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Harmon Releases Audit of Owsley County Fiscal Court

FRANKFORT, Ky. – State Auditor Mike Harmon has released the audit of the financial statement of the Owsley 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 Owsley 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 Owsley County Fiscal Court’s disbursements exceeded budgeted appropriations: The Owsley County Fiscal Court lacks strong internal controls over the budget process. The fiscal court exceeded their approved budgeted appropriations in the general fund, local government economic assistance (LGEA) fund, and solid waste fund. Fiscal courts are required to maintain disbursements within budgeted appropriations in all operating funds. The following line items exceeded the approved budget:

- The general fund, general government disbursements, exceeded budgeted appropriations by \$37,787.

- The general fund, protection to persons and property disbursements, exceeded budgeted appropriations by \$4,392.
- The general fund, general health and sanitation disbursements, exceeded budgeted appropriations by \$12,084.
- The general fund, administration disbursements, exceeded budgeted appropriations by \$230,234.
- The jail fund, protection to persons and property disbursements, exceeded budgeted appropriations by \$5,669.
- The LGEA fund, protection to persons and property disbursements, exceeded budgeted appropriations by \$19,606.
- The LGEA fund, administration disbursements, exceeded budgeted appropriations by \$6,040.
- The solid waste fund, general health and sanitation disbursements, exceeded budgeted appropriations by \$30,153.

By exceeding the budgeted line items listed above this caused the fiscal court to also exceed the overall approved budget for the following funds:

- The general fund budget was overspent in the amount of \$284,497.
- The LGEA fund budget was overspent in the amount of \$22,088.

The fiscal court failed to properly monitor budgeted disbursements of the county's operating funds and to submit budget amendments for approval as necessary. A portion of disbursements of the Owsley County Fiscal Court's general fund and LGEA fund were made without sufficient budget appropriations.

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 over financial reporting are vital in ensuring the fiscal court's actual disbursements do not exceed the amount budgeted in each fund.

We recommend the Owsley County Fiscal Court implement controls to ensure that disbursements are within budget appropriations as required by statute and if necessary, request a budget amendment prior to exceeding the budget.

County Judge/Executive's Response: The Fiscal Court will budget appropriately going forward, addressing necessities and making amendments when necessary.

The Owsley County Fiscal Court did not accurately report financial information on the fourth quarter financial report: The Owsley County Fiscal Court's financial information on the fourth quarter report contained the following material errors:

- Receipts of \$455,000 for a Community Development Block Grant (CDBG) received through the fiscal court and passed through to another entity were not recorded on the receipts ledger, disbursements ledger, or fourth quarter financial report.
- Receipts totaling \$41,075 were used to open a Certificate of Deposit (CD) at the local bank; however, the receipts were not recorded on the receipts ledger or the fourth quarter financial report. Further, a bank reconciliation was not prepared.
- The fourth quarter financial report's original budget column included a budgeted transfer of \$18,000 from the solid waste fund that was not included on the approved budget.
- The fourth quarter financial report's budget amendment column for American Rescue Plan Act (ARPA) fund receipts included a budgeted amount for a federal grant totaling \$800,000 which did not agree to the approved budget amendment. The approved budget amendment specified the federal grant totaling \$800,000 was to be received in a separate federal grant fund and not the ARPA Fund.
- The fourth quarter financial report's budget amendment column for ARPA fund disbursements included a budgeted amount for reserve for transfers totaling \$800,000. However, the approved budget amendment specified the reserve for transfer of \$800,000 was to be disbursed from a separate federal grant fund and not the ARPA Fund.
- The fourth quarter financial report included a recorded receipt for the general fund totaling \$29,220 that should have been recorded as a receipt for the road fund.
- Receipts totaling \$3,881 were recorded on the receipts ledger for the general fund but were not included on the financial report.
- A transfer from the general fund of \$15,000 was not included on the fourth quarter financial report, which resulted in transfers for the general fund being understated by that amount.
- Receipts totaling \$3,539 for the road fund were deposited into the road fund bank account but were not recorded on the receipts ledger or included on the financial report.
- A duplicate posting to road material sales of \$10,000 had already been included as transfers from other funds for the road fund, which resulted in receipts for road material sales being overstated by \$10,000.
- A duplicate posting to transfers from other funds for the road fund in the amount of \$28,477 which caused transfers in to be overstated by \$28,477.
- A duplicate posting to transfers from the ARPA fund for the LGEA fund in the amount of \$3,645 which caused transfers in to be overstated by \$3,645.
- A duplicate posting to transfers from other funds for garbage collections totaling \$4,029 and \$1,125, which resulted in receipts for garbage collections being overstated by \$5,154.
- A duplicate posting in the parks and recreation fund of \$10,407 to the federal grant receipt account and to transfers from other funds, which resulted in receipts for federal grant receipt account being overstated by \$10,407.

The fiscal court failed to recognize the importance of strong internal controls over reporting financial information, and instead relied on a single employee without sufficient oversight. Due to the lack of effective internal controls, the amounts reported on the quarterly financial report were materially misstated and did not agree with the actual budgeted amounts and the actual transaction amounts. Also, not having internal controls in place resulted in material receipts not being included on the financial report reducing the usefulness of the financial reports to the public as well as to the fiscal court.

KRS 68.020(4) states the county treasurer, “shall keep an accurate detailed account of all money received and disbursed by him for the county, and shall keep books of accounts 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 68.210 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 the county treasurer to, “[p]repare a quarterly financial statement for the State Local Finance Officer.” The manual provides a format to be used when preparing the quarterly financial statement. This format includes reporting original budget estimates, budget amendments, actual receipts and disbursements and total available in each line item. In addition, the manual provides a chart of accounts and states, “[a]ll counties must use the account numbers from the chart of accounts.”

Strong internal controls over financial reporting are vital in ensuring the fiscal court’s financial reports accurately reflect the financial activity of the fiscal court.

We recommend the fiscal court strengthen internal controls to help ensure accurate financial reporting by complying with the KRS and guidance located in the DLG policy manual by having the finance officer and treasurer reconcile the receipts and appropriation ledgers at least once a month and document the review by initialing and dating the reconciliation.

County Judge/Executive’s Response: The Fiscal Court will accurately report all financials on quarterly report.

The Owsley County Fiscal Court did not maintain documentation for encumbrances: This is a repeat finding and was included in the prior year audit report as Finding 2021-001. The Owsley County Fiscal Court did not include encumbrances on the fourth quarter financial statement. Purchase orders are issued manually by the finance officer and are not put into the accounting software until they are to be paid.

The county treasurer stated that the accounting software can create an encumbrance list for the financial statements; however, since the finance officer is the person who issues the purchase orders and does not have access to the accounting software the encumbrances are not included. The county could not provide the encumbrances on the fourth quarter financial report sent to the Department for Local Government (DLG). Without including the encumbrances on the fourth quarter financial report, the county’s financial status has not been accurately or properly reported.

The *County Budget Preparation and State Local Finance Officer Policy Manual*, issued pursuant to KRS 68.210, states “[e]ach department head issuing purchase request shall keep an updated appropriation ledger and/or create a system of communication between the department head and the judge/executive or designee who is responsible for maintaining an updated, comprehensive appropriation ledger for the county.” Also, the *County Budget Preparation and State Local*

Finance Officer Policy Manual states, “Total Encumbrances – Enter the total dollar amount of unpaid purchase orders from the purchase order journal.”

We recommend the fiscal court ensure the encumbrance listing is accurate and submitted as part of their fourth quarter report as well as the treasurer settlement.

County Judge/Executive’s Response: The Fiscal Court has already created adequate checks/balances to ensure proper documentation for encumbrances are maintained.

The Owsley County Fiscal Court's purchase order system did not operate correctly: This is a repeat finding and was included in the prior year audit report as Finding 2021-001. During Fiscal Year 2022, a lack of proper controls existed over purchasing and disbursement procedures by the Owsley County Fiscal Court. The purchase order system in place did not operate correctly and was not in compliance with the fiscal court's purchasing procedures. The following deficiencies were noted:

- Sixty-one invoices with no purchase order
- Sixteen disbursements with no invoice
- Six instances of invoices that were not itemized
- Seven instances of invoices that were not paid within 30 days with a finance charge paid on one invoice
- One purchase order was issued after the invoice date
- In two instances the county paid sales tax
- One instance of a required item that was not advertised for bids
- One instance of a purchased item that did not agree to the bid price
- Seventy-two instances of invoices not being canceled
- Two instances of duplicate payments for the same invoice totaling \$2,273 and \$287 respectively

The treasurer and finance officer were not aware that purchase orders should be issued for all disbursements, that the purchase order number should be noted on the related invoice, and that purchase orders should indicate the amount the purchase order was issued for. In addition, the county treasurer stated that the accounting software can create a purchase order; however, since the finance officer is the person who issues the purchase orders and does not have access to the accounting software, the purchase order system is not working properly.

The purpose of a purchase order system is to ensure the county is aware of cash balances and budget capacity at any given time. Without amounts or estimated amounts for purchase orders, it is impossible for the county to determine if there are adequate cash balances and budget capacity to cover the purchases, which could lead to overspending. The amount (or estimated amount) is the single most important piece of information to include on the purchase order listing. In addition, by not ensuring all payments are made timely, with proper supporting documentation, and at the agreed upon price, the county could be paying for the same items more than once.

KRS 68.210 gives the state local finance officer the authority to prescribe a uniform system of accounts. Pursuant to KRS 68.210, the state local finance officer has prescribed minimum

accounting and reporting standards in the Department for Local Government's (DLG) *County Budget Preparation and State Local Finance Officer Policy Manual*, which outlines the necessary requirements of a purchase order system. These requirements include listing the amount of the claim and the appropriation code to which the claim will be posted. Proper internal controls require the purchase order number be noted on the related invoice.

KRS 65.140(2) requires, “all bills for goods or services shall be paid within thirty (30) working days of receipt of a vendor's invoice[.]”

KRS 424.260 requires that when procuring services at a cost exceeding \$30,000, the county should make a newspaper advertisement for bids. A county should determine its reasonable and anticipated needs for at least a year. The fiscal court cannot divide the necessary purchases so as to reduce purchases below the required level for bidding.

We recommend the county strengthen controls over disbursements and the purchasing procedures by requiring disbursements to have purchase orders submitted prior to approval. All purchase orders should be completed properly with dates, amounts, and account codes. Each invoice should include the related purchase order number when being approved for payment. Furthermore, the county should not be paying sales tax and should ensure all invoices are properly canceled to ensure they are paid only once.

County Judge/Executive's Response: The Fiscal Court has already created adequate checks/balances to ensure Purchase Order System operates efficiently and correctly.

The Owsley County Fiscal Court did not have adequate controls over the payroll process: The Owsley County Fiscal Court's internal controls over payroll processes were not operating effectively as noted by the following deficiencies:

- One timesheet was not approved by the supervisor.
- One employee signed their timesheet at the start of the pay period.
- One timesheet was approved by the supervisor prior to the end of the pay period.
- One employee took leave which was not reflected on his timesheet.
- One employee's salary was approved by the fiscal court at a rate of \$547, however the check was written for \$528.
- One employee's salary was approved by the fiscal court at a rate of \$181, however the check was written for \$192. In addition, this employee is receiving a second salary that was approved by the fiscal court at a rate of \$466, however the check was written for \$552. This employee does not turn in a timesheet to the payroll officer.
- One employee works two part-time positions for the county, one position is paid at an hourly rate while the second is paid at a salary rate, however the employee does not turn in a timesheet for the salary position.
- One employee worked 49 hours but was only paid for 39 hours.
- Three employees exceeded the authorized accrued vacation as of December 31, 2021.
- Seven employees exceeded the authorized accrued vacation as of June 30, 2022, with accrued vacation of 620 to 1,387 hours.

- One employee was paid for 80 hours, however the timesheet showed no hours worked nor was any sick or vacation time indicated as being used.
- No employee's timesheet indicated they take a lunch nor does the county have a lunch waiver on file for the employees.

The above deficiencies occurred because of internal controls over payroll not being designed and/or operating effectively. A lack of good internal controls over payroll could allow employees to be under or over paid, in addition, the Owsley County Fiscal Court is not in compliance with Kentucky Revised Statutes (KRS) and the U.S. Department of Labor.

Strong internal controls over payroll and timekeeping are vital in ensuring that payroll amounts are calculated and accounted for properly. KRS 337.320 states "(1) Every employer shall keep a record of: (a) The amount paid each pay period to each employee; (b) The hours worked each day and each week by each employee; and (c) Such other information as the commissioner requires." The Owsley County Administrative Codes states, "each employee will receive one day annual leave for each complete month worked and may accumulate to a maximum of thirty days."

Section 13(a)(1) of the Fair Labor Standards Act provides an exemption from both the minimum wage and overtime pay requirements for employees employed as bona fide executive, administrative, and professional employees (including teachers and academic administrative personnel in elementary and secondary schools), outside sales employees, and certain skilled computer professionals (as defined in the Department of Labor's regulations).

U.S. Department of Labor Fact Sheet #17C states:

"To qualify for the administrative employee exemption, all of the following tests must be met:

- The employee must be compensated on a salary or fee basis (as defined in the regulations) at a rate not less than \$684 per week;
- The employee's primary duty must be the performance of office or non-manual work directly related to the management or general business operations of the employer or the employer's customers; and
- The employee's primary duty includes the exercise of discretion and independent judgment with respect to matters of significance."

KRS 337.355 states, "[e]mployers, except those subject to the Federal Railway Labor Act, shall grant their employees a reasonable period for lunch, and such time shall be as close to the middle of the employee's scheduled work shift as possible. In no case shall an employee be required to take a lunch period sooner than three (3) hours after his work shift commences, nor more than five (5) hours from the time his work shift commences. This section shall not be construed to negate any provision of a collective bargaining agreement or mutual agreement between the employee and employer."

We recommend the Owsley County Fiscal Court comply with KRS 337.320, KRS 337.355, and the administrative code regarding vacation hours. We further recommend the Owsley County Fiscal Court seek guidance from the Owsley County Attorney and the U.S. Department of Labor to determine if the employees being paid as salary employees meet the qualifications to be

considered salaried employees or should be paid as hourly employees. In addition, we recommend the employee under paid 10 hours be paid the additional wages due.

County Judge Executive's Response: The Fiscal Court has already taken action to ensure proper Checks/Balances with the Payroll Process.

The Owsley County Fiscal Court did not pay withholdings accurately and timely: This is a repeat finding and was included in the prior year audit report as Finding 2021-003. The county withholds taxes each pay period based on employees' payroll documentation. A review of the current year payments for withholding indicates the county was late paying the withholdings to the state in March 2022. In addition, the county also had five months that the proper payments had not been remitted and an additional four months that had not been properly documented in the ledgers. The improper and late payment caused the county to pay an additional \$89 in penalties. The county has also received a bill for prior year unpaid taxes of \$36,866 with \$5,400 in interest for a total of \$42,266 due to the state. This bill was paid on July 7, 2022. It was further noted that some of the items that were being taxed should have been considered pre-tax when making the tax calculation.

The lack of review or monitoring of the payroll process in the current and prior years allowed county employees' withholdings to go unpaid. The treasurer stated the past due payments have been an ongoing issue and the county was in the process of resolving the issues with the state. He further stated he was unaware of the items that were pre-tax and would make the necessary changes to the program to correct this issue. The treasurer also stated the bill was paid in error in July 2022, as it had already been previously paid by the former treasurer.

Failure to pay obligations to the state has resulted in penalties being assessed to the county, but can also result in collection via court action against the county.

Per the Withholding Kentucky Income Tax manual, "Wages paid to a Kentucky resident as a regular employee in the conduct of business of an employer required to withhold taxes, are subject to withholding on services performed both in and outside Kentucky." In addition, "[e]mployers withholding \$50,000 or more Kentucky income tax a year must file and pay on a twice-monthly basis. Employers meeting the twice-monthly filing requirement must notify DOR and be placed on a twice-monthly basis. When an account has been placed on twice-monthly filing and the employer fails to file twice-monthly, applicable interest and penalties will be assessed as described in Section X."

We recommend withholdings be accurately and timely paid to the department of revenue as well as properly documented on the payroll ledgers. We further recommend the county get with the Kentucky Department of Revenue to determine if the \$42,266 has already been paid over and if so, request a refund for the overpayment.

County Judge Executive's Response: The Fiscal Court has already taken action to ensure proper Checks/Balances in the payment of withholdings.

The Owsley County Fiscal Court did not have adequate segregation of duties and controls over the overall environment of the county: The Owsley County Fiscal Court lacks adequate segregation of duties over revenues, disbursements, cash (specifically bank reconciliations), and payroll. The Owsley County Treasurer was responsible for recording receipts and disbursements in the ledgers, preparing bank reconciliations, and preparing the county's payroll. Additionally, the Owsley County Treasurer prepared monthly, quarterly, and annual financial reports on behalf of the Owsley County Fiscal Court. The Owsley County Fiscal Court failed to establish adequate management oversight to ensure proper recording of receipts and disbursements and complete and accurate bank reconciliations.

The Owsley County Fiscal Court failed to adequately segregate the duties involved in recording revenues and disbursements, preparing monthly bank reconciliations, and preparing the Owsley County Fiscal Court's payroll. Management also failed to provide adequate oversight regarding the Owsley County Treasurer's preparation of financial reports. 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; preparing bank reconciliations; preparing payroll; 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. Appropriate management oversight should be provided to ensure the completion of accurate, timely financial reports.

We recommend the Owsley County Fiscal Court segregate the duties involved in recording receipts and disbursements, preparing bank reconciliations, preparing payroll, and preparing monthly, quarterly, and annual financial reports where possible. If this is not feasible due to a limited budget, appropriate management oversight should be established.

County Judge Executive's Response: The Fiscal Court has already taken action to ensure proper Checks/Balances over the Overall Environment of the County.

The Owsley County Fiscal Court did not charge or pay sales tax to the Kentucky Department of Revenue: The Owsley County Fiscal Court did not charge or pay sales tax on gravel sales totaling \$108,643 made through the county judge's office and included with road fund receipts. The county also did not charge or pay sales tax for receipts totaling \$9,305 collected at the recreation center and included with the parks and recreation fund.

The fiscal court was not aware of sales and use tax requirements. The fiscal court was not in compliance with Kentucky law.

KRS 139.200 states, in part, “[a] tax is hereby imposed upon all retailers at the rate of six percent (6%) of the gross receipts derived from: (1) retail sales of: (a) Tangible personal property, regardless of the method of delivery, made within this Commonwealth[.]”

KRS 139.260 states, in part, “it shall be presumed that all gross receipts and all tangible personal property, digital property, and services sold by any person for delivery or access in this state are subject to the tax until the contrary is established[.]”

KRS 139.540 requires that sales taxes are due and payable to the Kentucky Department of Revenue “monthly and shall be remitted on or before the twentieth (20th) day of the next succeeding month.”

We recommend the fiscal court comply with Kentucky law by accounting for sales tax and paying it timely.

County Judge Executive’s Response: The Fiscal Court will take appropriate corrective actions to ensure taxes are properly charged and remitted.

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

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