



Auditor of Public Accounts
Mike Harmon

FOR IMMEDIATE RELEASE

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

Harmon Releases Audit of McCreary County Fiscal Court

FRANKFORT, Ky. – State Auditor Mike Harmon has released the audit of the financial statement of the McCreary 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 McCreary 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.

Finding 5 of this report will be referred to the U.S. Department of Agriculture (USDA).

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 payroll revolving account was not properly reconciled: This is a repeat finding and was included in the prior year audit report as Finding 2020-002. The payroll revolving account did not reconcile to zero as of June 30, 2021, and the remaining balance could not be readily explained. According to the information available to auditors, the account balance as of June 30, 2021, was \$6,186. Of this balance, the county had outstanding liabilities of \$64,220 and outstanding receivables of \$76,492, leaving an unexplained balance of \$18,458 for fiscal year 2021.

In addition, the employee benefits account, which primarily receives funds from the payroll account, did not reconcile to zero. According to the information available to auditors, as of June 30, 2021, the account had an unexplained balance of \$682 for fiscal year 2021. Auditors noted the finance officer verified that funds were deposited, and checks or electronic withdrawals had cleared but no evidence of a monthly bank reconciliation was found for these accounts. In addition, the account was overdrawn 11 times during the fiscal year which indicates a lack of oversight.

According to the finance officer, a new payroll account was opened in July 2018 and he thought this corrected the prior year issue since he transfers payroll funds according to the summary produced by the computer software.

The unreconciled payroll account could cause the fiscal court to have insufficient funds to meet payroll requirements, cause the fiscal court's liabilities to not be properly paid, or cause liabilities to not be paid timely.

Per KRS 68.210, the state local finance officer has the authority to require a uniform system of accounts. The *County Budget Preparation and State Local Finance Officer Policy Manual* includes monthly bank reconciliations as a minimum requirement for all county officials. Since the payroll and employee benefits accounts are revolving accounts, only the funds necessary to pay employees and government agencies should be transferred from other county funds. Therefore, each month the account should reconcile to a zero balance.

Good internal controls dictate that revolving accounts be reconciled to a zero balance. In addition, monthly bank reconciliations should be prepared and reviewed by someone independent of the reconciliation process.

We recommend the fiscal court properly reconcile the payroll revolving account and the employee benefits account to a zero balance monthly. Additionally, we recommend the bank reconciliations be reviewed by an employee independent of the reconciliation process. These reviews should be dated and initialed by both the preparer and the reviewer to document evidence of oversight, accuracy, and completeness.

County Judge/Executive's Response: A new account will be implemented in the next budget to rectify this.

The fiscal court did not have proper purchase and procurement procedures: This is a repeat finding and was included in the prior year audit report as Finding 2020-003. The fiscal court did not have proper purchase and procurement procedures as noted by the following deficiencies:

Of the 82 invoices tested:

- The county did not properly accept bids for goods and services. The fiscal court did not document which bidder was selected and approved. It just stated all bids presented were being approved.
- The county did not maintain bid documentation for one disbursement over \$30,000.
- Fifty-four invoices tested did not have purchase orders.

- Nineteen invoices tested were paid past 30 working days of receipt.
- Four invoices tested did not have supporting documentation.
- Purchase orders that were completed are not consistent pertaining to the documentation of the issuance and authorization of the purchase order. Some purchase orders were documented as only being issued by the finance officer and some were issued by the finance officer and some were only authorized by the department head or county judge/executive. This process should document who issued the purchase order and who approved the purchase order.

The deficiencies are a direct result of the lack of adequate segregation of duties, improper accounting practices, and poor internal controls without sufficient management oversight. These deficiencies could have resulted in significant overpayments, misappropriations, inaccurate financial reporting, or penalties being assessed.

Section 9.1 of the McCreary County Administrative Code states, “All purchases must be accompanied by a purchase order as issued by the County Finance Officer, which shall be issued prior to the time of purchase or authorization of purchase by an employee or department and will be paid once an original invoice is in receipt of County Judge’s Office.”

The McCreary County Administrative Code Section 9.2(E) states, “The County Judge shall open all bids publicly at the time and place stated in the advertisements and shall select the lowest and/or best bid by qualified bidder. If the lowest bid is not selected, the reasons for the selection shall be stated in writing.” Also, section 9.2(H) states, “The County Judge shall submit the bid selected to Fiscal Court for approval.”

KRS 65.140(2) states, “Unless the purchaser and vendor otherwise contract, all bills for goods or services shall be paid within thirty (30) working days of receipt of a vendor's invoice except when payment is delayed because the purchaser has made a written disapproval of improper performances or improper invoicing by the vendor or by the vendor's subcontractor.”

We recommend the fiscal court take the steps necessary to ensure they are in compliance with the state local finance officer and the county administrative code. We recommend all items over \$30,000 county bid threshold be properly bid out and that all supporting documentation, such as approved bid specifications and purchase orders, be maintained with the original invoices. We recommend all disbursements are paid within 30 working days of receipt and all disbursements have supporting receipts. We further recommend that all purchase orders are completed properly in regards to the issuance and authorization of the purchase order.

County Judge/Executive’s Response: This is one area we have stressed repeatedly and diligently to fix.

The fiscal court did not have sufficient internal control procedures over credit card disbursements: This is a repeat finding and was included in the prior year audit report as Finding 2020-004. The fiscal court has not implemented proper internal control procedures over credit card disbursements. Credit card disbursements had the following deficiencies:

- Twenty out of the 34 charges tested included sales tax when the county is tax exempt.
- One credit card receipt was missing an itemized detail of charge.
- One credit card charge was paid without sufficient supporting documentation.

The deficiencies noted above stem from a lack of adequate segregation of duties, improper accounting practices, and poor internal controls without oversight. The county treasurer and county judge/executive are relying upon the finance officer to ensure all invoices are valid without proper review of the supporting documentation before authorizing disbursement. The lack of proper segregation of duties, improper accounting practices, and lack of oversight could result in misappropriation of assets, inaccurate financial reporting, or payment for personal purchases with public funds.

Good internal controls dictate that proper supporting documentation is maintained to support disbursements and the county does not pay sales tax since they are a tax-exempt entity.

We recommend the fiscal court take the steps necessary to ensure compliance with applicable statutes and proper accounting practices, by implementing additional internal controls on credit card disbursements. This could be accomplished by assigning an individual other than the finance officer to review all transactions to ensure that they have proper documentation (such as itemized receipts, etc.) and to ensure sales tax is not part of the claim before being submitted for approval to the fiscal court. We further recommend that the authorized check signers ensure credit card disbursements are properly supported before authorizing the checks.

County Judge/Executive's Response: We have gone to online payments but sometimes situations (ultimately notification, etc.) are beyond our control.

The fiscal court did not segregate duties over accounting functions: This is a repeat finding and was included in the prior year audit report as Finding 2020-005. A lack of segregation of duties exists over accounting functions. The county treasurer prepares and deposits receipts, posts to the ledgers, prepares financial reports, and prepares the monthly bank reconciliations. Items returned from the bank are handled by the county treasurer. The finance officer picks up mail from the post office then distributes to the proper department. The finance officer prepares a list of bills for the fiscal court's approval, prepares all checks, and makes adjustments to the appropriations ledger. The finance officer submits the financial statement electronically to the Department for Local Government (DLG). The finance officer maintains timesheets, prepares payroll, posts payroll to the ledgers, and transfers funds from the appropriate accounts to the revolving payroll account. In addition, the finance officer is responsible for employee benefits payments (health insurance, life insurance and payments to the employee benefit bank account).

According to the county judge/executive, a limited budget places restrictions on the number of employees the fiscal court can hire. The lack of oversight could have resulted in undetected misappropriation of assets and inaccurate financial reporting to external agencies such as DLG.

A segregation of duties over various accounting functions, collecting receipts, preparing bank deposits, and preparing reports and reconciliations, or the implementation of compensating controls, when needed because the number of staff is limited, 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 involving collecting and depositing receipts and preparation of reports and reconciliations. If this is not feasible due to limited staff, strong oversight over these areas could occur and involve an employee that is not currently performing any of those functions. For example, the county judge/executive could provide this oversight and document his oversight by initialing the source documents.

County Judge/Executive's Response: This is a common problem for everyone. We don't have the budget to hire more personnel.

The fiscal court did not have sufficient monitoring or internal controls over the revolving loan program: This is a repeat finding and was included in the prior year audit report as finding 2020-006. Since 1994, the McCreary County Fiscal Court has utilized U. S. Department of Agriculture (USDA) grants to run a Rural Business Enterprise Grant (RBEG) program. The program is designed to encourage new employment opportunities within the county by providing low cost financing to new businesses. The fiscal court has made 43 loans, totaling \$1,801,345 from Fiscal Year 1994 through Fiscal Year 2021. The following issues were noted for Fiscal Year 2021 as a result of reviewing the program:

- Multiple payments listed within revolving loan records of three businesses that could not be accounted for during the fiscal year. This resulted in the records of those businesses reflecting outstanding balances totaling \$5,905 lower than actually owed.
- Multiple payments recorded within the receipts ledger during the fiscal year, but not reflected within the loan records of ten businesses. This resulted in the records of those businesses reflecting outstanding balances totaling \$22,917 higher than actually owed.

Due to weak controls and inadequate monitoring over the revolving loan program, accurate amounts owed by businesses within the county were not accurately reported. Adequate monitoring and properly designed and implemented internal controls could allow early detection of possible non-paying borrowers. In addition, good internal controls dictate accurate records are maintained to support the activity of the program.

The USDA Application for Federal Assistance SF-424 states “[r]ecords will include an accurate accounting of any principal repayments, interest, or other proceeds generated by the loan fund and will document expenses paid for with interest, or other proceeds generated by the loan and will be documented for the grant audits.”

We recommend the fiscal court properly monitor the activities of the revolving loan program. Additionally, we recommend the fiscal court comply with the requirements of the USDA Application For Federal Assistance SF-424 and ensure that all loans are properly made, documented, collected, and reported. This matter will be referred to the USDA.

County Judge/Executive's Response: Due to past infractions over the past 20 years we have no control over this matter.

Auditor's Reply: While there have been issues over the past years with this program, the items noted above deal with current issues that can be resolved with proper controls and accounting.

The fiscal court did not budget two funds: The Marsh Creek Waterline Replacement Project Fund and the OVC Expansion Project Fund were not included in the fiscal court's budget and fourth quarter financial report. In addition, receipt and disbursement ledgers were not maintained for these funds.

The county did not include all funds in the budget as required by the Department for Local Government (DLG). Failing to budget and record all revenues and expenditures results in the quarterly financial statement being understated. The Marsh Creek Waterline Replacement Project Fund had receipts of \$609,959 and \$609,958 of disbursements. The OVC Expansion Project Fund had receipts of \$580,790 and \$510,950 of disbursements.

KRS 68.240(1) states, in part, "[t]he county judge/executive shall annually prepare a proposed budget for the expenditure of all funds, including those from state and federal sources, which are to be expended by the fiscal court in the next fiscal year." KRS 68.280 authorizes the fiscal court to amend the budget for "the expenditure of receipts unanticipated in the original budget by preparing an amendment to the budget."

We recommend the county present a budget which includes all funds of the county and include them on the fourth quarter financial report.

County Judge/Executive's Response: This was due to Grant monies from Federal Programs and has been fixed.

The fiscal court did not prepare an accurate Schedule of Expenditures of Federal Awards: The county's Schedule of Expenditures of Federal Awards (SEFA) required material adjustments to accurately document funds provided to subrecipients and total federal expenditures for the fiscal year ending June 30, 2021. The county prepared a SEFA for Fiscal Year 2021. The original schedule documented \$1,363,131 in federal expenditures. It was determined that the SEFA required material adjustments to accurately report federal expenditures for the FYE June 30, 2021.

The original schedule also included amounts provided to subrecipients of \$3,095,009. It was determined that the SEFA required further material adjustments which removed amounts provided to subrecipients. The fiscal court did not have adequate procedures in place to ensure that all federal expenditures were accurately reported. The failure to properly prepare the SEFA could cause the county to potentially miss obtaining a required single audit.

2 CFR 200.510(b) requires the auditee to "also prepare a schedule of expenditures of Federal awards for the period covered by the auditee's financial statements." At a minimum, the schedule should include the following if applicable.

- (1) List individual Federal programs by Federal agency.

- (2) For Federal awards received as a sub-recipient, the name of the pass-through entity and identifying number assigned by the pass-through entity shall be included.
- (3) Provide total Federal awards expended for each individual Federal program and the Assistance Listings Number (ALN) or other identifying number when the ALN information is not available.
- (4) The total amount provided to sub-recipients from each Federal program.
- (5) For loan or loan guarantee programs described in 2 C.F.R. 200.502(b), identify in the notes to the schedule the balances outstanding at the end of the audit period. This is in addition to including the total Federal awards expended for loan or loan guarantee programs in the schedule.
- (6) Include notes that describe the significant accounting policies used in preparing the schedule.

We recommend the fiscal court ensure that the SEFA is prepared and is reported accurately.

County Judge/Executive's Response: Fixed.

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

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