



Auditor of Public Accounts
Mike Harmon

FOR IMMEDIATE RELEASE

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Harmon Releases Audit of Martin County Fiscal Court

FRANKFORT, Ky. – State Auditor Mike Harmon has released the audit of the financial statement of the Martin County Fiscal Court for the fiscal year ended June 30, 2020. 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 Martin 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.

Finding 3 of this report will be referred to the U.S. Department of Housing and Urban Development, Special Projects Division.

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 Martin County Fiscal Court did not have adequate internal controls over receipts: This is a repeat finding and was included in the prior year audit report as Finding 2019-004. The Martin County Treasurer prepared and deposited receipts, posted receipts to the accounting system, prepared monthly reports for the fiscal court and quarterly reports for the Department for Local Government (DLG), made cash transfers between funds and bank accounts, and performed bank reconciliations. There was no review by another person to ensure daily deposits agree to the receipts ledger.

The lack of adequate segregation of duties and too much control by one individual could result in the undetected misappropriation of assets, errors that go unnoticed, and inaccurate financial reporting to occur.

Good internal controls dictate adequate segregation of duties to prevent the same person from having complete control in the receiving, recording, and reporting of funds. A strong internal control structure includes adequate segregation of duties or strong compensating controls to offset the risk caused by the lack of segregation of duties. Without proper segregation or strong compensating controls, the county cannot ensure all receipts are deposited and all bank activity is appropriately documented in the accounting system.

We recommend the fiscal court strengthen internal controls by segregating the duties involved in receiving, recording, reconciling and reporting receipts. If segregation is not possible, we recommend compensating controls, such as a receipt listing prepared by another person to compare to deposit tickets and ledger posting and documentation of oversight and review by a second person.

County Judge/Executive's Response: This item is related to the previous administration. When the current administration took office in January of 2019, changes were implemented. The Judge's Administrative Assistant opens all incoming mail and receipts all funds. Invoices and funds received are reviewed by either the Judge or Deputy Judge prior to routing to the Finance Office. The invoices are processed by the Finance Officer. Occupational taxes are routed to the Occupational Tax Director who prepares and makes the deposit, all other receipts are recorded and deposited by the Treasurer. The Finance Officer reconciles the accounts.

The Martin County Fiscal Court does not have adequate internal controls over disbursements: This is a repeat finding and was included in the prior year audit report as Finding 2019-003. The fiscal court's controls over disbursements were not operating as intended. Although, disbursements were properly authorized and had supporting documentation, proper procedures were not followed to pay timely.

The deficiencies listed below were able to occur due to lack of monitoring of controls and diminish the effectiveness of the controls put in place over disbursements by the fiscal court. These deficiencies could create errors in recording or allow for the possibility of misappropriation of assets.

As a result, the following exceptions were noted:

- Ten disbursements totaling \$641,766 were not paid within 30 days.
- Credit card transactions incurred monthly fees and interest due to not being paid timely.

Proper internal controls over disbursements are important to ensure purchase orders are created with sufficient funds available, include proper supporting documentation, and are paid in a timely manner. KRS 68.210 gives the state local finance officer the authority to prescribe a uniform system of accounts. Per the Department for Local Government's (DLG) *County Budget*

Preparation and State Local Finance Officer Policy Manual, “purchases shall not be made prior to approval by the County Judge/Executive (or designee) or department head.” Furthermore, KRS 65.140 requires invoices to be paid within 30 days of being received.

We recommend the fiscal court implement proper internal controls over expenditures and ensure they are operating effectively.

County Judge/Executive’s Response: *The previous administration left the court with several unpaid invoices from both current and prior year. The current administration issued a bank franchise tax and doubled the occupational tax. The court updated their purchasing policy which increased the bid threshold from \$10,000 to \$30,000 to match the states.*

The Martin County Fiscal Court owes \$58,000 to the county’s federal HUD fund due to prior year failures to have effective internal controls over federal grant expenditures: This is a follow-up finding which was included in the prior year audit report as Finding 2019-008. The Martin County Fiscal Court failed to implement effective internal controls over federal grant expenditures. Specifically, the county expends and reinvests funds derived from bond refinance savings arising from a partnership with the United States Department of Housing and Urban Development (HUD) from the 1990s, where such expenditures are required by law and specific express agreement of the county to be used to support low-income housing projects in Martin County. Numerous weaknesses were noted which significantly increased the risk of fraud, misappropriation of funds, and noncompliance with federal grant funds. Prior year testing revealed that a significant portion of these funds, \$133,000, had been diverted for use to finance the operation of county government, such as for the purchase of law enforcement equipment. While the county has begun repaying those funds, \$58,000 remains yet to be repaid.

The fiscal court has not sufficiently overseen the expenditure of federal grant funds and did not prioritize implementation of an effective internal control system.

An inaccurate implementation of controls, the lack of management oversight and involvement can cause noncompliance with federal grant requirements and jeopardize the fiscal court’s future funding. Here, the failure allowed a diversion of restricted funds into unallowable purposes.

Good internal controls dictate that controls be put in place over federal grant expenditures to ensure that they are spent according to the grant agreements and federal guidelines.

According to Section 3 of the HUD grant agreement, these funds are to be spent on replacing existing roofing material and sheathing, installation of permanent block foundation, doors and windows, exterior siding, insulation, replacement of damaged sheetrock, heating and cooling systems, replacement of existing plumbing and electrical system, installation of a potable drinking water supply and septic system, and renovations for handicapped accessibility.

We recommend the fiscal court implement adequate internal controls to ensure federal compliance requirements are met and continue its repayment efforts to eliminate the \$58,000 outstanding balance. This finding will be referred to the U.S. Department of Housing and Urban Development, Special Projects Division.

County Judge/Executive's Response: This occurred during a previous administration. The court will transfer \$58,000 to the HUD fund prior to the end of the current fiscal year.

The Martin County Fiscal Court did not have effective internal controls, review procedures, and oversight for the budget process: The budget approved in the fiscal court minutes and by the Department for Local Government (DLG) did not agree to the amount reported on the fourth quarter report. The approved budget for receipts was a total of \$8,063,395 and the amount reported on the fourth quarter was for \$7,933,664, for a difference of \$129,731. Also, line-item budget transfers did not zero out, as a \$180,128 difference was noted in the jail fund. Line-item budget transfers are allowable to move budget capacity where needed; however, these transfers must zero out in total among all funds or else it is indicative that the county utilized budget capacity that did not exist.

The fiscal court did not have effective internal controls, review procedures, and oversight for the budget process to ensure that correct budget amounts were reported on the fourth quarter report.

Inadequate controls over the budget process resulted in the undetected errors noted above. 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 DLG’s *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 DLG.

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.

County Judge/Executive's Response: For the first item - the difference between the budget and the report was an input error by treasurer inputting the original budget into the quarterly report. We have already changed the procedure to have the Finance Officer confirm the quarterly report to the budget - a second pair of eyes on the input as a compensating control.

For the second item - The \$180,128 was included in a budget amendment which was approved by DLG. The transfer procedure between funds from the DLG manual was correctly followed.

The Martin County Fiscal Court’s disbursements exceeded budget appropriations \$66,358:
Disbursements exceeded budget appropriations for the following funds:

State Grants Fund \$46,597

General Fund \$19,761

Due to not having adequate control procedures in place such as lack of review or monitoring, the county treasurer made a mistake that went undetected.

Failure to amend the budget or exceed budgeted appropriations is a violation of Kentucky Revised Statutes (KRS). In addition, failure to monitor the budget can lead to poor financial decision making.

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.”

We recommend the fiscal court and the county treasurer monitor the budget more closely and amend the county’s budget or transfer necessary appropriations in order to prevent the county from exceeding the budget.

County Judge/Executive’s Response: This was Treasurer error but it could have been prevented if we were utilizing government/fund accounting software rather than public accounting software. We are planning to update our software by the end of the current fiscal year.

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

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