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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, 2022. 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 findings:

The Fulton County Fiscal Court failed to implement adequate internal controls over accounting functions and financial reporting including adequately segregating duties: This is a repeat finding and was included in the prior year audit report as Findings 2021-001 and 2021-002. The Fulton County Fiscal Court lacks adequate segregation of duties and failed to provide proper oversight and monitoring of accounting functions and financial reporting. The treasurer was responsible for preparing monthly, quarterly, and annual financial reports, preparing debt schedules, and reconciling bank accounts. There were no functioning internal controls in place to monitor, provide oversight, or check the work performed by the county treasurer which allowed the county treasurer to have total control over the accounting and reporting functions.

The following deficiencies and reporting errors occurred due to the lack of internal controls, including the lack of segregation of duties, over accounting and reporting:

- Monthly bank reconciliations were not performed for any of the county's funds.
- Budgetary amounts reported on the fourth quarter financial statement were materially overstated. Receipts were overstated by \$343,890 in the fire rescue fund and \$15,200 in the clerk storage fund. Disbursements were overstated in the American Rescue Plan Act (ARPA) fund by \$1,159,408 and in various other funds by \$48,050.
- The fourth quarter financial statement summary section did not agree to the reconciliation section. Cash balances varied by \$2,048,609 on the face of the fourth quarter financial statement.
- The reported beginning fund cash balances were overstated by \$963,807 and ending fund cash balances were overstated by \$945,927 when reconciled to bank records.
- Receipts were understated by \$109,024 due to unrecorded deposits.
- Disbursements were understated by \$132,812 due to unrecorded payroll transactions processed in the payroll account.
- As reported in Finding 2022-002, outstanding debt balances do not agree with the long-term liabilities section of the fourth quarter financial statement.
- As reported in Finding 2022-003, the payroll revolving account is not properly reconciled.

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 an adequate system of oversight and internal controls to ensure that receipts and disbursements were properly recorded; completed bank reconciliations were accurate and agreed to financial records; and fund balances, cash balances, and outstanding debt balances were accurately reported. Instead, the county placed reliance on the county treasurer, and chose not to scrutinize the discrepancies noted on the monthly reports. Additionally, the county treasurer stated that the monthly treasurer's reports were presented but that the quarterly reports were not presented because they did not balance.

The lack of adequate segregation of duties, coupled with a lack of adequate management oversight, provided an environment in which an individual could manipulate financial records and misappropriate or misdirect county funds. The deficiencies, noncompliances, and undetected errors noted above occurred without detection.

The beginning and ending fund balances were overstated primarily because the amounts recorded for payroll expenditures did not agree with the amounts transferred to the payroll revolving account. The fiscal court relies on information presented on the quarterly financial reports to make financial decisions affecting the county. Therefore, this inaccurate financial information, including inflated budgetary and cash balance amounts, could affect fiscal court's ability to make well-informed financial decisions.

Strong internal controls including 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 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. These internal controls are 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.

KRS 68.210 gives the state local finance officer the authority to prescribe a uniform system of accounts which is outlined in the *County Budget Preparation and State Local Finance Officer Policy Manual* (Department for Local Government (DLG) Budget Manual). The DLG Budget Manual requires officials to maintain complete and accurate financial records which are reconciled monthly and submit quarterly reports to DLG by the 30th day following the close of each quarter.

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.”

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.”

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 so that one individual does not have control over the accounting functions. If segregation of duties is not possible, appropriate management oversight should be provided to ensure the completion of accurate, timely financial reports, including budgetary amounts, actual receipts and disbursements, as well as cash balances. This oversight should include a documented review of financial reports by management 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: We recognize a weakness in our accounting and reporting of county financials. This matter has been existing for some time. We have hired a consulting CPA to assist in correcting these issues. I believe that as of August 2022 we have corrected the major cause for this deficiency. I have examined the indicated sources of this finding and believe

we have corrected each of the reported deficiencies. The majority of this finding centers around a continuing payroll reporting and accounting issue that we have corrected.

The Fulton County Fiscal Court's outstanding debt balances were materially misstated: This is a repeat finding and was included in the prior year audit report as Finding 2021-005. For the fiscal year ending June 30, 2022, the Fulton County Fiscal Court reported outstanding debt principal of \$4,657,250 and outstanding interest of \$45,395 on the fourth quarter financial statement submitted to the Department for Local Government (DLG). However, the confirmed outstanding principal balance was \$4,630,500, and the outstanding interest balance was \$1,054,232 thereby resulting in variances of \$(26,750) and \$1,008,837, respectively.

This condition is also the result of the lack of segregation of duties and fiscal court's failure to establish adequate internal controls as reported in Finding 2021-001. Further, fiscal court failed to provide adequate oversight to ensure outstanding debt obligations were accurately reported. As a result, the outstanding debt obligations reported on the fourth quarter financial report were understated by \$982,087. Additionally, because outstanding liabilities were not accurately reported, the fiscal court cannot make effective management decisions relating to debt service.

Strong internal controls require accurate debt information be presented in order for the fiscal court to make informed financial decisions during budget preparation or when making large purchases.

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 reports be maintained and submitted, which includes the schedule of liabilities.

We recommend the Fulton County Fiscal Court implement internal control procedures to ensure outstanding principal and interest balances are accurately reported. At a minimum, the fiscal court should 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: The origin of this finding is that the Treasurer was posting long term debt liabilities from the original amortization schedule on long term notes the county has at the jail. She should have posted monthly from the monthly billing statement from the lender. This situation is an easy fix and has been corrected and will not reflect in future audit reports.

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 2021-006. The fiscal court lacks adequate controls over the payroll process. The payroll account is not reconciled to the payroll reports or the disbursements ledgers. Incorrect amounts are being transferred from the operating funds to the payroll revolving account and amounts being posted for payroll expenses do not agree with payroll reports. Payroll expenses were understated by \$179,895. Also, \$100,000 was transferred back to the general fund from the payroll account without being approved or recorded. As of June 30, 2022, the payroll revolving account had an audited reconciled bank balance of \$32,103, which will be included in the general fund ending fund balance.

The fiscal court has not implemented any internal control procedures to verify accurate amounts are transferred to the payroll account for payroll expenses, as well as reviews of the payroll account activity to verify transactions were properly handled and recorded, including monthly bank reconciliations. Because the payroll expenses are not properly accounted for, individual operating fund disbursements and ending balances were misstated on the fourth quarter financial report. Proposed adjustments are necessary to reflect proper amount of payroll expenses, affecting ending fund balance and resulting in overspending the budget.

Strong internal controls over the payroll process requires procedures to ensure accurate amounts are being transferred and recorded for payroll expenses. Also, the payroll account is a revolving account and should reconcile to zero.

We recommend the fiscal court implement internal controls procedures over the payroll processes and procedures. 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 include preparing monthly bank reconciliations on the payroll account.

County Judge/Executive's Response: This is part of the issue is in Finding 2022-001 above. This is a failure to properly post the proper accounts relative to the county payroll system. The auditors have called our payroll system the most complicated payroll account of all the counties they audit. The problem is that the program set up to account and report payroll activity years ago was defective and was not corrected until January 2023. We do not believe this finding will continue in the future. No money is missing and all employees have been paid the property amount on time. It is simply a failure to post payroll activity to accounts in the system that will produce proper reporting and balances.

The Fulton County Fiscal Court failed to approve quarterly financial reports and an annual settlement: This is a repeat finding and was included in the prior year audit report as Finding 2021-002. The Fulton County Fiscal Court meeting minutes did not have a record of the presentation and approval of the quarterly financial reports or the treasurer's annual settlement for the 2022 fiscal year.

The fiscal court does not require the county judge executive and county treasurer to present quarterly financial reports and an annual settlement as required by state regulations. According to the county treasurer, these reports were not presented to the fiscal court for approval because they contained errors that caused them not to be in balance. Since these reports are not presented or approved, the fiscal court is unaware of the financial condition of the county, which limits its ability to make informed financial decisions. Also, the fiscal court is not in compliance with KRS 68.360 and KRS 68.030.

Good internal controls include procedures to ensure compliance with state regulations related to financial reporting.

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 68.030 states, “[e]ach settlement made by the county treasurer shall be approved by the fiscal court in open court, and shall, by order of the fiscal court, be recorded by the county clerk in a book kept for that purpose.”

We recommend the fiscal court implement control procedures to ensure compliance with state regulations by requiring quarterly financial reports and an annual settlement be presented and approved by the fiscal court and be made a record in the books of the county clerk.

County Judge/Executive’s Response: This finding is correct. It appears that the Fiscal Court was not presented with a Quarterly Report for approval as required by audit guidelines. Monthly reports were provided and approved by the Fiscal Court. Quarterly Reports were provided to and approved by the Department for Local Government. Now that we are aware that the quarterly reports required Fiscal Court approval as well, our procedures for approval has been amended accordingly.

The Fulton County Fiscal Court failed to implement proper internal controls over disbursements: This is a repeat finding and was included in the prior year audit report as Finding 2021-003. The Fulton County Fiscal Court failed to implement proper internal controls over disbursements. We tested 74 transactions totaling \$2,440,189, which resulted in the following issues:

- Fifty-nine disbursements totaling \$1,815,699 had a purchase order that was dated after the invoice date.
- Seven disbursements totaling \$66,786 did not have a purchase order.
- One disbursement for contracted ambulance services did not have an invoice, nor did the amount paid agree to the contract amount. The contract terms were for the prior year and had not been updated.
- Eleven credit card transactions included sales tax and two meal receipts were not itemized.
- Encumbrances of \$9,285 were omitted from the fourth quarter financial statement submitted to the Department for Local Government.

According to the county treasurer, purchase orders are not issued until after the invoice is received to ensure accuracy, instead of having to adjust the amount recorded on the purchase order. The issues noted above could result in line-items being over budget, claims being paid which are not valid obligations of the fiscal court, and misappropriation of assets. The county could be missing potential monetary savings by not procuring the best services at the best prices.

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

KRS 68.210 gives the state local finance officer the authority to prescribe a system of uniform accounts. The Department for Local Government's (DLG) *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 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.

We recommend the Fulton County Fiscal Court implement internal controls over the disbursement process to ensure there are purchase orders issued prior to purchases being made and use the purchase orders to maintain an accurate list of encumbrances on the fourth quarter financial statement. We further recommend the fiscal court implement controls over the review process to ensure all purchases have an invoice, agree to the contracted amount, meal receipts are itemized, and sales tax is not being paid on purchases.

County Judge/Executive's Response: We did have some issues with when Purchase Orders were dated. There were a couple of procurement transactions that occurred and the PO's were added afterwards. One of the issues in this finding was seven disbursements for utilities that did not have a Purchase Order. Until this audit, the Fiscal Court annually approved Standing Orders which allowed the payment of reoccurring obligations, including utilities and those purchases never contained a PO. It was not until this audit that we learned a Purchase Order was required on Standing Orders. Auditors told us this was a new requirement. Now that we have been made aware of this requirement, we will continue forward in compliance with this regulation.

The Fulton County Fiscal Court exceeded budget appropriations for Fiscal Year 2022: The Fulton County Fiscal Court exceeded budget appropriations in one line item during Fiscal Year 2022. The general fund, general government line item, exceeded budgeted appropriations by \$58,430.

Budgeted appropriations were exceeded due to the budgeted amounts not being accurately reported by the treasurer on the quarterly financial statement and payroll expense not being properly recorded. Due to this error, the fiscal court exceeded budgeted appropriations which is a violation of state requirements causing the claim paid to be illegal and void.

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.”

Strong internal controls should include procedures to ensure sufficient budget appropriations are available prior to approving claims.

We recommend the fiscal court monitor the budget more closely and implement controls procedures to ensure budgeted appropriations are not exceeded without approving necessary transfers and amendments.

County Judge/Executive’s Response: This is a true assessment; the county did exceed an appropriation by \$58,430. This was an instance where the Sheriff’s office did not accumulate enough revenue from fees to sustain their payroll and other activities. In that case, the Fiscal Court voted to cover their shortfall and that amount approved by the Fiscal Court was more than the budget appropriation. The finding goes on to suggest the expenditure in excess of the appropriation might be a claim against the Treasurer’s bond. I would argue against that because the Treasurer cautioned against action taken, but the Fiscal Court believed it to be proper to support the Sheriff’s office by covering revenue shortfalls. Going forward, this situation will not reoccur because the Fiscal Court has taken corrective action by enacting a Fee Pooling Ordinance with the Sheriff’s office effective January 1, 2023.

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

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