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

FRANKFORT, Ky. – State Auditor Mike Harmon has released the audit of the financial statement of the Fulton County Fiscal Court for the fiscal year ended June 30, 2021. 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 Fulton 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 116 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:

The Fulton County Fiscal Court does not have adequate segregation of duties over accounting functions and financial reporting: This is a repeat finding and was included in the prior year audit report as Finding 2020-001. The Fulton County Fiscal Court does not have adequate segregation of duties over accounting functions and financial reporting of fund balances, cash balances, and debt service. The Fulton County Treasurer was responsible for preparing monthly, quarterly, and annual reports, financial reports, preparing debt schedules, and reconciling bank accounts.

The following control deficiencies occurred due to the lack of segregation of duties over these areas:

- As reported in Finding 2021-002, beginning and ending fund balances were misstated, and a large variance was noted between the total unencumbered cash balance and the total reconciled cash balance.
- As reported in Finding 2021-005, outstanding debt balances do not agree with the long-term liabilities section of the fourth quarter financial statement.
- As reported in Finding 2021-006, the payroll revolving account does not properly reconcile to zero.

While it may be customary for the county treasurer to perform these functions, the fiscal court failed to adequately segregate the duties involved. The fiscal court also failed to establish adequate management oversight to ensure receipts and disbursements were properly recorded and that completed bank reconciliations were accurate. Furthermore, the fiscal court failed to establish adequate management oversight to ensure fund balances, cash balances, and outstanding debt balances were accurately reported.

The lack of adequate segregation of duties, coupled with a lack of adequate management oversight, provides an environment in which an individual could manipulate financial records and misappropriate or misdirect county funds. The segregation of duties over various accounting functions such as recording receipts and disbursements, performing bank reconciliations, and preparing monthly, quarterly, and annual financial reports 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.

We recommend the fiscal court segregate the duties involved in recording receipts and disbursements, reconciling bank accounts, and preparing monthly, quarterly, and annual financial reports. If segregation of duties is not possible due to the limited number of staff, appropriate management oversight should be provided to ensure the completion of accurate, timely financial reports. This oversight should include a documented review of financial reports by management.

County Judge/Executive's Response: The County Judge and Administrative Assistant has developed a system to reconcile accounts for reporting purposes which will be in force for the monthly reporting as of July 2022. The system will be used to reconcile accounting records with bank statements and identify differences for reconciliation. Additionally, we are seeking outside professionals to evaluate our process and improve the process which should eliminate this finding.

The Fulton County Fiscal Court failed to implement adequate internal controls to ensure complete and accurate accounting records were maintained: This is a repeat finding and was included in the prior year audit report as Finding 2020-002. There were no functioning internal controls in place over the work performed by the county treasurer. The fiscal court failed to provide adequate oversight, allowing the county treasurer control over the accounting and reporting functions. The following deficiencies and errors were noted during the performance of the audit:

- The fourth quarter financial report was inaccurate:
    - The beginning fund balance of the general fund was overstated by $658,100.
    - The beginning fund balance of the jail fund was overstated by $605.

    - The ending fund balances of the general fund and jail fund were overstated by $904,407 and $400 respectively.
    - On the fourth quarter financial report, there was a $1,688,359 variance noted between the total reported cash balance and total reconciled cash balance.
- The total budgeted amounts per the original budget and budget amendment do not agree with the budgeted amounts reported on the fourth quarter report for the American Recovery Plan Act (ARPA) Fund. Total budgeted amounts on the fourth quarter financial report were $1,167,978, while actual budgeted amounts were $579,704 for a variance of $588,274.
- There was no record in the fiscal court minutes that the quarterly reports were presented to the fiscal court as required by KRS 68.360.

The Fulton County Fiscal Court failed to implement a strong internal control system or provide proper oversight to ensure complete and accurate accounting records were maintained. Instead, the county placed reliance on the county treasurer, and chose not to scrutinize the discrepancies noted on the quarterly reports. The overstatement of beginning and ending fund balances of the general fund was primarily related to the fact that the amounts recorded for payroll expenditures did not agree with the amounts transferred to the payroll fund. The overstatement of the ending balance of the jail fund was the result of posting errors.

According to the county treasurer, the quarterly reports were not presented to and/or approved by the fiscal court because it was believed that quarterly reports were not required to be presented to the court.

Due to the fiscal court's lack of effective oversight of the treasury functions, the deficiencies, noncompliances, and undetected errors noted above pertaining to required record-keeping occurred without detection. Additionally, the fiscal court was unable to properly budget and plan for the following fiscal year due to inaccurate financial information being presented.

Strong internal controls over the reporting process are vital in ensuring the financial reports accurately reflect the financial activity of the fiscal court as well as ensuring adherence to applicable laws and regulations.

KRS 68.360(1) states, "[t]he county treasurer shall balance his books on the first day of each month, so as to show the correct amount on hand belonging to each fund on the day the balance is made, and shall within ten (10) days file with the county judge/executive and members of the fiscal court a monthly statement containing a list of warrants paid by him during the month, showing all cash receipts and the cash balance at the beginning and at the end of the month, and certifying that each warrant or contract is within the budget appropriation."

Additionally, KRS 68.360(2) states, "[t]he county judge/executive shall, within fifteen (15) days after the end of each quarter of each fiscal year, prepare a statement showing for the current fiscal year to date actual receipts from each county revenue source, the totals of all encumbrances and expenditures charged against each budget fund, the unencumbered balance of the fund, and any transfers made to or from the fund. The county judge/executive shall post the statement in a conspicuous place in the courthouse near the front door for at least ten (10) consecutive days and transmit a copy to the fiscal court and to the state-local finance officer. The statement shall be read at the next meeting of the fiscal court."

KRS 65.905(2) requires, "[t]he final quarterly report filed by a county within fifteen (15) days after the end of the last quarter of the fiscal year, in accordance with KRS 68.360(2), shall be deemed the uniform financial information report for that county for purposes of compliance with KRS 65.900 to 65.925."

KRS 68.020(4) states that county treasurer, "shall keep an accurate detailed account of all money received and disbursed by him for the county and shall keep books of account of the financial transactions of the county in the manner required by the uniform system of accounting prescribed by the state local finance officer."

We recommend the Fulton County Fiscal Court strengthen oversight and internal controls in order to ensure complete and accurate accounting records are maintained and that no one individual has control over the accounting functions without establishing checks and balances to verify amounts recorded and reported are accurate. We also recommend the fiscal court scrutinize any unusual amounts or variances noted on the quarterly reports.

County Judge/Executive's Response: The Fiscal Court has requested the County Judge employ an accounting firm to assist with evaluating the accounting and financial record keeping system used by the county and to recommend modifications of the system aimed at corrective actions requested by the audit. The evaluation is to consider provisions for staffing, internal controls procedures, and accounting technology necessary to streamline the process and effectiveness of the accounting system. This finding involves an accounting (posting) error that has accumulated over the past 10+ years. It is a function of the complexity of the payroll system. The payroll system, which operates in the General Fund, has five separate payroll entities with three separate pay periods. Making the system more complex is the fact that three of the initiates perform their own payroll but remit all withholdings to the county payroll system where their local, state, and federal taxes are paid. The Sheriff's Office has contributed greatly to the accounting error in question. The Sheriff runs his own payroll. For reporting purposes, he remits his withholding to the Treasurer for the reporting and payment of Sheriff's Department payroll. Often the Sheriff, being a Fee Office, does not have the cash to remit to the Treasurer. When that happens, the Treasurer must report Sheriffs withholding and make remittance to local, state, and federal authorities the withholding reported by the sheriff. Without the actual remittance from the Sheriff, the Treasurer must then make that payment out of the General Fund subject to the Sheriff catching up on his payment to the county at a later time. According to the auditor, this is a major contributor to the accounting issue.

The accounting firm to be employed will examine payroll records to the extent the beginning of this accumulative accounting error can be located and corrected allowing us to move all data forward in order to correct the error. The current Treasurer, County Judge and Fiscal Court did not create this problem; however, the problem has continued during the current term in office. It was difficult to detect and address the problem over the past 8 years because due to several issues, audits were delayed outside the control of the Treasurer and the Fiscal Court. It would be difficult to correct an audit finding before we knew the finding existed. For example, during the previous 12-month period the county will have had audits presented for the past 5 years. How could we address an audit finding for the FY 2017-2018 when the audit report for that year was not presented to the county until FY 2021-2022?

This finding also involved an ARPA deposit which was posted incorrectly, adding to the volume of the error. The ARPA posting has already been corrected.

Once the work is completed by the proposed CPA firm, this finding should be corrected. However, the likelihood of it reoccurring is good if we do not reinvent the payroll system used. The current recommendation by the County Judge is that the fee offices take complete control of their payroll, including reporting and remitting to the various taxing organizations.

Auditor's Reply: The amounts transferred to the payroll account for all entities, including the sheriff were not properly recorded by the treasurer, resulting in a materially incorrect general fund balance. As discussed with the county judge/executive, a CPA firm, which the county hired, did not release the FY 2017, 2018, and 2019 audit reports until 2022. The delay in completing the FY 2017 through 2019 audits did not allow timely completion of the FY 2020 and 2021 audits. As a result, we completed the FY 2020 and 2021 audits consecutively to expedite their release.

The Fulton County Fiscal Court's purchase order system did not function as designed: Purchase orders were either not issued for all purchases or in other instances were issued after the purchase had been made and the invoice was received.

We tested 64 transactions totaling $1,653,883. Four of these transactions totaling $2,566 did not have a purchase order prepared for the purchase. Fifty-four of these transactions totaling $1,554,429 had purchase orders prepared after the invoice was received from the vendor. Furthermore, one transaction for $3,936 did not have an itemized invoice, but had a purchase order, and one transaction was paid after 30 days. Due to the purchase order system not working as designed, encumbrances listed on the fourth quarter financial statement were not accurate. Outstanding invoices dated for the 2021 fiscal year were not reported as encumbrances but were instead included in the 2022 fiscal year. According to the county treasurer, individuals sometimes make purchases prior to requesting purchase orders. In these instances, the fiscal court will prepare purchase orders when invoices are received.

The issues noted above could result in line-items being over budget, claims being paid which are not valid obligations of the fiscal court, inaccurate reporting, and misappropriation of assets.

KRS 68.210 gives the state local finance officer the authority to prescribe a system of uniform accounts. The *County Budget Preparation and State Local Finance Officer Policy Manual* states, “[p]urchase requests shall not be approved in an amount that exceeds the available line item appropriation unless the necessary and appropriate transfers have been made.”

Additionally, according to a memorandum from the Department for Local Government (DLG) dated August 4, 2016, “[t]he main purpose of this system is to ensure that purchases can be made if there are sufficient appropriations available within the amount of line items in the county’s budget. Because of this, it is a requirement by the State Local Finance Officer that all counties have a purchase order system and follow the guidelines prescribed on Page 54 of the *County Budget Preparation and State Local Finance Officer Policy Manual*.” Furthermore, DLG highly recommends that counties accept the practice of issuing purchase orders for payroll and utility claims.

Lastly, strong internal controls dictate the purchase orders be issued and approved prior to items being ordered and expenses being incurred, in order to ensure available line-item appropriation exists.

We recommend the Fulton County Fiscal Court strengthen internal controls over disbursements by ensuring that purchase orders are issued prior to all purchases being made. We further recommend that the fiscal court use these purchase orders to keep an accurate list of encumbrances.

County Judge/Executive’s Response: This finding is about 4 purchases that did not have a PO attached. The treasurer stated that the POs could have been displaced during the audit or when claims were copied for magistrate review, but she was not sure. She is sure that an effort is always made to make sure POs are attached to each claim. Another part of this finding was several POs were dated after the purchases were approved or made. Going forward a renewed effort will be made to assure POs are used for their intended purpose and are dated before purchases are made.

Pledged securities were insufficient to cover deposits and the pledge agreement was not properly signed: Fulton County’s deposits as of June 30, 2021, were undercollateralized by $611,503. Additionally, the county failed to sign the pledge agreement with one banking institution bringing into question the validity of the pledged securities. Also, the Fulton County Detention Center failed to obtain a written pledge agreement with the banking institution used for the jail commissary.

The county and the depository institution had a written agreement stating the depository institution would provide adequate collateral to protect the county’s deposits. In this case, the bank pledged a $3,500,000 line of credit. As of June 30, 2021, this pledged line of credit was not sufficient to cover the deposits of the county. The validity of the agreement is uncertain because, according to the bank, the county failed to return a copy of the agreement that was signed by the county judge/executive.

The detention center wasn’t covered by the county’s pledge agreement because they used a different banking institution. They failed to get a pledge agreement because the commissary balance is usually less than FDIC coverage.

Because the pledged line of credit was insufficient, the pledge agreement was not signed by both parties, and the detention center failed to obtain a written agreement, the county's deposits could be exposed to risk in the event of bank failure or insolvency.

The Fulton County Fiscal Court maintained deposits of public funds with federally insured banking institutions as required by the Department for Local Government's (DLG) *County Budget Preparation and State Local Finance Officer Policy Manual*. The DLG manual strongly recommends perfected pledges of securities covering all public funds except direct federal obligations and funds protected by federal insurance. In order to be perfected in the event of failure or insolvency of the depository institution, this pledge or provision of collateral should be evidenced by an agreement between the fiscal court and the depository institution, signed by both parties, that is (a) in writing, (b) approved by the board of directors of the depository institution or its loan committee, which approval must be reflected in the minutes of the board or committee, and (c) an official record of the depository institution. Pledged securities should be sufficient enough to cover the amount of funds that exceed FDIC coverage.

We recommend the county provide the bank with a signed copy of the pledge agreement and monitor deposits and bank balances and notify banking institutions to pledge or provide collateral in an amount sufficient to secure deposits of public funds at all times. We also recommend the detention center enter into a perfected pledge agreement with the depository institution and obtain pledged securities, which are sufficient enough to cover the amount of deposits in excess of FDIC coverage.

County Judge/Executive's Response: This finding was because, according to the auditor, the pledge agreement was not signed by the county. During the audit exit meeting the Treasurer provided evidence that she requested the bank send us a pledge agreement. In reviewing the Treasurer's file on this subject, the bank sent a signature card used to authorize changes in the pledge. The Treasurer had the card signed by the appropriate parties and ask if the bank wanted the card returned. The bank said "no," just maintain the cards for county use if the level of the pledge were to be released by the county. The Treasurer may have assumed this was the document required by DLG. The Treasurer's file did contain an irrevocable letter of credit dated September 19, 2019, which increased the LOC to $4,500,000, which expired September 18, 2020. The LOC in the file for September 18, 2020, through September 17, 2021, was for $3,500,000 and from May 26, 2021, through May 25, 2022, is $5,000,000. The issues I have with the finding is, if the LOC covering the security deposit for the balance on June 30, 2021, was $611,503 short based on the bank pledge of $3,500,000, that would mean our balance on that date would have been $4,111,503. If that balance is correct, the finding may be incorrect because according to the LOC providing for the $3,500,000 was amended on May 26, 2021, through May 25, 2022, in the amount of $5,000,000. I request this part of the find be reevaluated.

Another issue is the security agreement indicates the bank will keep the county security arrangement at 102% of deposits. That being the case, the bank did not maintain its commitment if the finding is current. If the finding is incorrect and the $5,000,000 LOC was in effect, the banks obligation was met.

On the issue of the unsigned security agreement. It appears that the bank may have sent a contract to be signed on behalf of the county in September of 2019. They have emails that indicate such but evidence of that is not present on any of our emails. There is evidence that the Treasurer was asking for an agreement. I now have a copy of the 2019 agreement, which is still in affect and is now signed by myself and a copy has been placed in our files as well as returned to the bank. In the future, we will keep closer watch on deposits and security arrangements to make sure the county is not at risk in this matter.

Auditor's Reply: This finding is based on a third-party confirmation obtained from the county's banking institution. According to the banking institution, a copy of the collateral security agreement signed by the bank was sent to the county. However, a copy of the agreement signed by the county was never returned to the bank. As stated in the finding, in order to be perfected in the event of failure or insolvency of the depository institution, the pledge or provision of collateral should be evidenced by an agreement between the fiscal court and the depository institution, signed by both parties, that is (a) in writing, (b) approved by the board of directors of the depository institution or its loan committee, which approval must be reflected in the minutes of the board or committee, and (c) an official record of the depository institution. Given that all of the criteria were not met, the validity of the line of credit pledged to cover the county's deposits is in question. Regardless of the validity, the $3,500,000 line of credit, as confirmed by the banking institution, was not sufficient to cover the county's deposits as of June 30, 2021.

Debt balances do not agree with the long-term liabilities section of the fourth quarter financial statement: This is a repeat finding and was included in the prior year audit report as Finding 2020-003. On the liabilities section of the June 30, 2021 quarterly financial statement, the Fulton County Fiscal Court reported outstanding debt principal in the amount of $3,946,280 and outstanding interest in the amount of $1,155,736. However, the confirmed outstanding principal balance was $3,936,655, and the outstanding interest balance was $1,192,486 thereby resulting in variances of $9,625 and $36,750, respectively. According to the county treasurer, the misstatement occurred due to clerical errors that were not caught. This condition is also the result of the lack of segregation of duties and fiscal court's failure to establish adequate management oversight as reported in Finding 2021-001. As a result, the fourth quarter financial statement was understated. Additionally, because outstanding liabilities were not accurately reported, the fiscal court cannot make effective management decisions relating to debt service.

KRS 68.210 gives the state local finance officer the authority to prescribe a uniform system of accounts. The *County Budget Preparation and State Local Finance Officer Policy Manual* requires accurate financial records be maintained, which includes the schedule of liabilities. Furthermore, good internal controls require accurate information be presented in order for the fiscal court to make informed financial decisions during budget preparation or when making large purchases.

We recommend the Fulton County Fiscal Court review debt schedules and the debt liabilities section of the quarterly financial statements to ensure that outstanding principal and interest are reported accurately.

County Judge/Executive's Response: I have examined the Long-Range Liabilities contained in the quarterly financial statement mentioned in this finding. I note the balances mentioned in this finding and concur with the amounts in the financial report. The amounts mentioned in the finding which were reported as the amount confirmed by the lender is also believed to be true. The difference as mentioned in the finding as the variances ($9,625 and $36,750) are likely since the lender for the $199,000 loan did not provide an amortization chart for that loan. I found evidence where the Treasurer requested the amortization chart in order to post to her ledger which would track the liability for the purpose of reporting. The lender's response was "we do not do amortization charts; we only do payment history." The reason for the variances is likely because the anticipated amortization was not posted to the Treasurer ledger, therefore creating the differences. I did not extend my review to verify the exact amount but believe this to be the reason for the difference in long term liabilities in the financial report and that reported by the lender. The loan in question was paid off shortly after the audit period which would correct the finding going forward. Furthermore, I have instructed the Treasurer to correspond with debt holders in the future monthly to assure this finding does not persist.

The Fulton County Fiscal Court does not have proper oversight of the payroll revolving account: This is a repeat finding and was included in the prior year audit report as Finding 2020-004. As of June 30, 2021, the payroll revolving account had a reconciled balance of $87,379. This was due to incorrect amounts being transferred from the operating funds to the payroll revolving account. Because there are no internal controls verifying payments to and from the payroll account, as well as no review of the payroll account activity to verify transactions were properly handled and recorded, the payroll account does not reconcile to zero.

Because the payroll account does not reconcile to a zero balance, individual operating fund disbursements and ending balances were misstated on the fourth quarter financial statement.

Good internal controls over the payroll account require oversight by the fiscal court to protect employees while performing duties and to protect county assets against misappropriation. The payroll account is a revolving account and should reconcile to zero.

We recommend the fiscal court implement strong internal controls over the payroll revolving account. These controls should include having someone independent of the payroll function verify proper amounts are transferred to the payroll revolving account from the corresponding operating funds. These controls should also include verifying that any accumulated balance is properly allocated and reflected on the county's financial statement.

County Judge/Executive's Response: The Fiscal court has requested that I employ a CPA firm to assist in isolating audit issues and particularly the payroll audit issues and come to a solution of payroll fund audit findings. This process is already under way and hopefully we can track down years of accounting errors in the payroll system. This is a systemic issue which has been going on for several years. Multi years delays in audits and changing Treasurers has hindered our ability to correct this issue before now.

Auditor's Reply: As discussed with the county judge/executive, a CPA firm, which the county hired, did not release the FY 2017, 2018, and 2019 audit reports until 2022. The delay in completing the FY 2017 through 2019 audits did not allow timely completion of the FY 2020 and 2021 audits. As a result, we completed the FY 2020 and 2021 audits consecutively to expedite their release.

Cash transfers were not properly approved by the fiscal court: Three cash transfers in the amount of $206,644 were transferred from the jail fund to the ambulance reserve fund without being approved by the fiscal court. According to the county judge/executive, these transfers were approved by a blanket order approved by the fiscal court. However, the actual fiscal court order only approved transfers up to $30,000. Because the cash transfers were not approved by fiscal court, the county's funds were at an increased risk of being misappropriated.

Strong internal controls dictate that the fiscal court oversee the movement of funds in order to decrease the risk of misappropriation. It is also the responsibility of the fiscal court to make financial decisions for the county, such as, transferring cash between funds.

We recommend that all cash transfers be presented to, and approved by, the Fulton County Fiscal Court prior to being made.

County Judge/Executive's Response: This finding involves three transfers from the Jail Fund to the Ambulance Reserve Fund, now called the Jail Sinking Fund. The fact is that these transfers were approved by the Fiscal Court on several occasions. The Fiscal Court gave the Treasurer a standing order to transfer funds from the Jail Fund to the Jail Sinking Fund on a monthly basis. This was a second monthly debt payment the Fiscal Court wanted to make to accomplish early retirement of jail debt. The audit is saying that the Fiscal Court cannot give the Treasurer a standing order, but the order has to be given monthly. The Treasurer and I believed the standing orders were appropriate and made the transfer when appropriate. The standing order was to make a second monthly debt payment by transferring money from the Jail Fund to the Sinking Fund. No one had ever suggested that it could not be a standing order but had to come before the Fiscal Court monthly for monthly approval. The monthly Treasurer report always stated when this transfer was made. In fact, on several occasions the Treasurer did not make the transfer because funds were not available in the Jail Fund and on those occasions the Fiscal Court was critical of the Treasurer for not making the transfers. In other words, the Fiscal Court said they wanted to make the transfer and the Treasurer had to explain why the transfers were not made. As far as correcting this finding, the Treasurer has been instructed to have all transfers approved and such approvals reflected in the minutes of Fiscal Court minutes, even standing orders.

Auditor's Reply: The fiscal court order referenced in the county judge/executive's response, as documented in the fiscal court minutes, allowed the county treasurer to transfer $30,000 to the sinking fund monthly if funds were available. The three transfers in question exceeded the $30,000 threshold, therefore, the blanket order was not considered valid in these instances.

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

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