

**REPORT OF THE AUDIT OF THE
FORMER BREATHITT COUNTY
SHERIFF'S SETTLEMENT - 2017 TAXES**

**For The Period
April 18, 2017 Through April 16, 2018**



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MIKE HARMON
AUDITOR OF PUBLIC ACCOUNTS

To the People of Kentucky

The Honorable Matthew G. Bevin, Governor
William M. Landrum III, Secretary
Finance and Administration Cabinet
The Honorable Jeff Noble, Breathitt County Judge/Executive
The Honorable Ray Clemons, Former Breathitt County Sheriff
The Honorable John Hollan, Breathitt County Sheriff
Members of the Breathitt County Fiscal Court

Independent Auditor's Report

Report on the Financial Statement

We have audited the former Breathitt County Sheriff's Settlement - 2017 Taxes for the period April 18, 2017 through April 16, 2018 - Regulatory Basis, and the related notes to the financial statement.

Management's Responsibility for the Financial Statement

Management is responsible for the preparation and fair presentation of the financial statement in accordance with accounting practices prescribed or permitted by the laws of Kentucky to demonstrate compliance with the Commonwealth of Kentucky's regulatory basis of accounting as described in Note 1. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of a financial statement that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the financial statement based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and the *Audit Guide for Sheriff's Tax Settlements*, issued by the Auditor of Public Accounts, Commonwealth of Kentucky. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statement is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statement. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statement, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statement in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statement.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.



To the People of Kentucky

The Honorable Matthew G. Bevin, Governor
William M. Landrum III, Secretary
Finance and Administration Cabinet
The Honorable Jeff Noble, Breathitt County Judge/Executive
The Honorable Ray Clemons, Former Breathitt County Sheriff
The Honorable John Hollan, Breathitt County Sheriff
Members of the Breathitt County Fiscal Court

Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles

As described in Note 1 of the financial statement, the financial statement is prepared by the former Breathitt County Sheriff on the basis of accounting practices prescribed or permitted by the laws of Kentucky to demonstrate compliance with the Commonwealth of Kentucky's regulatory basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America.

The effects on the financial statement of the variances between the regulatory basis of accounting described in Note 1 and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

Adverse Opinion on U.S. Generally Accepted Accounting Principles

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles paragraph, the financial statement referred to above does not present fairly, in accordance with accounting principles generally accepted in the United States of America, the taxes charged, credited, and paid of the former Breathitt County Sheriff, for the period April 18, 2017 through April 16, 2018.

Opinion on Regulatory Basis of Accounting

In our opinion, the financial statement referred to above presents fairly, in all material respects, the taxes charged, credited, and paid for the period April 18, 2017 through April 16, 2018 of the former Breathitt County Sheriff, in accordance with the basis of accounting practices prescribed or permitted by the Commonwealth of Kentucky as described in Note 1.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated April 11, 2019, on our consideration of the former Breathitt County Sheriff's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the former Breathitt County Sheriff's internal control over financial reporting and compliance.

To the People of Kentucky

The Honorable Matthew G. Bevin, Governor

William M. Landrum III, Secretary

Finance and Administration Cabinet

The Honorable Jeff Noble, Breathitt County Judge/Executive

The Honorable Ray Clemons, Former Breathitt County Sheriff

The Honorable John Hollan, Breathitt County Sheriff

Members of the Breathitt County Fiscal Court

Other Reporting Required by *Government Auditing Standards* (Continued)

Based on the results of our audit, we have presented the accompanying Schedule of Findings and Responses, included herein, which discusses the following report comments:

- 2017-001 The Former Sheriff Has A Deficit Of \$313 In His 2009 Tax Account
- 2017-002 The Former Sheriff's Office Did Not Have Adequate Segregation Of Duties
- 2017-003 The Former Sheriff Did Not Complete An Accurate Franchise Settlement

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Mike Harmon", with a long horizontal line extending to the right.

Mike Harmon
Auditor of Public Accounts

April 11, 2019

BREATHITT COUNTY
 RAY CLEMONS, FORMER SHERIFF
SHERIFF'S SETTLEMENT - 2017 TAXES

For The Period April 18, 2017 Through April 16, 2018

<u>Charges</u>	<u>County Taxes</u>	<u>Special Taxing Districts</u>	<u>School Taxes</u>	<u>State Taxes</u>
Real Estate	\$ 434,531	\$ 1,200,833	\$ 1,667,712	\$ 358,195
Tangible Personal Property	48,522	142,455	138,729	77,640
Fire Protection	5,085			
Franchise Taxes	65,075	201,926	221,352	
Oil Property Taxes	967	2,672	4,096	797
Gas Property Taxes	2,612	7,217	11,064	2,153
Bank Franchises	32,561			
Penalties	3,800	10,924	14,412	2,039
Adjusted to Sheriff's Receipt	(167)	(1)	(7)	(16)
Gross Chargeable to Sheriff	<u>592,986</u>	<u>1,566,026</u>	<u>2,057,358</u>	<u>440,808</u>
<u>Credits</u>				
Exonerations	6,376	17,620	26,973	5,233
Discounts	8,180	20,838	27,258	6,575
Delinquents:				
Real Estate	50,409	137,980	200,178	41,158
Tangible Personal Property	2,017	5,922	7,001	2,695
Total Credits	<u>66,982</u>	<u>182,360</u>	<u>261,410</u>	<u>55,661</u>
Taxes Collected	526,004	1,383,666	1,795,948	385,147
Less: Commissions *	<u>22,355</u>	<u>58,806</u>	<u>53,878</u>	<u>16,369</u>
Taxes Due	503,649	1,324,860	1,742,070	368,778
Taxes Paid	503,628	1,324,748	1,743,231	368,723
Refunds (Current and Prior Year)	<u>74</u>	<u>184</u>	<u>325</u>	<u>55</u>
Refunds Due Sheriff as of Completion of Audit	<u>\$ (53)</u>	<u>\$ (72)</u>	<u>\$ (1,486)</u>	<u>\$ 0</u>
		**		
* Commissions:				
4.25% on \$ 2,294,817				
3% on \$ 1,795,948				
** Special Taxing Districts:				
Extension District	<u>\$ (72)</u>			
Refunds Due Sheriff	<u>\$ (72)</u>			

The accompanying notes are an integral part of this financial statement.

BREATHITT COUNTY
NOTES TO FINANCIAL STATEMENT

April 16, 2018

Note 1. Summary of Significant Accounting Policies

A. Fund Accounting

The sheriff's office tax collection duties are limited to acting as an agent for assessed property owners and taxing districts. A fund is used to account for the collection and distribution of taxes. A fund is a separate accounting entity with a self-balancing set of accounts. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities.

B. Basis of Accounting

The financial statement has been prepared on a regulatory basis of accounting, which demonstrates compliance with the laws of Kentucky and is a special purpose framework. Basis of accounting refers to when charges, credits, and taxes paid are reported in the settlement statement. It relates to the timing of measurements regardless of the measurement focus.

Charges are sources of revenue which are recognized in the tax period in which they become available and measurable. Credits are reductions of revenue which are recognized when there is proper authorization. Taxes paid are uses of revenue which are recognized when distributions are made to the taxing districts and others.

C. Cash and Investments

KRS 66.480 authorizes the sheriff's office to invest in obligations of the United States and of its agencies and instrumentalities, obligations and contracts for future delivery or purchase of obligations backed by the full faith and credit of the United States, obligations of any corporation of the United States government, bonds or certificates of indebtedness of this state, and certificates of deposit issued by or other interest-bearing accounts of any bank or savings and loan institution which are insured by the Federal Deposit Insurance Corporation (FDIC) or which are collateralized, to the extent uninsured, by any obligation permitted by KRS 41.240(4).

Note 2. Deposits

The former Breathitt County Sheriff maintained deposits of public funds with depository institutions insured by the FDIC as required by KRS 66.480(1)(d). According to KRS 41.240, the depository institution should pledge or provide sufficient collateral which, together with FDIC insurance, equals or exceeds the amount of public funds on deposit at all times. In order to be valid against the FDIC in the event of failure or insolvency of the depository institution, this pledge or provision of collateral should be evidenced by an agreement between the sheriff and the depository institution, signed by both parties, that is (a) in writing, (b) approved by the board of directors of the depository institution or its loan committee, which approval must be reflected in the minutes of the board or committee, and (c) an official record of the depository institution.

Custodial Credit Risk - Deposits

Custodial credit risk is the risk that in the event of a depository institution failure, the sheriff's deposits may not be returned. The former sheriff did not have a deposit policy for custodial credit risk but rather followed the requirements of KRS 66.480(1)(d) and KRS 41.240. As of April 16, 2018, all deposits were covered by FDIC insurance or a properly executed collateral security agreement. However, as of December 3, 2017, public funds were exposed to custodial credit risk because the bank did not adequately collateralize the former sheriff's deposits in accordance with the security agreement.

- Uncollateralized and Uninsured \$2,030,058

BREATHITT COUNTY
 NOTES TO FINANCIAL STATEMENT
 April 16, 2018
 (Continued)

Note 3. Tax Collection Period

A. Property Taxes

The real and personal property tax assessments were levied as of January 1, 2017. Property taxes were billed to finance governmental services for the fiscal year ended June 30, 2017. Liens are effective when the tax bills become delinquent. The collection period for these assessments was November 1, 2017 through April 16, 2018.

B. Oil and Gas Property Taxes

The oil and gas property tax assessments were levied as of January 1, 2017. Property taxes are billed to finance governmental services. Liens are effective when the tax bills become delinquent. The collection period for these assessments was November 13, 2017 through May 15, 2018.

C. Franchise Taxes

The franchise tax assessments were levied by the Department of Revenue for various tax years. Property taxes are billed to finance governmental services. Liens are effective when the tax bills become delinquent. The collection period for these assessments was April 18, 2017 through April 16, 2018.

Note 4. Interest Income

The former Breathitt County Sheriff earned \$618 as interest income on 2017 taxes. As of April 11, 2019, the sheriff owed \$141 in interest to the school district and \$184 in interest to his fee account.

Note 5. Sheriff's 10% Add-On Fee

The Breathitt County Sheriff collected \$16,068 of 10% add-on fees allowed by KRS 134.119(7). This amount was used to operate the sheriff's office.

Note 6. Unrefundable Duplicate Payments And Unexplained Receipts

The sheriff deposited unrefundable duplicate payments and unexplained receipts in an interest-bearing account. The sheriff's escrowed amounts were as follows:

2014 \$316

KRS 393.090 states that if the funds have not been claimed after three years, they are presumed abandoned. Abandoned funds are required to be sent to the Kentucky State Treasurer pursuant to KRS 393.110 and its accompanying regulations.

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND
ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF THE FINANCIAL
STATEMENT PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

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MIKE HARMON
AUDITOR OF PUBLIC ACCOUNTS

The Honorable Jeff Noble, Breathitt County Judge/Executive
The Honorable Ray Clemons, Former Breathitt County Sheriff
The Honorable John Hollan, Breathitt County Sheriff
Members of the Breathitt County Fiscal Court

**Report On Internal Control Over Financial Reporting And
On Compliance And Other Matters Based On An Audit Of The Financial
Statement Performed In Accordance With *Government Auditing Standards***

Independent Auditor's Report

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the former Breathitt County Sheriff's Settlement - 2017 Taxes for the period April 18, 2017 through April 16, 2018 - Regulatory Basis and the related notes to the financial statement and have issued our report thereon dated April 11, 2019. The former Breathitt County Sheriff's financial statement is prepared on a regulatory basis of accounting, which demonstrates compliance with the Commonwealth of Kentucky's regulatory basis of accounting and budget laws, which is a basis of accounting other than accounting principles generally accepted in the United States of America.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statement, we considered the former Breathitt County Sheriff's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statement, but not for the purpose of expressing an opinion on the effectiveness of the former Breathitt County Sheriff's internal control. Accordingly, we do not express an opinion on the effectiveness of the former Breathitt County Sheriff's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying Schedule of Findings and Responses, we identified certain deficiencies in internal control that we consider to be material weaknesses.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statement will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying Schedule of Findings and Responses as items 2017-002 and 2017-003 to be material weaknesses.



Report On Internal Control Over Financial Reporting And On
Compliance And Other Matters Based On An Audit Of The Financial
Statement Performed In Accordance With *Government Auditing Standards*
(Continued)

Compliance And Other Matters

As part of obtaining reasonable assurance about whether the former Breathitt County Sheriff's financial statement is free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards* and which is described in the accompanying Schedule of Findings and Responses as item 2017-001.

Views of Responsible Official and Planned Corrective Action

The former Breathitt County Sheriff's views and planned corrective action for the findings identified in our audit are described in the accompanying Schedule of Findings and Responses. The former Breathitt County Sheriff's responses were not subjected to the auditing procedures applied in the audit of the financial statement and, accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Respectfully submitted,



Mike Harmon
Auditor of Public Accounts

April 11, 2019

SCHEDULE OF FINDINGS AND RESPONSES

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BREATHITT COUNTY
RAY CLEMONS, FORMER SHERIFF
SCHEDULE OF FINDINGS AND RESPONSES

For The Period April 18, 2017 Through April 16, 2018

STATE LAWS AND REGULATIONS:

2017-001 The Former Sheriff Has A Deficit Of \$313 In His 2009 Tax Account

This is a repeat finding and was included in the prior year audit report as finding 2016-002. The former sheriff has a deficit of \$313 in his 2009 tax account because the sheriff still owes tax distributions from that year to the extension taxing district. The former sheriff must deposit personal funds to cover the deficit.

The former sheriff has failed to take corrective action regarding this deficit for several years. As a result, the taxing district has been deprived of much needed resources for a significant time period.

KRS 134.192 requires the sheriff to, “annually settle his or her accounts with the department, the county, and any district for which the sheriff collects taxes on or before September 1 of each year.”

We recommend the former sheriff take corrective action to settle and close the 2009 tax account immediately. This matter will be referred to the Breathitt County Attorney to pursue collection.

Former Sheriff's Response: We will correct it and make corrections.

INTERNAL CONTROL - MATERIAL WEAKNESSES:

2017-002 The Former Sheriff's Office Did Not Have Adequate Segregation Of Duties

This is a repeat finding and was included in the prior year audit report as finding 2016-001. The former sheriff's office lacked adequate segregation of duties due to the responsibilities of receiving, recording, depositing, disbursing, and reconciling funds being delegated to the same individual.

The former sheriff's bookkeeper received payments for taxes, recorded receipts, prepared deposits, prepared checks for payments, recorded disbursements, prepared monthly tax reports, and completed monthly bank reconciliations. The former sheriff was aware of the risk associated with inadequate segregation of duties; however, due to small staff size and budget constraints, the former sheriff decided to accept these risks and did not implement compensating controls to offset this weakness.

Since only one person performed all the accounting functions, there was no assurance that financial transactions were accurate, complete, and free of error and misstatement. The lack of adequate segregation of duties increased the risk of undetected misappropriation of funds, misstatements, errors, and fraud.

Good internal controls require the duties of receiving, recording, depositing, disbursing, and reconciling to be separated when possible. If these duties cannot be separated due to small staff size, the official should provide strong oversight and implement compensating controls to decrease the risk associated with inadequate segregation of duties.

We recommended the sheriff's office segregate the duties of receiving, recording, depositing, disbursing, and reconciling tax funds or to implement and document compensating controls to offset this control deficiency. Examples of compensating controls include: the sheriff comparing the daily checkout sheet to the receipts ledger and bank deposit, reviewing bank reconciliations for accuracy, performing surprise cash counts, and reviewing all financial reports. The sheriff could document this review process by initialing reports and supporting documentation.

Former Sheriff's Response: Working to change this in 2018.

BREATHITT COUNTY
RAY CLEMONS, FORMER SHERIFF
SCHEDULE OF FINDINGS AND RESPONSES
For The Period April 18, 2017 Through April 16, 2018
(Continued)

INTERNAL CONTROL - MATERIAL WEAKNESSES: (Continued)

2017-003 The Former Sheriff Did Not Complete An Accurate Franchise Settlement

The former sheriff did not prepare a complete and accurate franchise tax settlement. The settlement reported some bills as delinquent that were not actually delinquent as of April 16, 2018. The settlement was also materially misstated and inaccurate.

A lack of internal controls over the reporting of franchise taxes and a lack of understanding of the reporting requirements by KRS 134.122(1)(a) caused this error. As a result, the franchise settlement was materially misstated and included bills that were not delinquent.

Good internal controls are necessary to ensure accurate and complete financial reporting as well as ensure that the person responsible for report preparation understands the reporting requirements.

We recommend the sheriff's office strengthen internal controls over preparing the franchise tax settlement to ensure the settlement is complete and accurate.

Former Sheriff's Response: This will be corrected.