrected beginning May 2019. Any and all interfund transfers are now listed separate on the accounts payable for approval by the Fiscal Court.

The fiscal court did not report the Public Properties Corporation Debt and did not include long term liabilities schedule with the fourth quarter report: This is a repeat finding and was included in the prior year audit report as finding 2018-013. The treasurer did not report public properties corporation fund debt principal outstanding of $7,235,000 and did not report lease principal outstanding of $1,003,632 on the fourth quarter financial report.

The fourth quarter financial report submitted to the Department for Local Government (DLG) did not include a liabilities section; therefore, none of the county's outstanding debt obligations were reported properly.

Quarterly reports provide valuable information to the fiscal court and are an essential component of sound financial management practices. Complete and accurate quarterly reports enable the fiscal court to be fully informed of its financial activity and obligations. Failure to include material debt obligations may adversely affect the fiscal court's decision making capabilities.

KRS 68.210 gives the state local finance officer the authority to prescribe a uniform system of accounts. Pursuant to KRS 68.210, the state local finance officer has prescribed minimum accounting and reporting standards in the DLG's *County Budget Preparation and State Local Finance Officer Policy Manual*, which requires counties to include a liabilities listing for all outstanding debt with the quarterly financial report.

We recommend the fiscal court ensure that all outstanding bonds, leases, notes, and other debt obligations are reported in the liabilities section of the fourth quarter financial statement.

County Judge Executive's Response: February 2019 through April 2019 was spent recreating the Fiscal Court Accounting system. During this time we were in the process of creating new budgets following DLG timetable recommendations. Due to being inexperienced, many errors that may have occurred was an oversight. We feel confident these issues will be less likely to occur in the future as time and experience will correct them.

The fiscal court did not establish adequate controls over the Justice Center Corporation Fund: No financial statements were prepared and no information regarding the activity in the fund was submitted to the fiscal court for review. The treasurer was unaware he had to prepare a financial statement for the Justice Center Corporation Fund. This fund is for reporting of debt financing for the fiscal court and not included on the quarterly report, per Department for Local Government (DLG) guidelines.

By not preparing an annual financial statement, the fiscal court is not aware of the transactions that are occurring relating to the receipts and disbursements of the unbudgeted fund. This could result in fraud, errors, or undetected misstatements. The fiscal court is financially accountable and legally obligated for the debt of the Justice Center Corporation Fund. The fiscal court should establish adequate controls over the fund so that proper records are maintained, and complete and accurate information is available for review.

We recommend the county treasurer reconcile this account and prepare a financial statement for the Justice Center Corporation Fund.

County Judge Executive's Response: This is not a budgeted fund, current treasurer was unaware this needed to be monitored by the Fiscal Court. No previous financial statements were located. We plan to create a financial statement to monitor this fund. Due to being inexperienced, many errors that may have occurred was an oversight. We feel confident these issues will be less likely to occur in the future as time and experience will correct them.

Road funds were used to pay the full amount of insurance premiums: This is a repeat finding and was included in the prior year audit report as Finding 2018-004. During Fiscal Year 2019, the fiscal court expended road funds to pay the full amount of premiums, totaling $176,953, to Kentucky Association of Counties (KACo) for the county's liability insurance, workers compensation, and unemployment insurance. These premiums were paid entirely from the road fund because other funds had negative fund balances. As a result, the county did not use road funds appropriately.

It would be acceptable if the road fund had paid a portion of the insurance invoice, as counties often prorate the premiums to each participating fund. However, road funds are not permitted to be used for general government purposes and should not pay the full insurance premiums for the county. Road funds are restricted and are required to be expended for road related purposes, except for the amount approved by the Department for Local Government (DLG) on the road cost allocation worksheet.

We recommend the fiscal court prorate the insurance premium among participating funds, such as the general fund, jail fund, solid waste fund, and other participating funds.

County Judge Executive's Response: July 2018 the General fund was negative $24,665, the Jail fund was negative $28,494. Funds coming into these accounts were not sufficient enough to cover the debt along with the premium at the time. Due to this issue the Fiscal Court recognized it would be best to pay the bill from the Road fund which had sufficient money to cover the premium. The Fiscal Court was not fully aware the transaction was not allowed, and corrected this in July 2019.

The fiscal court failed to remit a share of the national forestry receipts to the school district: This is a repeat finding and was included in the prior year audit report as Finding 2018-006. The fiscal court received one check totaling $1,844, in national forestry receipts in Fiscal Year 2019. A portion of that amount was to be remitted to the Wolfe County Board of Education. The fiscal court failed to remit funds to the board of education and this error was undetected by management. As a result, the board of education did not receive their share of the national forestry receipts.

KRS 149.130(3) states, "[t]he county treasurer shall place one-half (1/2) of the funds to the credit of the public roads of his county and the other half (1/2) shall be distributed among the school districts in the county according to the area of the reserve in each school district."

We recommend the fiscal court remit the required amount of national forestry receipts to the board of education.

County Judge Executive's Response: This is an oversight issue.

The fiscal court lacked adequate segregation of duties and internal controls over the payroll process: This is a repeat finding and was included in the prior year audit report as Finding 2018-010. During our testing of payroll, we noted the following:

- Payroll checks for the first half of the audit period were only signed by one individual, either the former county judge/executive or the former treasurer but not both.
- State tax withholdings for July 2018 to January 2019 were not paid timely for which $232 in interest was paid.
- Payroll transfers from the general, road, jail, Local Government Economic Assistance (LGEA), and solid waste funds to the revolving payroll account were not made timely for July to December 2019. Road fund monies totaling $8,500 were transferred to the payroll revolving account to cover the deficit created by untimely transfers, but was not returned.

The fiscal court lacked adequate segregation of duties and internal controls over payroll. The former treasurer handled all aspects of the payroll process and there appeared to be no independent review of payroll by anyone other than the preparer.

The payroll issues noted above could have been prevented, detected, or corrected timely had proper internal controls and segregation of duties existed. The road fund transfer that was not returned by the revolving payroll account creates an interfund liability of $8,500 from the general fund to the road fund. Since the revolving payroll account has no source of revenue except transfers from various funds, the liability must be paid from the general fund.

Good internal controls require different individuals to process, calculate, authorize, record, and reconcile payroll information. One individual should not have sole control over the entire process. If segregation of duties is not possible, strong management oversight and a documented review process should be implemented to offset the risk of inadequate segregation of duties. Additionally, KRS 68.020(1) requires, "[a]ll warrants for the payment of funds from the county treasury shall be co-signed by the county treasurer and the county judge/executive."

Strong internal controls and good financial management practices require transfers to the revolving payroll account be made timely so that all withholdings, deductions, taxes, matching contributions, etc. can be paid timely. Furthermore, KRS 141.330(1) states, "[e]very employer required to deduct and withhold tax under KRS 141.310 and 141.315 shall, for the quarterly period beginning on the first day of January of each year, and for each quarterly period thereafter, on or before the last day of the month following the close of each quarterly period make a return and report to the department the tax required to be withheld under KRS 141.310 and 141.315, unless the employer is permitted or required to report monthly or annually. Such employer shall, on or before the last day of the month following the close of each quarterly period, pay over to the department the tax required to be withheld under KRS 141.310 and 141.315; Provided, however, That the department may, by regulations, require employers to remit the tax withheld under KRS 141.310 and 141.315 within a reasonable time after the payroll period or other period. A return shall be filed by every employer making payment of wages even though no tax has been withheld. (2) If the department, in any case, has reason to believe that the collection of the tax."

We recommend the fiscal court review payroll procedures and implement effective internal controls, review procedures, and oversight to ensure payroll is accounted for correctly and all applicable rules, regulations, and statutes are followed.

County Judge Executive's Response: January 2019 new Judge Executive was elected. February 2019 new Treasurer was appointed. Since then, the entire payroll process has been completely revamped. All checks are required to have 2 signatures, and withholdings are paid up to date and being submitted properly. Electronic payroll reports are created to request disbursement checks for required funds to be deposited in the payroll revolving account before payroll checks are issued. Treasurer and CFO each have segregated duties throughout the process to ensure payroll is done correctly.

The fiscal court is not monitoring The Chop Shop agreement: This is a repeat finding and was included in the prior year audit report as Finding 2018-014. In January 2013, the county entered into a loan agreement with J.S.W. Farm, LLC DBA The Chop Shop for the purchase of the land and building pad located in the Wolfe-Morgan Industrial Park. The agreement requires ten annual payments of $47,500 beginning January 2014, payable to the Wolfe County Fiscal Court. The county will forgive the principal and interest payments if The Chop Shop creates and maintains employment at levels equal or greater than 15 full-time employees for calendar year 2014 and 2015, increasing to thirty full-time employees for the remaining eight years of the agreement. The agreement further defines full-time as working 1,820 hours per year and average wage of at least $14,560 per year, $8 per hour average.

The prior audit finding noted that the fiscal court had not determined if The Chop Shop had created and maintained the required employment levels. No evidence was provided that the fiscal court was attempting to monitor The Chop Shop's compliance with the terms of the loan agreement for Fiscal Year 2019.

The fiscal court may be owed principal and interest from The Chop Shop if employment levels have not been verified and documented per the terms of the agreement.

The loan agreement outlines provisions for which the principal and interest can be forgiven. If compliance with these requirements cannot be documented by The Chop Shop and the Wolfe County Fiscal Court, the fiscal court should seek loan repayment in accordance with the agreement. The fiscal court should be requesting payroll information at least annually to determine compliance with the agreement.

We recommend the fiscal court review their agreement with The Chop Shop and put in place a process to monitor compliance with the terms of the agreement. We further recommend the fiscal court determine if The Chop Shop owes principal and interest to the fiscal court.

County Judge Executive's Response: The County receives payroll tax from The Chop Shop showing they do have employees. County Judge Executive has recently met with owners of JSW Chop Shop to discuss the issue. It was verbally discussed the number of employees employed by the Chop Shop and would appear they are in compliance. The Fiscal Court is in the process of creating a system to effectively monitor the compliance of this agreement in the future.

The fiscal court did not properly budget for and record all debt related disbursements: The fiscal court entered into a lease agreement in the amount of $154,760 for the purchase of road equipment. The transactions were not reflected in the county's bank activity, budget process, or fourth quarter financial report as these funds were paid directly to the vendor by the financing entity. The treasurer was not aware that this transaction should be reflected on the county's financial information. As a result, the fiscal court failed to properly budget and record $154,760 in debt related receipts and disbursements for the fiscal year.

KRS 68.210 gives the state local finance officer the authority to prescribe a uniform system of accounts. The uniform system of accounts is set forth in the *County Budget Preparation and State Local Finance Officer Policy Manual*, which requires all borrowed money that is not part of the original budget be amended into the budget and be properly reflected on the financial report. Furthermore, KRS 68.280 states, "[t]he fiscal court may make provision for the expenditure of receipts unanticipated in the original budget by preparing an amendment to the budget, showing the source and amount of the unanticipated receipts and specifying the budget funds that are to be increased thereby."

We recommend the fiscal court comply with regulatory reporting requirements by budgeting and recording all borrowed money, including those transactions handled by a third-party lender.

County Judge Executive's Response: The purchase of this equipment is created by the Fiscal Court but the County never receives the money in any account nor does the County issue a disbursement check from any fund. This purchase is handled by the lender of the money and the vendor of the equipment. The lease payments are budgeted in the budget but the purchase itself is not. We were not aware this purchase should be logged into our accounting software. However, since no transactions exist in our bank records, logging this transaction into our accounting software would create an issue during reconciliation. We will look further into the matter to find a solution to prevent future issues.

The fiscal court did not have effective internal controls, review procedures, and oversight for the budget process: Numerous budgetary issues were noted for Fiscal Year 2019:

- The county's fourth quarter report included a budgeted amount of $25,000 for the road fund that did not appear on the original budget. The former treasurer erroneously recorded this amount on the quarterly report and erroneously recorded line item budget transfers out of this account code even though there was no budgeted amount to transfer.

- The revolving grant account had $72,735 of activity for the fiscal year but this fund was not part of the original budget nor were budget amendments prepared and submitted to account for the activity in this fund.

- Budget amendments for the fiscal year were not filed until May 2019 even though activity that required budget amendment occurred throughout the fiscal year.

- The fiscal court did not comply with 65 percent spending limits for first half of the fourth year for the Pavilion Fund and the United Against Drugs Fund. These funds had expenditures totaling $6,348 and $7,981, respectively, as of December 31, 2018. The budget amendments for these funds were not filed until May 2019.

The fiscal court did not have effective internal controls, review procedures, and oversight for the budget process. Inadequate controls over the budget process resulted in the undetected errors noted above. Additionally, the fiscal court is not in compliance with statutes regarding budget preparation, budget amendments, and spending limits for the first half of the fourth year. Furthermore, the fiscal court relies on information presented in the quarterly financial reports and inaccurate information could lead to improper decision making.

KRS 68.210 states, "[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 and shall install, by July 1, 1985, a system of uniform accounts for all counties and county officials." The Department for Local Government's (DLG) *County Budget Preparation and State Local Finance Officer Policy Manual* requires county officials to submit quarterly reports that show, among other things, the amounts from the original budget for each category of receipts and expenditures. The fourth quarter financial report must agree to the original budget and budget amendments submitted to and approved by the DLG.

Regarding budget amendments, KRS 68.280 states, "[t]he fiscal court may make provision for the expenditure of receipts unanticipated in the original budget by preparing an amendment to the budget, showing the source and amount of the unanticipated receipts and specifying the budget funds that are to be increased thereby. The amendment shall be submitted to the state local finance officer subject to the same provisions as the original budget." Budget amendments should be prepared when unanticipated revenues are received so that the funds can be expended without consequence.

KRS 68.300 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. No member of the fiscal court shall vote for any such illegal appropriation or claim. The county treasurer shall be liable on his official bond for the amount of any county warrant willfully or negligently signed or countersigned by him in excess of the budget fund out of which the warrant is payable."

Limitations on expenditures in the first half of each fourth year are outlined in KRS 68.310: "Except in case of an emergency concerning which the county judge/executive, the fiscal court and the state local finance officer unanimously agree in writing, and, except for encumbrances or expenditures from the county's road fund, no county shall, during the first half of any fourth fiscal year, beginning with the fiscal year 1998-1999, encumber or expend more than sixty-five percent (65%) in any fund budgeted for that fiscal year, not counting as current funds any budgetary allotments for or payments of principal and interest of bonded indebtedness."

We recommend the fiscal court implement effective internal controls, oversight, and review procedures to ensure all budgeted amounts reflected on the fourth quarter financial report are complete and accurate and agree to the original budget and budget amendments and that all funds be budgeted in accordance with KRS 68.300. Furthermore, we recommend timely budget amendments be submitted for unanticipated receipts. Finally, we recommend the fiscal court adhere to limitations on expenditures in the first half of each fourth year.

County Judge Executive's Response: February 2019 new Treasurer was appointed. No receipts had been posted to the system to keep accurate data on financials since March 2018. Therefore February 2019 through April 2019 was spent recreating the Fiscal Court Accounting system. As noted in the comment, amendments were not submitted until May of 2019, during this time we were also in the process of creating new budgets following DLG timetable recommendations. Due to being inexperienced, many errors that may have occurred was an oversight. We feel confident these issues will be less likely to occur in the future as time and experience will correct them.

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

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