



**ADAM H. EDELEN**  
**AUDITOR OF PUBLIC ACCOUNTS**

June 3, 2013

Lori H. Flanery, Secretary  
Finance and Administration Cabinet  
702 Capitol Avenue, Room 383  
Frankfort, KY 40601

Subject: Division of Local Government County Fees Systems Branch Review

Dear Secretary Flanery,

This letter is to notify you of conclusions reached during our review of the Division of Local Government County Fees Systems Branch per our procedures established in our engagement letter dated April 8, 2013. Our findings, recommendations, and management's response and corrective action plan are provided below.

We appreciate the cooperation and assistance provided during our review by agency staff. If you would like to discuss these findings and recommendations further, please contact Libby Carlin, Assistant Auditor of Public Accounts or me.

Sincerely,

A handwritten signature in black ink, appearing to read "Adam H. Edelen", written over a horizontal line.

Adam H. Edelen  
Auditor of Public Accounts



## **FINDINGS AND RECOMMENDATIONS**

### **Finding 1 - Policy And Procedures Manuals Were Not Up To Date**

During our review of the Division of Local Government's County Fees Systems Branch (County Fees), we noted their policy and procedure manuals were not maintained and updated in order to assist local governmental officials and County Fees staff with their daily job functions and responsibilities.

A review of the procedures manual provided to local government officials of the State's larger counties, titled Financial Operation In Counties With Population of 70,000 Or More, identified that key operational and procedural changes revolving around the implementation of the Kentucky Human Resource Information System (KHRIS) were not updated within the manual to provide adequate guidance to county officials. The manual was for the January 2007 through December 2011 timeframe.

Additionally, further requests to review the County Fees daily operation manuals revealed that a written policy and procedures manual was not up to date, but staff was currently in the process of preparing and updating all manuals to be distributed to all employees.

Organizations with minimal turnover or veteran employees can often times become complacent with routine day to day operations, therefore, the necessity in revising and updating policy and procedures manuals can be overlooked. Also, policy and procedures manuals are key to assisting employees in addressing non-routine transactions or disputes that may arise in the course of their work, and when training the temporary employees periodically used by the branch.

The failure to develop and routinely update policy and procedure manuals could lead to accounting errors, lapses in the effectiveness or internal controls, or could leave an organization vulnerable to the loss of the ability to provide timely and effective services due to the turnover of key employees.

Sound internal controls dictate organizations maintain current policy and procedures manuals detailing day to day operations, including required procedures in relation to internal controls. By having policies and procedures documented in writing, there exists a clear understanding between the organization and the expectations of its personnel. Additionally, documented policies and procedures promote consistency, effectiveness, and efficiency in operations which also provides a training guide for new employees in the event of key personnel turnover.

### **Recommendation**

We recommend the Division of Local Government's County Fees Systems Branch prepare and/or update policy and procedures manuals related to their own organizational procedures as well as any guidance and expectations as provided to the county officials. Each manual should be detailed and assist in strengthening the control environment of the Division.

### **Management's Response and Corrective Action Plan**

*The Division is currently in the process of rewriting its policy and procedures manuals and updating its webpage within the Finance and Administration Cabinet's website. This rewrite is designed to provide guidance and expectations for the Cabinet to advise County Officials.*

## **FINDINGS AND RECOMMENDATIONS**

### **Finding 2 - Receipts And Expenditures Processing Lacked Adequate Internal Controls**

During our review of the Division of Local Government's County Fees Systems Branch (County Fees), we noted inadequacies in internal controls over the receipts and expenditures processes including:

- Staff providing management approvals over receipts and expenditures posted within eMARS were not provided the supporting documentation in order to make a determination that the transaction was complete and accurately entered into eMARS prior to approving. During receipts testing, a \$2,641,597 JV was sampled which was identified by the accounting line description as "Correction of error made 3/27/12." The JV was not processed until eight months later on November 29, 2012. This error may have been discovered at the time of entry had an adequate supervisory review been conducted;
- A chain of custody was not established for deposits picked up by the Department of Revenue courier for delivery in order to transfer the responsibility for the deposits from County Fees; and
- Deposits not picked up for delivery to Treasury were not locked in a safe in accordance with the Finance and Administration Cabinet's guidance on cash handling procedures.

The Failure for County Fees to implement adequate internal controls over the processing of receipts and expenditures could lead to errors in the financial information being posted into eMARS, or the loss of assets due to theft or misappropriation.

### **Recommendation**

We recommend the Division of Local Government's County Fees Systems Branch implement the following procedures:

- Following the processing of receipts and expenditures by personnel responsible for posting the activity into eMARS, all supporting documentation for each transaction should be provided to the next level supervisor so that they may conduct an adequate review of the information to substantiate that it is complete and accurate within eMARS prior to the next level approval being applied;
- County Fees should establish a custody or log sheet for the deposits as picked up by the Department of Revenue courier to help establish a chain of custody of deposits, therefore transferring the responsibility for the funds at the time of pickup; and
- County Fees should purchase a safe to further safeguard deposits that were unable to be deposited on the day of receipt. Access to the safe should be restricted to only pertinent personnel within the organization.

Additionally, any new procedures should be documented and included in County Fees' updated policies and procedures manual.

## FINDINGS AND RECOMMENDATIONS

### **Finding 2 - Receipts And Expenditures Processing Lacked Adequate Internal Controls (Continued)**

#### **Management's Response and Corrective Action Plan**

- *The Division has directed that supporting documentation for each transaction remain available for review by the supervisor providing the eMARS level 1 approval.*
- *Since the Division is currently housed with the Kentucky Department of Revenue (DOR), the Division is conducting a review of DOR procedures of deposit transmission to the Kentucky State Treasurer so their procedures will be emulated.*
- *The Division is reviewing providing two drawer, locking, fire-proof file cabinets at each of the four operating desks for overnight storage of deposits. This would restrict access to each of the cabinets and would also address the greater danger of a fire.*

### **Finding 3 - Payments To Fiscal Courts Were Not In Compliance With KRS 64.350**

During our review of the Division of Local Government's County Fees Systems Branch (County Fees), we tested a sample of the quarterly payments made to the fiscal courts for compliance with KRS 64.350. All 14 of the payments selected for testing were non-compliant with KRS 64.350 as funds were not paid in a timely manner to the fiscal courts, and payments, when made, included five to seven months of receipts which exceeded the three month requirement per the statute.

The failure for County Fees to ensure compliance with KRS 64.350 could put additional financial strain on county governments who may depend on receiving their funding timely for their daily operations. Additionally, having an inconsistent payment timeframe can create difficulty for county governments and County Fees in tracking fees required to be remitted.

KRS 64.350 states, "The amount of twenty-five percent of the fees collected by the county clerks and sheriffs during each calendar year shall be paid to the fiscal courts, urban-county governments, or consolidated local governments of the respective counties quarterly no later than April 15, July 15, October 15, and January 15. Each payment shall be for the preceding three months during which fees were received by FAC."

#### **Recommendation**

We recommend the Division of Local Government's County Fees Systems Branch implement adequate policies and procedures to become compliant with KRS 64.350 as to ensure that 25 percent of the fees collected by the county clerks and sheriffs are reverted to the fiscal courts quarterly on April 15, July 15, October 15, and January 15 of each calendar year.

## FINDINGS AND RECOMMENDATIONS

### **Finding 3 - Payments To Fiscal Courts Were Not In Compliance With KRS 64.350**

#### **Management's Response and Corrective Action Plan**

*The Division has developed a procedure that recaps by quarter the 25% fees for each County Official on a calendar year basis so the respective Fiscal Court transfer will be made as directed by KRS 64.350.*

### **Finding 4 - County Fees Failed To Fulfill Its Management And Fiscal Responsibilities Per KRS 42.0201**

During of our review of the Division of Local Government's County Fees Systems Branch (County Fees), we noted that a clear level of authority and oversight had not been established in order to provide adequate monitoring of the activities of the sheriffs and county clerks of the over 70,000 population counties.

We noted the following:

- Discussions indicated that there was some confusion between what the roles and responsibilities of County Fees should be. In the past, County Fees has delegated key decisions to the Auditor's Office or others that should be reserved for management, as well as relying on the external audit function as a key internal control in the monitoring of the over 70,000 population counties. Whereas there is no weakness in utilizing opinions of others as resources in making decisions, management of County Fees expressed a reluctance to make decisions and their belief that policy interpretation functions should be deferred.
- Annually, each sheriff and clerk is required to submit a General Term Order to County Fees which serves as an operating budget documenting estimated receipts, payroll, regular office expense, and equipment. County Fees failed to continually monitor each official's General Term Order to ensure they operated within their approved budget;
- Review of the expenditures processing procedures identified that County Fees performs a desk audit of purchase orders and invoices received; however, no clear guidelines have been established and provided to county officials to distinguish between allowable and unallowable items. During the testing of expenditures, we noted one instance where a possible unallowable expenditure was paid, one instance where an employee was incorrectly reimbursed for a meal on their travel voucher, one instance where a payment was approved without an itemized receipt, and one instance where a vendor was overpaid by five dollars per the provided supporting documentation. These exceptions support that an adequate review of submitted requests for payment was not conducted;

## FINDINGS AND RECOMMENDATIONS

### **Finding 4 - County Fees Failed To Fulfill Its Management And Fiscal Responsibilities Per KRS 42.0201 (Continued)**

- Review of the receipts process revealed that County Fees relies on the information provided on the pay-in voucher submitted by the county officials for determining which funds should be credited to the 25 percent account to be paid to the fiscal court without reviewing provided documentation to determine if their allocation is complete and accurate. Additionally, of the 20 tested receipts two pay-in vouchers were not accompanied by any supporting documentation, so a review of the allocation would not have been possible had it been a required procedure;
- Review of the payroll procedures revealed County Fees provides minimal oversight over the county official's submitted payroll into KHRIS. Generally, this process is controlled at the county level, therefore, County Fees only ensures that a county's payroll was uploaded into KHRIS as there is no way from them to verify that the information is correct and that all employees were paid in accordance with their approved authorized pay schedule.
- Review of the April 15, 2013 payroll revealed the Campbell County Clerk was not compensated accordingly to the maximum salary authorization schedule, as they had been underpaid by \$74 per check since the beginning of the 2013 calendar year.

The failure for County Fees to provide proper monitoring over the financial activities of sheriffs and county clerks of the over 70,000 population counties could lead to inaccurate financial reporting or the loss of assets due to waste, fraud, or abuse. Deferring to others by-passes the responsibility of the agency, and may inadvertently impair audit independence for over 70,000 counties by relying heavily on the judgment of audit staff for key management functions.

KRS 42.0201 section (6)(c)(4) states The Division of Local Government Services shall be responsible for "Serving as the payroll and fiscal officer for the sheriff and clerk in counties over seventy thousand (70,000) in population, disbursing various reimbursements and expenditures to local governments and serving as liaison and conduit for all court fees associated with report of state money through the Circuit Courts."

### **Recommendation**

The Division of Local Government's County Fees Systems Branch should implement policies and procedures to ensure they are providing adequate and effective oversight and monitoring of the over 70,000 population counties in accordance with Kentucky Revised Statutes. We recommend County Fees:

- Adopt measures to recognize its responsibility in ensuring compliance with KRS 42.0201 by distinguishing themselves as a part of management of the over 70,000 population counties. Adequate and effective policies and internal controls should be established and distributed to help monitor county activities independent of the external audit function;

## FINDINGS AND RECOMMENDATIONS

### **Finding 4 - County Fees Failed To Fulfill Its Management And Fiscal Responsibilities Per KRS 42.0201 (Continued)**

#### **Recommendation (Continued)**

- Track and monitor the activity of each official to ensure they are spending funds in accordance with their approved budget per their submitted General Term Order. Any overages should be discussed with the county official, and an amendment should be obtained, as approved by the fiscal court, to justify the increased expenses;
- Develop a listing of unallowable expenditures and communicate them to the county officials in order to provide a clear record of what should not be purchased with fee account funds. This listing should be continually updated as new determinations are made. Additionally, all expenditures processed by County Fees should be reviewed against this list to ensure all items are allowable and necessary;
- Require all county officials submit a breakdown of their fees and commissions collected with their monthly Pay-In Voucher and review to verify that fees to be deposited in the 25 percent and 75 percent accounts were accurately categorized; and
- Require county officials with each KHRIS payroll submission provide an excel spreadsheet and timesheets to further substantiate the amounts reported in KRHIS. County Fees should then review the spreadsheets and other supporting documentation, checking against what was entered into KHRIS, to ensure that all information was properly uploaded, investigating any differences noted. During this review, County Fees should ensure employees were not overpaid or underpaid per their approved payroll authorization form. Additionally, County Fees should implement procedures to continually monitor payroll expenses, comparing them to the approved budget per the General Term Order, to ensure that the total payroll is within the approved budget.

#### **Management's Response and Corrective Action Plan**

- *The Finance and Administration Cabinet has directed the Division to administer under KRS 42.0201 (6) (c) and KRS 64.345, the Office of the Controller's oversight of expenditure of necessary office expenses of each County Official as budgeted by the respective Fiscal Court, Urban County Government or the Legislative Council of the Metropolitan Government.*
- *The Division has the statutory responsibility of limiting the County Official's expenditures to necessary office expenditures, as enacted in the approved budget per their General Term Order. The Division will address providing eMARS reports that reflect calendar year data that is immediately available for Division tracking procedures, and the County Official for budgetary monitoring.*

## FINDINGS AND RECOMMENDATIONS

### **Finding 4 - County Fees Failed To Fulfill Its Management And Fiscal Responsibilities Per KRS 42.0201 (Continued)**

#### **Management's Response and Corrective Action Plan (Continued)**

- *The Division will continue to develop separately for the Clerks and for the Sheriffs what expenditures do qualify as "necessary office expenditures," and communicate these to the respective officials.*
- *The Division will review the monthly Pay-In Voucher procedures and documentation, to verify that the proper support is provided for separation of the fees and commissions deposited into the 25% Fiscal Court account and the Official's 75% operating account.*
- *The Division will address with each County Official that does not provide the payroll excel spreadsheet, so the Division can monitor the official's KHRIS payroll. Since the KHRIS payroll system is only programmed to accept the gross pay of the county employees from the uploaded spreadsheet, the Cabinet refers to the internal control system of the County Official to address any errors in calculation. Divisional staff position budget limitations impedes the pre-audit of detailed county time reporting.*

### **Finding 5 - County Fees Failed To Implement Adequate Controls Over The Payment Of Insurance Premiums**

During our review of the Division of Local Government's County Fees Systems Branch (County Fees), discussions and inquiry with staff identified that the utilization of KHRIS in processing county employee payroll is problematic due to the timing differences related to the health insurance withholdings. KHRIS was developed with the intentions of being utilized for State employees, where a systematic approach for processing payroll is consistent for each employee. Most county governments do not operate under the same terms of employment as the State. These differences in operating have created instances where withholdings and subsequent payments made to the counties as withheld in KHRIS does not agree to the premium the county was actually required to pay.

County Fees is fully aware of the problems and shortcomings related to the current procedures and have begun to meet with affected parties in order to determine a resolution.

Inquiry with staff identified that the issues concerning health insurance withholdings has created situations where counties are receiving excess payments for health insurance which is not necessary and subsequently returned to County Fees for redeposit. Alternatively, discussions identified other instances where health insurance providers were threatening to discontinue service due to a lack of funds being provided.

## FINDINGS AND RECOMMENDATIONS

### **Finding 5 - County Fees Failed To Implement Adequate Controls Over The Payment Of Insurance Premiums (Continued)**

#### **Recommendation**

We recommend the Division of Local Government's County Fees Systems Branch continue to meet with Finance and Administration officials, county officials, or other interested parties to work out a resolution to this problem. Also, County Fees should remain mindful of implementing internal controls necessary to safeguard assets as well as ensuring that any newly adopted procedures be documented in the agencies policy and procedures manual.

#### **Management's Response and Corrective Action Plan**

*The Division will continue to meet with the Kentucky Personnel Cabinet in developing a procedure whereby payments for the County employee health insurance can be made in a timely manner to the providers.*

### **Finding 6 - County Fees Failed To Distribute Adequate Information Necessary For County Officials To Conduct Proper Reconciliations**

During our review of the Division of Local Government's County Fees Systems Branch (County Fees), we noted instances where complete reporting information was not provided to the County Fee Officials to allow for an accurate reconciliation between eMARS and the Fee Officials accounting records to be conducted. We noted the following:

- Inquiry identified that the Monthly Cash Detail Report in eMARS (2550 report), 153 payroll report (per KHRIS), and the County Fee Officials accounting records could not be easily reconciled between one another to ensure the financial information is complete and accurate.
- Detailed information on the 2550 report for some journal vouchers (JV), intercept transfer (IT) documents, and other document types, some of which were not prepared by County Fees, was not adequately disclosed to the Fee Officials. Without further information, Fee Officials had no way of knowing if the JV or other transaction was accurate and/or necessary. Some of these transactions occurred within the State's closeout period (Period 13) and would not be immediately known by County Fees without a special report being run.

The failure for County Fees to provide complete and accurate financial information to Fee Officials in order to ensure a timely reconciliation process can be conducted could lead to inaccurate financial reporting or the loss of assets due to error, waste, fraud, or abuse, which could go undetected.

## FINDINGS AND RECOMMENDATIONS

### **Finding 6 - County Fees Failed To Distribute Adequate Information Necessary For County Officials To Conduct Proper Reconciliations (Continued)**

Sound internal controls dictates that adequate procedures should be in place to allow for the timely reconciliation of financial data between County and State accounting systems recording the same financial activity.

#### **Recommendation**

The Division of Local Government's County Fees Systems Branch should implement policies and procedures to ensure they are providing detailed financial information to the over 70,000 population counties for reconciliation purposes including:

- County Fees should distribute the 2550 reports for any period 13 activity occurring after the close of the State's fiscal to the Fee Officials;
- All JVs or other irregular transactions processed within eMARS, as identified on the 2550 report and provided to the Fee Officials, should be accompanied by an explanation identifying any pertinent information surrounding the reasoning/necessity for the transaction that Fee Officials could utilize as part of their reconciliation process;
- County Fees should take the responsibility of reconciling the 153 payroll reports against the eMARS 2550 report prior to submission to the Fee Officials, investigating any differences; and
- Policy and procedures manuals should be updated to reflect any changes to the reporting process implemented to address the recommendations described above. Additionally, County Fees should formally require that counties reconcile their accounting records with the 2550 report monthly in order to catch any errors and allow for any corrections to be made timely.

#### **Management's Response and Corrective Action Plan**

*Until the payroll of the County Officials (calendar year) became part of KHRIS, there was no period 13 activity (fiscal year) in their accounts. Balancing their July and August cash balances surfaced as a problem in July, 2012. This has now been addressed by the Division for FY 2013.*

*With the exception of payroll transactions, all other JV or correction documentation originate in each County Official's office. The Division is reviewing the current 2550 report (fiscal year), and comparing information to the (calendar year) reporting information that the county needs for their operations, for the design of a new report.*

## FINDINGS AND RECOMMENDATIONS

### **Finding 6 - County Fees Failed To Distribute Adequate Information Necessary For County Officials To Conduct Proper Reconciliations (Continued)**

#### **Management's Response and Corrective Action Plan (Continued)**

*The Division is reviewing the procedure of reconciling the Payroll 153 reports against the eMARS 2550 report. Again, the availability of Division personnel will be limited. Training of the county personnel will be reviewed, because the budget section of the County Official reconciles to the 2550 report and the payroll section of the County Official reconciles to the 153 report.*

*Any changes in the reporting process will require notification to the respective County Official and the updating of the policy and procedures manuals. The Division will continue to work with each County Official to timely reconcile monthly reports.*

### **Finding 7 - County Fees Failed To Update Applicable Statutes To Conform To Current Policy And Procedures**

During our review of the Division of Local Government's County Fees Systems Branch (County Fees), we requested to review any information regarding jailer activity processed by County Fees per KRS 64.345 and KRS 64.350. Discussions and inquiry with staff identified that County Fees does not currently process any activity related to the jailers, and therefore, each KRS is not up to date with current procedures. County Fees acknowledged that a cleanup of statutes was on the agenda for the upcoming legislative session.

#### **Recommendation**

We recommend the Division of Local Government's County Fees Systems Branch ensure that adequate policies and procedures are in place to ensure compliance with state regulations. County Fees should continually review the applicability of statutes in relation to current practices and request revisions to statutes as changes in operations, organizational structure, or control environment occur that may impact statutory requirements.

#### **Management's Response and Corrective Action Plan**

*During the 1990's, the Large County Jailer operations were statutorily changed from the Finance and Administration Cabinet to their fiscal court, county government or merged government. The Division has already targeted KRS 64.345 (removal of "Jailer" in the heading) and KRS 64.350 (removal of phrase in section one relating to Jailers) for a revision by the 2014 General Assembly.*