



Auditor of Public Accounts
Mike Harmon

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Harmon Releases Audit of Muhlenberg County Fiscal Court

FRANKFORT, Ky. – State Auditor Mike Harmon has released the audit of the financial statement of the Muhlenberg 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 Muhlenberg 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 Muhlenberg County Fiscal Court failed to implement internal controls over the Schedule of Expenditures of Federal Awards: During the testing of Muhlenberg County's Schedule of Expenditures of Federal Awards (SEFA), we found significant issues in the SEFA.

- The SEFA was not submitted to the Department for Local Government (DLG) with the fourth quarter financial report as required by DLG.
- The Muhlenberg County Fiscal Court's original SEFA was misstated by \$444,209. The following errors were included in the SEFA provided to auditors.

- (a) Assistance Listing Number 21.027 – \$200,855 was included on the SEFA that were not federal expenditures .
- (b) Assistance Listing Number 97.036 – \$114,747 was included that was reimbursed by state funds and not federal funding. \$128,607 was included on the schedule of expenditures of federal awards that was the state and local share of the expenditures and were not reimbursed by the federal government.
- The fiscal court did not maintain appropriate documentation to support amounts recorded on the SEFA.

According to the county treasurer:

- The payments included for Assistance Listing Number 21.027 had the appearance of being a federal payment and he did not realize they were state funds.
- For Assistance Listing Number 97.036, due to this federal funding being sent to them from the state, the \$114,747 came in the same manner and was originally requested for federal reimbursement. The \$128,607 was included as this was the total expenditure made by the county for the funds reimbursed by the federal government and he was unaware that matching portions should have been removed.
- The treasurer was unaware that the SEFA was supposed to be attached to the financials submitted for the fourth quarter financial report.

Additionally, there was a lack of understanding of the fiscal court's responsibilities for the required documentation since they had hired a company to manage their federal disbursements.

As a result of the errors made and lack of effective operating controls, the original SEFA was misstated. By not maintaining proper adequate internal controls over federal disbursements documentation, the fiscal court was not able to document items on their SEFA without first contacting an outside source. This could create issues with future federal reimbursements if they cannot verify what amounts have been requested beforehand and could lead to duplication or omission on future requests.

Strong internal controls over financial reporting are vital in ensuring that federal awards expended are accounted for, reported properly, and adequately supported by proper documentation. Strong internal controls are also important in safeguarding the county's assets and those given the responsibility of accounting for them, as well as helping make certain the county is in compliance with all requirements and guidance. Additionally, 2 CFR 200.510(b) states, "[t]he auditee must also prepare a schedule of expenditures of Federal awards for the period covered by the auditee's financial statements which must include the total Federal awards expended." Additionally, KRS 68.210 give the state local finance officer the right to prescribe the reporting requirements for all counties. One of the requirements set forth in the *County Budget Preparation and State Local Finance Officer Policy Manual* is the requirement for the preparation of a SEFA to be submitted with the 4th quarter financial reports.

We recommend the Muhlenberg County Fiscal Court implement internal controls over federal award expenditures reporting to ensure the SEFA is properly submitted to DLG, that amounts reported on the SEFA represent true federal expenditures, and maintain appropriate records to support the amounts recorded on the SEFA.

County Judge/Executive's Response: County Treasurer was not aware the SEFA report was due with the fourth quarterly report to DLG. This task would have been impossible to provide with the fourth quarter report anyway because the FEMA grant requests for tornado DR#4630 expenses were not formulated until three or four months after the fiscal year during this period. Per the contractor's reimbursement reports, the reports were not prepared and submitted until a few months after year end. Some were dated as late as January 2023. None of the awards reported on the SEFA report were received during the audit year. The earliest was received August 2022, the last in January 2023. In addition, FEMA's acceptance to pay such expenses was not authorized until even after this period.

The two errors on the SEFA report are discussed below:

- 1. The \$200,855 in the SEFA report was acknowledged as Federal money on two different occasions by personnel at the Jail inquiring from the State of Kentucky, where this money was received. The first inquiry was to verify that this was actually federal monies and was represented as such by state officials. On a subsequent inquiry, this money was represented as federal ARPA money but the auditor says that because it passed through the state that is it not accounted for as federal money for single audit act purposes. With our inquiries, we reasonably should have concluded this was Federal money.*
- 2. Our FEMA account project manager did not provide information to separate the matching portion of federal money regarding the \$114,747 and \$128,607 when the FEMA request was submitted. The FEMA project manager put together grant reimbursement grouped expenses for grant categories, no payments from FEMA or STATE for the disaster were received in this fiscal year. While Muhlenberg County suffered a major disaster with the Tornado that hit Bremen, killing 11 of our citizens, the Fiscal court did expend monies as any government would during a catastrophic emergency. As I am sure you are aware we are still dealing with this storm and recouping money.*

Both findings above are unintentional.

This finding can be corrected by closer coordination with our contracted federal grant supervisor. The finding should not be an issue in the future and we are currently working on a plan to adhere to proper filing of SEFA timely submitted SEFA information.

Auditor's Reply: The Schedule of Federal Expenditures is based on the county's expenditures for the fiscal year, receipt dates are null to the schedule. Proper documentation and understanding of expenditures and receipts are vital to ensure accurate reporting of federal expenditures.

The Muhlenberg County Fiscal Court does not have adequate controls over disbursements and procurement processes: During testing of disbursements and procurement, we found the following issues:

- Two disbursements for fire department donations totaling \$54,000 and two disbursements for insurance totaling \$643 were not presented to the fiscal court prior to payment.
- Two disbursements totaling \$54,000 did not have adequate supporting documentation.
- Finance charges of \$411 were paid.
- Sales tax was paid on 19 purchases for a total of \$273.

- Fifty-six out of 56 items tested had missing or inadequate purchase orders.
- A jail grant paid for items that were not presented to the fiscal court. Instead, invoices are sent to a company who pays the invoices directly. The amounts paid by the company are then provided to the treasurer who includes the amounts in his financial report.
- The jail vending contract in the amount of \$370,142 was not properly procured through competitive bidding. Additionally, paid invoices were not itemized by the vendor.

The above findings are due to a lack of oversight and insufficient internal control procedures and a lack of knowledge about proper procurement procedures.

Due to the lack of controls over the disbursement process, invoices were paid without approval, finance charges and interest were unnecessarily paid, and there is an increased risk of misappropriation. Strong internal controls require proper documentation to be kept for all disbursements, as well as accurate journal posting and dual signatures for all checks. Additionally, 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 Department for Local Government's (DLG) *County Budget Preparation and State Local Finance Officer Policy Manual* which requires a purchase order system for all counties and each county is responsible for ensuring their purchase order system is executed and working properly.

KRS 68.275(2) states, "the county judge/executive shall present all claims to the fiscal court for review prior to payment and the court, for good cause shown, may order that a claim not be paid."

KRS 139.470(6) and (7) exempts local governments from paying state sales tax on goods and services.

The Muhlenberg County Administration Code section 9.2 (C.), "Any expenditure or contract for materials, supplies (except perishable meat, fish, and vegetables), equipment, or for contractual services other than professional, involving an expenditure of more than Twenty Thousand Dollars (\$20,000) shall be subject to competitive bidding.

We recommend the Muhlenberg County Fiscal Court strengthen controls over the disbursement process to ensure all disbursements are valid and presented to fiscal court prior to payment. The fiscal court should require that proper documentation be maintained for all expenditures. The Muhlenberg County Fiscal Court should also ensure that bidding procedures are followed for all purchases that exceed \$20,000 in accordance with the administrative code. We also recommend that supporting documentation be maintained for the entire bid transaction.

Views of Responsible Official and Planned Corrective Action:

County Judge/Executive's Response:

1. *A. Disbursements/contributions for the volunteer fire departments totaling \$54,000 were approved in the initial budget as well as recorded in the claims for payment. This is not a new process for the fiscal court as it has been done this way since the Muhlenberg County*

Fiscal Court has been contributing monies to our volunteer fire departments over 30 years ago.

B. Disbursements for the Pennyrile Narcotics Task Force, AFLAC invoices totaling \$643.14 are paid and kept in the Treasurer's office. The Treasurer states that insurance is not listed on claims for approval as it is his understanding that is not required.

- 2. Finance charges were accrued in the amount of \$411 on some of the [credit card name redacted] purchases. The Finance Officer states she would try and recoup these as they were noticed but only a few were reimbursed by the credit card company. Corrective Action was implemented by changing the credit card company to [bank name redacted] locally in August 2022. Since that change and appropriate account set up, there has been no more finance charges to date.*
- 3. Sales tax was accrued in the amount of \$273- The Treasurer and Finance Officer recognize that sales tax is not to be paid as the Fiscal Court is a tax exempt entity. Corrective Action: The Judge Executive and Finance Officer are currently working on a Credit Card Policy to implement by 08/01/2023. This policy will address and stop the sales tax issue.*
- 4. 56/56 purchase orders were missing or inadequate-Corrective Action: Purchase Orders have been reinforced with all departments effective May 1, 2023.*
- 5. Four [brand name redacted] Trucks purchased and held for resale totaling \$611,576 were procured through the state bid list facilitated by KACo (Kentucky Association of Counties) and the DLG (Department for Local Government). The vendor, [vendor name redacted], provides a master agreement with the State of Kentucky. All parties involved were not aware that a catalogue was to be provided with the master agreement. Corrective Action: a catalogue will be requested along with a master agreement before the Muhlenberg County Fiscal Court enters into a purchasing contract with the entities on the state list effective 06/30/23.*
- 6. A jail grant paid for items that were not approved by the fiscal court. Corrective Action: effective 06/30/2023 the Muhlenberg County Detention Center will supply all documentation needed to properly administer protocols and seek Fiscal Court approval.*
- 7. The jail vending contract is the amount of \$370,142 was not properly procured through competitive bidding, invoices were not itemized. Corrective Action: Effective 06/30/2023 the Jail will properly procure through competitive bidding. All invoices will be itemized.*

Auditor's Reply: The disbursements to the volunteer fire departments totaling \$54,000 were not presented to the fiscal court until after the disbursements were already made. Approving a budget does not replace the fiscal court's requirement of presenting each appropriation before payment is made. KRS 68.275(2) in part states, "the county judge/executive shall present all claims to the fiscal court for review prior to payment.."

The Muhlenberg County Jailer does not have internal controls over commissary reporting:

The jail commissary year-end report was misstated. Receipts and disbursements of \$47,115 each were omitted from the commissary report provided to auditors and submitted to the county treasurer. Additionally, the jail commissary report was not submitted to the treasurer until after auditors arrived on site.

According to the bookkeeper, the original report submitted was misstated because of refunds and error adjustments. The county jailer corrected these misstatements and resubmitted the commissary report to the treasurer.

The information in the jail commissary report could not be relied upon. Internal controls require that the commissary report be accurate and complete. KRS 68.210 gives the state local finance officer the authority to prescribe a system of uniform accounts. The uniform system of accounts is set forth in the Department for Local Government's (DLG) *County Budget Preparation and State Local Finance Officer Policy Manual* requires that the commissary report be submitted to the County Treasurer.

We recommend that the jailer maintain accurate receipts and disbursements ledgers in order to prepare an accurate financial report which should be submitted to the county treasurer after the fiscal year end.

Jailer's Response: We will work with all parties involved to maintain a timely and accurate financial report starting immediately.

The Muhlenberg County Fiscal Court failed to implement adequate internal controls over accounting functions and financial reporting: The Muhlenberg County Fiscal Court 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:

- There was no documentation to support the encumbrances reported on the fourth quarter financial statement.
- The treasurer did not maintain an accurate liability schedule. The liabilities section of the fourth quarter financial statement omitted \$210,000 outstanding debt principal and \$17,222 outstanding interest due.
- The treasurer did not maintain an accurate lease schedule. Lease receipts were understated by 15,600 and lease disbursements were understated by \$48,739.
- The payroll revolving account does not properly reconcile to zero (See Finding 2022-006).
- Schedule of Expenditures of Federal Awards (SEFA) was not correctly maintained, nor was one submitted to the Department for Local Government (DLG) (See Finding 2022-001).

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 to ensure fund balances, cash balances, and outstanding debt balances were accurately reported.

The lack of adequate management oversight created an environment in which an individual could manipulate financial records and misappropriate or misdirect county funds. The deficiencies, non-compliances, and errors noted above occurred without detection. The fiscal court relies on information presented on the quarterly financial reports to make financial decisions affecting the county. Therefore, this inaccurate financial information could affect fiscal court's ability to make well informed financial decisions.

Strong internal controls 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, KRS 68.210 gives the state local finance officer the right to prescribe the reporting requirements for all counties. One of the requirements set forth in the *County Budget Preparation and State Local Finance Officer Policy Manual* is the requirement for the preparation of a SEFA to be submitted with the 4th quarter financial reports.

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 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:

Encumbrances were shown on the fourth quarter report to DLG but the detail of these balances was misplaced. This obviously can be easily fixed by safeguarding a schedule of such encumbrances for the auditors.

The liability schedule mentioned in the audit findings all from the county's office machine lease obligations are not part of the financial report. All bond and note obligations are properly and accurately maintained by the county Treasurer. One audit finding was the omissions of an interest free grant/loan from a nonprofit foundation that was originally booked as revenue. This account was rectified before the conclusion of the audit and properly reported to DLG, it was also included on the financial report several months ago. This loan is scheduled to be paid in full at the first of the new fiscal year. The monies for the loan were received for a landfill transfer station. This project has been dropped and the funds will be repaid.

The lease schedule will be corrected once the proper leasing documents are submitted to the Judge Executive's Office. We will have this rectified by 08/01/2023 for both the lease receipts and disbursements schedule.

The Muhlenberg County Treasurer failed to properly reconcile the payroll revolving account: The Muhlenberg County Fiscal Court uses a payroll revolving account for payroll processing. Payroll revolving accounts are established in order to process individual payroll transactions. The county treasurer did not properly reconcile the payroll revolving account each month. Employee withholdings for health insurance were left in the payroll account each month, while the monthly health insurance invoices were paid in full out of the general fund for most of the year. The treasurer uses the excess employee withholdings to make the health insurance payments the first few months of the fiscal year. As of June 30, 2022, the payroll revolving account had a balance of \$136,582, with no documentation maintained that the account was reconciled or that the balance is comprised solely of employee withholdings. According to the treasurer, he was unaware that this process was not sufficient, or that a balance should not be maintained in a payroll revolving account.

Errors in payroll processing could go undetected when a sitting balance is maintained in the account throughout the year. In addition, this also results in funds of the county being maintained in an account that is not reported on quarterly reports or other financial statements presented to fiscal court and outside entities.

Good internal controls require timely, accurate reconciliations for bank accounts, and all other reports concerning payroll, to ensure all funds are properly accounted for and to prevent misappropriation of funds and inaccurate financial reporting. Due to the nature of revolving accounts, only the funds necessary to pay employees and government agencies should be transferred from other funds. Therefore, the reconciled balance each month of the payroll revolving account should be zero.

We recommend the payroll revolving account be properly reconciled monthly. Because the payroll revolving account is a clearing account, this account should reconcile to a zero ending cash balance or a minimal carrying balance at the end of each month.

County Judge/Executive's Response: First of all, the payroll revolving account is reconciled on a timely basis, monthly, along with all bank accounts maintained by the county Treasurer. All the insurance withholdings are kept in this revolving account until the end of the fiscal year because of the cumbersome matching of the amounts withheld compared to the everchanging amounts

payable. These amounts are then paid by check and carried as outstanding checks until the account has reached a zero balance. The insurance vendor requires electronic withdrawals from the general fund account and we ask they cease this process at year end and write the remaining checks from the payroll revolving account as described above. We have handled this account in a similar manner several years in the past. We do agree that this is a confusing procedure and will only write one actual check at June 30 in the future from this revolving account to the insurance company to zero this account. This has been a practice for many years except in most prior years only one check is written by June 30 to zero the account due to employee withholdings.

The Muhlenberg County Fiscal Court did not establish and maintain effective internal controls over compliance with Coronavirus State and Local Fiscal Recovery Fund (SLFRF) requirements:

Federal Program: 21.027 COVID-19 - Coronavirus State and Local Fiscal Recovery Funds

Award Number and Year: 2022

Name of Federal Agency: U.S. Department of the Treasury

Compliance Requirements Activities Allowed or Unallowed; Allowable Costs/Cost Principles

Type of Finding: Significant Deficiency

Amount of Questioned Costs: \$9,425

COVID Related: Yes

The Muhlenberg County Fiscal Court transferred Coronavirus State and Local Fiscal Recovery Funds (SLFRF) from the economic assistance fund (where SLFRF funds were maintained) to the general fund without sufficient supporting documentation of allowable expenditures. Once the list of reimbursed expenditures supporting the transfer was created, auditors found unallowable costs had been reimbursed.

In June 2022, the county transferred \$1,346,255 from the economic assistance fund into the general fund for “lost revenue”. At the time of the transfer, and until auditors inquired about the supporting documentation, the county did not maintain a list of expenditures that reconciled to the transfer total. Instead, the treasurer, with help from an outside company, used estimates for fourth quarter expenditures to arrive at this total. After this inquiry, the county gathered documentation and provided auditors a reconciliation of expenditures of eligible costs that supported the amount transferred into the general fund.

However, during testing we noted the following issues:

- A portion of the deputy judge/executive’s salary in the amount of \$4,967 was included in the reimbursement total however, this portion of the salary had been reimbursed by another federal grant.
- One employee had two timesheets that had no time documented as worked but was signed by the employee. Unsupported time charges applied to the SLFRF grant were \$3,280.
- One employee’s timesheet did not calculate properly to support the charge of \$1,178.

The Muhlenberg County Fiscal Court failed to implement an adequate system of internal controls due to a lack of understanding of the requirements provided by the U.S. Department of the

Treasury. An effective internal control system was not established to ensure compliance with requirements related to the SLFRF funds and the Allowable Costs/Cost Principles compliance requirements. According to the treasurer the unallowable and unsupported charges were due to an oversight by the department heads and the treasurer. He attempted to remove all unallowable or unsupported costs but missed these.

Failure to establish and maintain effective internal controls over compliance with federal program requirements could subject the county to the risk of using federal funds for unallowable purposes. These funds could be requested back from the federal government and could cause increased scrutiny for any federal awards in the future.

2 CFR 200.303 states in part: “The non-Federal entity must: (a) Establish and maintain effective internal control over the Federal award that provides reasonable assurance that the non-Federal entity is managing the Federal award in compliance with Federal statutes, regulations, and the terms and conditions of the Federal award.”

We recommend the county establish and maintain internal controls over compliance for all federal program expenditures to ensure accurate use and reporting of federal awards, including maintaining sufficient supporting documentation of expenditures that reconciles to any transfer from a federal program fund into another county fund. Additionally, documentation used to support federal expenditures should be reviewed by someone who is knowledgeable about the federal program requirements and should verify the supporting documentation is adequate.

County Judge/Executive’s Response: The County made the decision to contract a professional organization with a legal staff to monitor and prepare all funding requests for all SLFRF funds. In April, 2022 the first funding request and transfer request was received from the contracted firm and the transfer of funds was made in June, 2022. This request was presented on the county’s Schedule of Federal Financial Assistance and presented to the auditor. Because the request included some projected payroll amounts rather than actual payroll amounts, the auditor stated these projections were not allowable. The County Treasurer then reworked the schedule to include only expenses (payroll) paid through the date of transfer which the auditor said was in compliance. The questioned payroll costs disallowed can be substantiated and are immaterial. The finding regarding the Deputy Judge Executive salary of \$4,967 being ineligible because paid by another grant is incorrect.

Auditor’s Reply: A portion of the deputy judge/executive’s salary was included in reimbursements requested under a federal emergency management grant. The remainder of their salary was an eligible use of SLFRF funds.

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

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