



Auditor of Public Accounts
Mike Harmon

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

Harmon Releases Audit of Edmonson County Fiscal Court

FRANKFORT, Ky. – State Auditor Mike Harmon has released the audit of the financial statement of the Edmonson County Fiscal Court for the fiscal year ended June 30, 2017. 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 Edmonson 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 115 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 comments:

The Edmonson County Fiscal Court lacks segregation of duties over cash, receipts, disbursements, capitals assets, and reconciliations: This is a repeat finding and was included in the prior year audit report as Finding 2016-003. The Edmonson County Fiscal Court lacks adequate segregation of duties over receipts, disbursements, cash (specifically bank reconciliations), and capital assets. The Edmonson County Treasurer was responsible for recording receipts and disbursements in the ledgers, preparing checks, signing checks, and preparing bank reconciliations. Additionally, the county treasurer prepared the capital asset schedule, monthly, quarterly, and annual financial reports on behalf of the fiscal court. The fiscal court failed to establish adequate management oversight to ensure proper recording of receipts, disbursements, and capital assets and the completion of accurate bank reconciliations.

The fiscal court failed to adequately segregate the duties involved in recording receipts, disbursements, and capital assets, and preparing monthly bank reconciliations. Management also failed to provide adequate oversight regarding the 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 following control deficiencies occurred due to the lack of segregation of duties over these areas:

- The fiscal court did not accurately report financial information as reported in Finding 2017-002.
- The fiscal court did not perform accurate bank reconciliations as reported in Finding 2017-003.
- The fiscal court did not properly reconcile the payroll revolving account as reported in Finding 2017-004.
- The fiscal court did not have adequate internal controls over disbursements as reported in Finding 2017-010.
- The fiscal court did not maintain complete and accurate capital asset schedules as reported in Finding 2017-011.

The segregation of duties over various accounting functions such as recording receipts and disbursements, preparing bank reconciliations, 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 fiscal court segregate the duties involved in recording receipts, disbursements, and capital assets, preparing bank reconciliations, and preparing monthly, quarterly, and annual financial reports where possible. If segregation of duties is not possible, due to the limited number of staff, strong oversight should be implemented. The employee providing this oversight should document his or her review by initialing all source documentation.

County Judge/Executive's Response: Treasurer was terminated effective May 14, 2018. We are currently restructuring our office to have better internal control and implementing a more structured and strict check and balance system to reduce the amount of errors found in our audit.

The Edmonson County Fiscal Court did not accurately report financial information: The Edmonson County Fiscal Court approved the fourth quarter financial report prepared and submitted by the Edmonson County Treasurer on July 7, 2017. The county treasurer submitted this report to the Department for Local Government (DLG) on August 8, 2017, by exporting an electronic file. However, transfers out and disbursements in this electronic file did not agree to the report approved by the fiscal court due to the county treasurer removing transfers out in the amount of \$4,000 and voiding checks in the amount \$1,421 after presenting the report to the fiscal court. Neither the report nor the electronic file was reviewed by another employee to ensure accuracy. The fourth quarter financial report was misstated for original budget, budget

amendments, budget transfers, beginning book balance, receipts, disbursements, transfers in, transfers out, and ending book balance. The misstatements were as follows:

- The total original budgeted receipts were understated by \$42,353 for all operating funds since the recorded amount was \$4,625,386 while DLG approved the budgeted receipts per the original budget at \$4,667,739. This misstatement was a combination of the budgeted receipts of the general fund being overstated by \$17,647 and the emergency 911 fund being understated by \$60,000.
- The total amendments to the budgeted receipts were understated by \$43,854 for all operating funds since the recorded amount was \$66,394 while DLG approved the amendments to the budgeted receipts at \$110,248. This misstatement was a combination of the amendments to the budgeted receipts of the general fund being understated by \$61,501 and the parks and recreation fund being overstated by \$17,647.
- The total original budgeted disbursements were overstated by \$1,000 for all operating funds since the recorded amount was \$4,668,739 while DLG approved the budgeted disbursements per the original budget at \$4,667,739. This misstatement was to the original budgeted disbursements of the road fund.
- The total amendments to budgeted disbursements was understated by \$61,501 for all operating funds since the recorded amount was \$48,747 while DLG approved the amendments to budgeted disbursements at \$110,248. This misstatement was a combination of the amendments to the budgeted disbursements of the general fund being understated by \$43,854 and the parks and recreation fund being understated by \$17,647.
- Budgeted transfers for disbursements of the general fund were understated by \$35,294 and the parks and recreation fund were overstated by \$35,294.
- The beginning book balance as of July 1, 2016 was overstated by \$689 for all operating funds since the recorded amount was \$1,470,660 while the audited beginning book balance was \$1,469,971. This misstatement was a combination of the beginning balance of the general fund and the emergency 911 fund being understated by \$916 and \$90, respectively, due to voiding outstanding prior year checks and the room tax fund being overstated by \$1,695 due to unposted disbursements in Fiscal Year 2016.
- Receipts were understated by \$284 for all operating funds since the recorded amount was \$4,162,160 while audited receipts were \$4,162,444. This misstatement of receipts was due to recreational tax being posted incorrectly in the general fund as transfers in.
- Disbursements were overstated by \$1,903 for all operating funds since the recorded amount was \$3,809,737 while audited disbursements were \$3,807,834. This misstatement was a combination of the disbursements of the general fund being understated by \$304 in unrecorded gross payroll disbursements due to not recording a transfer to the payroll revolving account; the general fund, the road fund, and, the jail fund being overstated by \$1,079, \$170, and \$173, respectively, due to voiding outstanding checks between the fourth quarter financial report approved by the fiscal court on July 7, 2017, and the exports file submitted to DLG on August 8, 2017; and the general fund, the road fund, and the parks and recreation fund being overstated by \$36, \$124, and \$625, respectively, due to voiding outstanding checks during the fiscal year and not removing them from the quarter financial report.
- Transfers in were overstated by \$8,682 for all operating funds since the recorded amount was \$491,780 while audited transfers in were \$483,098. This misstatement is a

combination of the transfers in of the general fund and the emergency 911 fund being overstated by \$284 and \$4,000, respectively, due to posting a bank error as a transfers in and the general fund, the parks and recreation fund, and the emergency 911 wireless fund being overstated by \$199, \$199, and \$4,000, respectively, due to recording transfers in that did not occur.

- Transfers out were overstated by \$4,682 for all operating funds since the recorded amount was \$487,780 while audited transfers out were \$483,098. This misstatement is a combination of the transfers out of the parks and recreation fund being overstated by \$284 due to posting a bank error as a transfers out and the general fund and the emergency 911 fund being overstated by \$199 and \$4,199, respectively, due to recording transfers out that did not occur.
- The ending book balance as of June 30, 2017, was overstated by \$2,503 for all operating funds since the recorded amount was \$1,827,084 while the audited ending book balance was \$1,824,581. This misstatement was a combination of the ending balance of the general fund, the room tax fund, and the emergency 911 wireless fund being overstated by \$304, \$1,695, and \$4,000, respectively, due to recording deposits in transit that did not exist; the parks and recreation fund being understated by \$84 due to the recorded bank balance not agreeing to the bank statement; the parks and recreation fund being understated by \$405 due to reducing the recorded bank balance for outstanding checks that have not cleared the bank; the emergency 911 fund being understated by \$199 due to reducing the bank balance for a transfer out that did not occur; the general fund, the road fund, the jail fund, the parks and recreation fund, and the emergency 911 fund being understated by \$1,995, \$170, \$173, and \$90, respectively, due to voiding outstanding checks; and the general fund, road fund, and the parks and recreation fund being understated by \$36, \$124, and \$220, respectively, due to voiding outstanding checks during the fiscal year and not removing them from the quarterly financial report.
- General fund disbursements general government courthouse renewal and repairs AOC line item was misstated by \$5,000 due to recording a transfer to the payroll revolving account to this line item. This amount was reclassified to general fund disbursements administration.
- General fund disbursements administration employer's share social security was misstated by \$8,002 due to recording the remaining payment on a radio system for the sheriff's department to this line item. This amount was reclassified to general fund disbursements general government.
- General fund disbursements administration workman's compensation line item was misstated by \$4,000 due to recording a transfer to the payroll revolving account to this line item. This amount was not reclassified since both line items are general fund disbursements administration.
- General fund disbursements administration workman's compensation line item was misstated by \$2,000 due to recording the remaining balance on a backyard theatre system for the parks department to this line item. This amount was reclassified to general fund disbursements recreation and culture.
- Road fund disbursements debt service principal was misstated by \$8,850 due to recording the remaining payment on new trucks to this line item. This amount was reclassified to road fund disbursements roads because amounts paid to vendor to purchase a truck should not be recorded to debt service.

The misstatements noted above are the result of a weak internal control system over the financial reporting system. The fiscal court failed to realize the importance of strong internal controls over reporting financial information, and instead relied on a single employee without sufficient oversight. The errors were not detected because the fourth quarter financial report was not reviewed by another employee to ensure accuracy. The county treasurer stated she misclassified disbursements because she booked the disbursements to line items that had sufficient budget available.

Because of this weak internal control system, the amounts reported on the quarterly financial reports are not always in agreement with the actual budgeted amounts and the actual transaction amounts. When the amounts reported on the quarterly financial reports do not agree with the actual budgeted amounts and the actual transaction amounts, these misstatements occur. In addition, budgeted amounts being misstated could result in over spending budgeted line items. The weak internal control system has also resulted in disbursements being posted to the wrong line items reducing the usefulness of the financial reports to the public as well as to the fiscal court. The fiscal court needs accurate financial information to oversee the financial condition of the government as well as to prepare future budgets.

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 DLG’s *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. These controls should include an individual independent of the accounting function reviewing the financial reports for compliance with DLG’s reporting requirements.

We recommend the fiscal court implement stronger internal controls. Internal controls such as a thorough review of quarterly financial reports by someone independent of the accounting function can help detect misstatements and errors that have occurred. This review should include tracing budgeted amounts reported on the reports to the original budget and budget amendments approved by DLG. This review should also include tracing transactions posted to the receipts and disbursements ledgers to actual bank statement transactions. It should also include agreeing fund balances between the quarterly financial reports and bank reconciliations, agreeing bank balances per the bank statements to the quarterly financial reports and bank reconciliations, checking for mathematical accuracy, and verification of bank reconciliation amounts. Ledgers should also be reviewed to verify transactions have been recorded to the correct account codes. Once the ledgers and reconciliations are deemed accurate, the reviewer should document that fact and submit the

review to the fiscal court for approval. By implementing these procedures, the fiscal court can strengthen its internal control system and help ensure accurate financial reporting.

County Judge/Executive's Response: Have implemented stronger internal controls.

The Edmonson County Fiscal Court did not perform accurate bank reconciliations: Bank reconciliations provided for the audit did not accurately reflect the Edmonson County Fiscal Court's financial condition. Bank reconciliations provided for the audit included inaccurate balances because they did not include all necessary information. Errors included incorrect beginning balances, voided checks not being removed from the financial report, voided checks being included on the outstanding check list, voided checks being deducted from the bank balance, and actual outstanding checks being omitted from the outstanding check lists.

In addition, the reconciliation section included on the financial cover sheet of the quarterly financial report did not agree to the bank reconciliations prepared by the county treasurer. Errors include incorrect bank balances, deposits in transit being included that did not exist, ending cash balances not agreeing to the bank reconciliation prepared by the county treasurer, and ending cash balances not agreeing to the cash balance per the financial report section. The following errors were noted:

- The bank balance per bank statement did not agree to the bank balance per the fourth quarter financial report or bank reconciliation for the parks and recreation fund and emergency 911 fund. The actual bank balance for June 30, 2017, was more than reported on the fourth quarter financial report and bank reconciliations by \$489 and \$199, respectively. In addition, the bank balance per bank statements did not agree to the quarterly financial reports for the second quarter and third quarter for the general fund and room tax fund.
- Total deposits in transit of \$5,999 that did not exist were erroneously included on the fourth quarter financial report to balance the general fund, room tax fund, and parks and recreation fund. Total deposits in transit of \$629, \$124, and \$4,393 that did not exist were also included on the first, second, and third quarter financial reports, respectively.
- The ending cash balances per the fourth quarter financial report did not agree to the cash balances per the bank reconciliations for the general fund, room tax fund, and emergency 911 wireless fund. The actual ending cash balance for June 30, 2017, was less than reported on the fourth quarter financial report by \$304, \$1,695, and \$4,000, respectively. In addition, the cash balances per the bank reconciliations did not agree to the ending cash balance per the quarter financial reports for the road fund in the first quarter, and the general fund, room tax fund, and emergency 911 wireless fund in the third quarter.
- The ending cash balances per the reconciliations included on the financial cover sheet of the quarterly financial reports did not agree to the cash balances per the financial report section for the room tax fund by \$1,641 in the first quarter and the road fund by \$7 in the second quarter.

The bank reconciliations and financial cover sheet of the quarterly financial reports were not reviewed by another employee to ensure accuracy. The fiscal court failed to establish appropriate oversight of the county treasurer's reconciliation activities. The fiscal court did not establish

relevant review procedures to determine if the county treasurer was submitting complete and accurate reconciliations on a monthly basis as well as correctly reporting amounts on the quarterly financial reports.

The fiscal court's failure to establish a review of the county treasurer's reconciliations resulted in incorrect financial reporting for the fiscal year ending June 30, 2017. The fiscal court also did not have accurate financial information in order to plan for the subsequent fiscal year. In addition, lack of accurate reconciliations allowed the parks and recreation fund to be overdrawn by \$585 on July 7, 2016, resulting in a \$25 overdraft fee.

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 *County Budget Preparation and State Local Finance Officer Policy Manual* which requires officials handling public funds to prepare monthly bank reconciliations. The example of the financial cover sheet of the quarterly financial report included in the manual indicates that the bank reconciliation should include the bank balance and a listing of all outstanding reconciling items (deposits in transit, outstanding checks, investments, etc.). Strong internal controls over the bank reconciliations should be implemented to ensure that proper amounts are reported to the fiscal court monthly and on the financial cover sheet of the financial reports quarterly.

We recommend the fiscal court establish oversight procedures for all reconciliations and financial reports prepared by the county treasurer to be reviewed by an independent employee to verify accuracy and completeness.

County Judge/Executive's Response: Current reconciliations are being processed for all banking statement.

The Edmonson County Fiscal Court did not properly reconcile the payroll revolving account: The Edmonson County Fiscal Court's payroll revolving account did not reconcile to a zero balance as of June 30, 2017, and the remaining balance could not be readily explained. The bank balance as of June 30, 2017, was \$41,667, with outstanding checks of \$1,270, and outstanding liabilities of \$35,651, leaving an unexplained balance of \$4,746 for Fiscal Year 2017. The payroll revolving account was not properly reconciled every month. The bank balance on the bank reconciliations for nine months did not agree to the bank statements. The actual bank balance for June 30, 2017, was \$5,335 more than reported on the bank reconciliation. The outstanding liabilities reported by the county treasurer were also misstated by \$4,492. The bank reconciliations were not reviewed by another employee to ensure accuracy.

The reconciliation process also did not include reconciling the appropriation expenditure ledger and warrant distribution ledger to the bank. The following recording errors were noted on the appropriation expenditure ledger and warrant distribution ledger for the payroll revolving account:

- Retirement payments for May and June 2017 were booked incorrectly by \$1,417 because credits taken on retirement reports were not deducted.
- A check written July 1, 2016, for \$2,095 for state tax withholdings was not recorded.
- A check written for \$132 was recorded to the wrong life insurance line item.

- A check written for \$4,806 for state tax withholdings was misclassified as federal tax deposit.
- A check written for \$2,526 for state tax withholdings was recorded twice.
- Two payments totaling \$28,020 for federal tax deposits were dated 3/16/2014 instead of 3/16/2017 so the transactions were not booked to the appropriation expenditure ledger.

In addition, during Fiscal Year 2017 the amount transferred to the payroll revolving account from the operating funds did not agree to the total payroll per payroll register. Actual transfers to the payroll revolving account were \$30,781 more than the total payroll per payroll register. The following five checks were written to the payroll revolving account without any supporting documentation:

- Check written from the general fund on October 6, 2016, for \$10,000 to cover overdraft.
- Check written from the general fund on March 10, 2017, for \$14,541 to cover federal tax owed for Fiscal Year 2016.
- Check written from the jail fund on March 10, 2017, for \$209 to cover federal tax owed for Fiscal Year 2016.
- Check written from the general fund on April 24, 2017, for \$4,000 for unknown reason.
- Check written from the general fund on May 3, 2017, for \$5,000 to cover shortage.

The fiscal court failed to realize the importance of strong internal controls over the payroll revolving account, and instead relied on a single employee without sufficient oversight. The county treasurer incorrectly prepared the bank reconciliations, appropriation expenditure ledger, and warrant distribution ledger. The errors were not detected because the reconciliations and ledgers were not reviewed by another employee to ensure accuracy.

The unreconciled payroll revolving account resulted in the fiscal court having insufficient funds to meet payroll requirements. The payroll revolving account was overdrawn by \$5,112 on October 15, 2016, resulting in a \$25 overdraft fee. In addition, the unreconciled payroll revolving account and lack of oversight over the payroll revolving account resulted in the following:

- The fiscal court paid \$16,249 more for withholdings and matching than amount per payroll register.
- The fiscal court paid \$363 more for gross payroll than the amount per payroll register.
- The fiscal court paid penalties of \$3,329 for late federal tax deposits.
- The fiscal court paid the employee's share of retirement without properly withholding from seven employees' payroll checks as reported in Finding 2017-006.
- The fiscal court improperly withheld employee's share of retirement from two employees' payroll checks as reported in Finding 2017-006.
- The fiscal court paid \$520 on a life insurance policy for 11 months after the employee cancelled the policy.
- The fiscal court withheld \$182 too much for the employee's share for vision insurance.
- The fiscal court paid \$1,428 for the employee's share for life, dental, and health insurances without properly withholding from 11 employees' payroll checks as reported in Finding 2017-008.

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 *County Budget Preparation and State Local Finance Officer Policy Manual* which requires the county treasurer to prepare monthly bank reconciliations. Due to the nature of revolving accounts, only the funds necessary to pay employees and government agencies are transferred from other funds. Therefore, the reconciled balance each month of the payroll revolving account should be zero or a small reserve balance. Strong internal controls over the account should be implemented to ensure that proper amounts are transferred timely. Should a balance accrue in the payroll revolving account, the fiscal court should allocate this balance to the appropriate fund(s).

In the future, we recommend the fiscal court implement strong internal controls over the payroll revolving account. These controls should include reconciling the payroll revolving account balance to zero each month, bank reconciliations reviewed by an independent employee to verify accuracy and completeness, reconciling the appropriation expenditure ledger and warrant distribution ledger to the bank, and an individual independent of the payroll function verifying proper payroll amounts are transferred to the payroll revolving account from the corresponding operating funds prior to each pay period. These controls should also include verifying that withholdings amounts and county contributions are handled properly, and paid over to the proper authorities timely, and that any accumulated balance in the payroll revolving account is properly allocated and reflected on the fiscal court's financial statement.

County Judge/Executive's Response: Finance Officer is reconciling retirement payments prior to payment being submitted with Treasurer reviewing. Finance Officer is reconciling payroll report after each payroll to ensure the proper amounts are being deposited into Payroll Account to balance with Treasurer. Payroll is currently out sourced, they are now responsible for all tax reporting liabilities and payments. All benefits and retirement payments are now being coded by Finance Officer with Treasurer reviewing and processing payments to ensure there is more internal control. All discrepancies have been corrected with benefits effective February 2018.

The Edmonson County Fiscal Court lacks adequate controls over payroll: The Edmonson County Fiscal Court lacks adequate controls over payroll. Although the fiscal court has segregation of duties over payroll, they lack monitoring controls to ensure reports are accurate. The following control deficiencies were noted with the fiscal court's payroll:

- The fiscal court does not properly reconcile the payroll revolving account as reported in Finding 2017-004.
- The fiscal court did not properly reconcile retirement reports with payroll reports as reported in Finding 2017-006.
- The fiscal court did not pay tax liabilities timely resulting in penalties and interest as reported in Finding 2017-007.
- The fiscal court did not properly withhold employees' share of insurance as reported in Finding 2017-008.
- Deferred compensation balance is not being counted as FICA income resulting in FICA being underpaid.

- Leave balances are not being maintained by the fiscal court for all employees.
- Employee authorization forms in employee folders are not up to date.
- One employee's timesheet was not signed by the supervisor.
- Road employees received ten hours holiday pay when administrative code states all employees are to only receive eight for holidays.
- Of individuals selected for testing, one employee's timesheet did not agree with the payroll earnings report. The employee was paid \$50 more for overtime hours than overtime hours worked per timesheet.
- County judge/executive's office employees are not clocking in and out with a time clock as required by the Edmonson County Administrative Code.
- The county treasurer has not been working 40 hours every week but has been receiving full salary pay. For pay periods ending February 3, 2017, and March 3, 2017, the county treasurer's time cards showed hours worked as 76 and 77, respectively, yet the payroll report showed the county treasurer was paid for 80 hours each pay period.

Rather than implement a strong internal control system to monitor the payroll process, the fiscal court relied on individual employees to perform specific functions of payroll without sufficient oversight to ensure accuracy of work performed. As a result, the aforementioned findings occurred and the fiscal court's administrative code was not followed.

Strong internal controls over payroll and timekeeping are vital in ensuring that payroll amounts are calculated and accounted for properly. Strong internal controls are also important in safeguarding the fiscal court's assets and those given the responsibility of accounting for them, as well as helping make certain the fiscal court is in compliance with state statutes.

The *Edmonson County Administrative Code* section 340.10 states "[a]ll hourly employees paid by county funds are required to use time clocks with the exception of elected officials secretaries." However, on May 23, 2016, the fiscal court approved installing a time clock "in the Judge's Office to maintain time worked by the office's two employees."

The *Edmonson County Administrative Code* section 340.3 states, "[e]ach Supervisor shall keep records of vacation time allowance, vacation time taken, and the balance of vacation time allowance for each employee under his supervisor." Also, the *Edmonson County Employee Policy And Procedure Handbook* states, "[t]he Personnel Officer or his/her designee shall ensure that accurate records are kept for vacation leave allowance and vacation leave taken."

The *Edmonson County Administrative Code* section 340.4 states, "[a]ll county employees will be paid eight (8) hours holiday pay observed by the County Judge/Executive office of the given year. When it is essential for an employee to work on a declared holiday, he/she shall be paid time and a half hourly pay not to exceed holiday pay of twelve hours at time and a half."

The *Edmonson County Employee Policy and Procedure Handbook* states, "[n]on-supervisory, full-time employees shall work a minimum of 40 hours per week."

We recommend the following improvements:

- Review all deductions and make sure they are being coded correctly for pre-tax and after-tax deductions.
- Leave balances should be maintained for all employees.
- Personnel files should be complete as to all withholding authorizations and updated when any changes occur. Also, any adjustments to employees' pay should be properly included in employees' personnel files.
- All timesheets should be signed by the employee and his or her supervisor.
- All employees should only receive eight hours of holiday pay.
- An individual independent of the payroll process should review payroll transactions, including payroll checks, to verify that amounts have been calculated properly and that they are properly supported. This review can be documented by signing or initialing the payroll report.
- Ensure all employees follow administrative code and county judge/executive's office employees clock in and out for the day using a time clock.
- Ensure all full-time employees are working their correct amount of time to receive their salary pay.

By implementing the above recommendations, the fiscal court can strengthen its internal control system over payroll and timekeeping and reduce the risks of noncompliance and payroll errors. Such procedures will also protect the fiscal court against potential payroll disputes.

County Judge/Executive's Response: Payroll is currently being processed by an outside company who is now responsible for tax reporting and liabilities. The Finance Officer is reviewing and balancing to their reports on a pay period basis and monthly basis. The correct amounts of insurance is being withheld from employee pay, and benefit bills being reconciled prior to payment being submitted. Updated benefit forms are now up to date on all employees. All aspects of payroll are being reconciled, balanced and reviewed by Finance Officer and Treasurer.

The Edmonson County Fiscal Court did not properly reconcile retirement reports with payroll reports: The Edmonson County Fiscal Court reports retirement to the County Employees Retirement System (CERS) and can print the retirement reports. Discrepancies were noted between these reported amounts and the payroll reports. The reported amounts are not reconciled to the payroll reports when preparing the monthly CERS report. The fiscal court did not have adequate controls implemented to ensure the retirement reports were reconciled to the payroll reports. The following errors or problems were noted with the fiscal court's CERS retirement benefits:

- Detailed retirement reports and invoices are not printed and maintained in the fiscal court's records to document the payments made to retirement.
- The amounts reported for gross salaries on the retirement reports did not agree with gross salaries per the payroll summaries for two of 18 employees tested.
- Two employees had the additional 1 percent employee contribution for employees hired on or after September 1, 2008, withheld from their wages even though they were hired before September 1, 2008.

- One employee did not have the additional 1 percent employee contribution for employees hired on or after September 1, 2008, withheld from their wages even though they were hired after September 1, 2008.
- One employee had withholdings and matching reported on the monthly CERS reports, but correct amounts were not withheld from the employee's wages. Only the additional 1 percent was withheld instead of 6 percent.
- One employee had the 5 percent employee contribution withheld from his wages even though he did not participate in CERS because he was a Kentucky Retirement System retiree.
- For five part-time employees, retirement was calculated and paid on the wages reported on the monthly CERS report. The wages reported agreed to the payroll reports, but retirement was not withheld from the employees' paychecks. The fiscal court's records indicate these employee worked under 100 hours per month and did not participate in retirement; therefore, retirement should not have been paid on these employees.
- Six employees' wages were included on the monthly CERS report that were not on the payroll earning report. The fiscal court paid employer's share of retirement on one of these individuals.
- The employer's share of retirement was calculated wrong on the payroll reports and the wrong amounts were transferred over to the payroll revolving account. The percentage for employer's share of retirement was 18.68 for Fiscal Year 2017, however, the employer's share was being figured with previous year's percentages on some of the payroll reports.

The fiscal court did not devote sufficient resources to internal controls over retirement benefits, and instead relied on a single employee without sufficient oversight. The retirement reports were not reconciled to the payroll earning reports.

The fiscal court has overpaid retirement on some employees and under paid retirement on others. This deficiency also explains the problems associated with a proper reconciliation of the payroll revolving account since the transfer of funds from each department is based on the payroll report but the fiscal court pays the Kentucky Retirement System based on the calculations on the retirement report. In addition, retirement withheld from the employees at the wrong rate has been noted and the employees are due a refund.

A strong internal control system over retirement is essential in ensuring that retirement benefits are calculated, reported, and paid over to CERS properly. KRS 78.625 requires the fiscal court to file employee and employer contributions to CERS by the tenth day of the month following the period being reported. KRS 78.610 states "[e]ach employee shall, commencing on August 1, 1990, contribute, for each pay period for which he receives compensation, five percent (5%) of his creditable compensation[.]" and "[t]he agency reporting official of a participating county shall cause to be deducted from the 'creditable compensation' of each employee for each and every payroll period subsequent to the date the county participated in the system the contribution payable by the member as provided in KRS 78.510 to 78.852. The agency reporting official shall promptly pay the deducted employee contributions to the system in accordance with KRS 78.625." Furthermore, KRS 61.702(2)(b)(1.) states "[e]ach employer described in paragraph (a) of this subsection shall deduct from the creditable compensation of each member having a membership date on or after September 1, 2008, an amount equal to one percent (1%) of the member's creditable

compensation. The deducted amounts shall be credited to accounts established pursuant to 26 U.S.C. sec. 401(h), within the funds established in KRS 16.510, 61.515, and 78.520.”

In order to strengthen internal controls over retirement, we recommend an individual independent of the payroll process reconcile the monthly retirement reports to monthly payroll summaries. This reconciliation should include tying all wage and retirement amounts on the retirement report to the payroll summary. This reconciliation should then be reviewed by the county judge/executive or the fiscal court.

Once the retirement report and payroll summary are deemed accurate, retirement benefits should be submitted to CERS on a timely basis. We also recommend the detailed retirement reports be printed each month from the Kentucky Retirement System website with the electronic funds payment confirmation which breaks out gross wages, withholdings, and employer’s share by employee to compare to the payroll register for accuracy. Any invoices or adjustments obtained each month should also be documented and kept with the monthly report to explain any differences. Furthermore, all employees’ retirement withholdings need to be checked for accuracy. Any retirement erroneously withheld from an employee’s paycheck should be refunded to the employee. Other errors should be corrected by reporting and submitting the correct amount to CERS and obtaining amounts not withheld from employees.

County Judge/Executive’s Response: Retirement reports are being reconciled to the payroll reports on a monthly basis prior to payment being submitted by the Finance Officer with the Treasurer reviewing.

The Edmonson County Fiscal Court did not pay tax liabilities timely resulting in penalties and interest: During Fiscal Year 2017, federal tax withholdings and employer contributions were not properly turned over to the Internal Revenue Service (IRS) timely. For the pay periods from July 3, 2016 through March 13, 2017, payments for federal tax withholdings and employer contributions were being misapplied to the amounts due for prior pay periods. When the fiscal court failed to make a federal payment in the previous fiscal year, the IRS misapplied current payments to previous pay periods until the fiscal court made an additional payment on March 13, 2017, to cover the payment missed. Additionally, the state tax return for February 1 to 15, 2017, was filed in August 2017. Local taxes were computed incorrectly and the fiscal court is paying city tax on four employees that was not withheld from the employees’ checks. Eleven of 12 employees tested had the incorrect city tax withheld from their paychecks. For the 12 employees tested, calculated city tax was \$198, but city tax withheld was \$66, for a difference of \$132.

The Edmonson County Fiscal Court failed to make a federal tax payment in the previous fiscal year causing the IRS to misapply current payments to previous pay periods. The fiscal court also failed to implement internal controls to monitor that tax liabilities are reported correctly and instead relied on a single employee without sufficient oversight. As a result, federal taxes, including Social Security and Medicare, were not remitted in accordance with the federal deposit withholding deposit schedule as determined by employers tax guidance published by the IRS. In addition, state taxes were paid late and city taxes were underpaid. As a result, the fiscal court paid penalties and interest of \$3,329 to the IRS due to late payments.

Strong internal controls over the payroll process are essential in ensuring that employee withholdings and employer contributions are turned over to the appropriate taxing authorities. In addition, *Publication 15 Employer's Tax Guide (Circular E)* and *Notice 931 Deposit Requirements For Employment Taxes* issued by the IRS require employers who are semiweekly schedule depositors to deposit federal taxes accumulated on taxes for payroll paid on Wednesday, Thursday, or Friday by the following Wednesday and federal taxes accumulated on taxes for payroll paid on Monday or Tuesday by the following Friday.

103 KAR 18:150 Section 2(4)(a) states in part, "any employer who withheld income tax of \$50,000 or more during the lookback period shall report and pay the tax twice monthly using Revenue Form K-1, 'Employer's Return of Income Tax Withheld.' Revenue Form K-1 and the income tax withheld during the first through the 15th day of each month of the calendar year shall be reported and paid on or before the 25th day of that month. Revenue Form K-1 and the income tax withheld during the 16th through the last day of each month of the calendar year shall be reported and paid on or before the tenth day of the following month." City of Brownsville Ordinance No. 1-08 states, "[t]he occupational license tax shall be measured by 1 % of: (a) All wages and compensation paid or payable in the city for work done or services performed or rendered in the city by every resident and nonresident who is an employee, whether temporary, transient, or permanent without regard to home office location or address of payroll issuer."

We recommend the fiscal court implement internal controls over tax liabilities. Internal controls such as a thorough review of payroll earnings records should be performed by an individual independent of the payroll process and comparison of amounts due to amounts paid. Once completed, the review should be signed by the individual performing the review and submitted to the county judge/executive and the fiscal court.

County Judge/Executive's Response: All tax liabilities are now being processed and paid by the Payroll company with Finance Officer verifying and balancing.

The Edmonson County Fiscal Court did not properly withhold employees' share of insurance: The Edmonson County Fiscal Court did not properly withhold from employees' paychecks for employee deductions such as health, life, accidental, vision, and dental insurance. The fiscal court paid the employee's share for vision, life, dental, and health insurances without properly withholding from the employees' payroll checks as follows:

- \$729 was paid on life insurance policies for four employees including \$317 on behalf of the county treasurer.
- \$492 was paid on dental insurance for three employees including \$166 on behalf of a magistrate.
- \$207 was paid on health insurance for two employees including \$140 on behalf of a magistrate.

In addition, the fiscal court withheld \$182 too much on vision insurance for two employees and the fiscal court paid \$520 on a life insurance policy for 11 months after the employee cancelled the policy.

The various insurance invoices are not compared to the employee withholding to ensure proper withholdings are being made from employees' paychecks. The fiscal court is paying additional insurance on some employees since those employees are not paying the proper portion. As a result, the fiscal court was unable to reconcile the payroll revolving account to zero. Additionally, the fiscal court was required to transfer an additional \$30,781 to the payroll revolving account without documentation.

Good internal controls require original supporting documentation for all payments and reconciliation of the amount withheld to the amount due for voluntary deductions. In addition, the fiscal court should only pay disbursements they are responsible for from the operating funds.

We recommend the fiscal court require someone to verify that employees' withholdings cover their required portion of insurance premiums. This review can be documented by printing a deduction report and comparing it to the insurance invoice prior to paying. In addition, we recommend the fiscal court refund amounts over withheld from employees' paychecks.

County Judge/Executive's Response: An internal detailed audit was completed by the Fiscal Court in February 2018 to ensure that all employees were having the correct amount of voluntary insurance amounts withheld from their paychecks. This has been corrected and is verified on a pay period basis to ensure proper amounts are being withheld.

The Edmonson County Fiscal Court was not in compliance with their Section 218 Social Security Agreement: This is a repeat finding and was included in the prior year audit report as Finding 2016-001. Prior year testing revealed the county treasurer (former finance officer) is now subject to Social Security withholdings since she moved into a new position as of January 2015. Two Edmonson County employees have not been subject to Social Security coverage upon approval by the State Social Security Office. The county judge/executive and county treasurer stated they had started paying FICA on the county treasurer starting December 7, 2016 pay check for pay period November 14, 2016 to November 25, 2016. They had not contacted the State Social Security Office to determine how to handle wages paid to employee from January 1, 2015 to November 13, 2016.

This noncompliance occurred due to failure to follow up on the prior year audit report finding. No documented evidence existed that the prior year finding had been addressed to properly withhold, report, and pay FICA on the county treasurer's wages for the period January 1, 2015 to November 13, 2016.

Edmonson County's Section 218 Agreement with the State Social Security Office revealed that on February 7, 2007, Modification 855 providing Social Security/Medicare coverage for the employees of the County of Edmonson was approved and became in force on April 1, 2007. The employees who voted no remained in the original retirement coverage group. As of July 1, 2014, only two of these employees remained employed by the fiscal court. Since Social Security coverage is contingent upon the position and not the employee, as long as the two employees who opted to waive Social Security remain in the position they held when the election was conducted, they are not subject to Social Security coverage. If they assume any other position with this

employer, they are subject to Social Security coverage and become part of the coverage group who received Social Security coverage. In January 2015, one of these employee moved to a new position as noted above.

We recommend the fiscal court contact the State Social Security Office to determine how to handle wages paid to the county treasurer from January 1, 2015 to November 13, 2016.

County Judge/Executive's Response: All county employees are currently in compliance under The Social Security Agreement. We are also researching an isolated incident that was not in compliance and correcting it.

The Edmonson County Fiscal Court did not have adequate internal controls over disbursements: This is a repeat finding and was included in the prior year report as Finding 2016-002. Internal controls over disbursements were not operating as intended during Fiscal Year 2017. The following control deficiencies were noted:

- The fiscal court approved one claim without sufficient budget available in the parks and recreation fund for the recreation supplies and equipment line item when the claim was approved and paid.
- One invoice of \$30 for travel reimbursement on a meal while attending training was not detailed. Documentation included the signed credit card slip only.
- Nine disbursements tested were recorded to the wrong account codes. One of these payments had two different check numbers when comparing to the warrant distribution ledger and the bank statement. This was check #23501 on the warrant distribution ledger was actually check #23502 on the bank statement copy of the cancelled check.
- Seven disbursements tested were not presented to the fiscal court.
- One disbursement tested for asphalt in the amount of \$5,917 was paid to vendor twice in error. This error was later credited to the fiscal court's account; however, the vendor was still showing the fiscal court owing an additional \$15,038.

The deficiencies listed above were able to occur due to lack of monitoring of controls. These deficiencies could result in line items being over budget, claims being paid not related to the fiscal court, inaccurate reporting, and misappropriation of assets.

Proper internal controls over disbursements are important to ensure purchase orders are created when sufficient funds are available, proper supporting documentation is being maintained, payments are posted to the correct accounts, and claims are presented to the fiscal court. 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 *County Budget Preparation and State Local Finance Officer Policy Manual* which states "purchases shall not be made without approval by the Judge/Executive (or designee), and/or department head. Purchase requests shall not be approved in an amount that exceeds the available line item appropriation unless the necessary and appropriate transfers have been made."

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."

KRS 68.275 requires claims within budget line items and presented to the fiscal court be paid by the county judge/executive and co-signed by the county treasurer.

We recommend the fiscal court improve internal controls over disbursements to ensure they are operating effectively.

County Judge/Executive's Response: Finance Officer and Treasurer both double check all bills to include proper documentation, as well as both are double checking account codes for proper codes.

The Edmonson County Fiscal Court did not maintain complete and accurate capital asset schedules in compliance with regulatory requirements: Material weaknesses existed over the reporting of capital assets and infrastructure of Edmonson County. The schedule of capital assets and infrastructure for the audit period did not recognize all asset purchases that occurred throughout the year and the beginning balances did not agree to the prior year schedule of capital assets ending balances.

The county treasurer is responsible for maintaining the schedule and had several workbooks from the former county treasurer in which she included additions and deletions from the prior year in error. Vehicles and equipment additions were understated by \$179,795 for not including the purchase of a new radio system and a new computer aided dispatch system. Infrastructure had to be restated by \$389,450 due to errors in the prior year audit, including roads that did not meet the fiscal court's capitalization policy. In addition, the county treasurer included four vehicles totaling \$140,000 for the sheriff's office which were leased vehicles, not fiscal court owned vehicles. Two vehicles purchased in Fiscal Year 2018 were included in error and two more vehicles were added which did not meet the fiscal court's capitalization threshold. Furthermore, capital asset records did not include any supporting documentation, such as invoices, to support amounts recorded for assets included on the fiscal court's capital asset schedule.

The fiscal court lacks adequate controls over reporting of capital assets. Each department is required to submit inventory listings to the fiscal court; however, these were not reconciled with the capital asset schedules maintained by the county treasurer. The county treasurer stated she was never trained on how to properly maintain the capital asset schedule and what documentation was required to be maintained. By having weak internal controls over capital assets, assets are left vulnerable to misappropriation or misstatement. In this case, misstatements were able to occur without detection.

Strong internal controls over capital assets are necessary to ensure accurate financial reporting, to protect assets from misappropriation, and to ensure accurate insurance coverage. 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 *County Budget Preparation and State Local Finance Officer Policy Manual* which states, "[f]ixed asset records are necessary for proper asset valuation, adequate and accurate insurance coverage, internal control, and long range planning for property replacement. An annual physical inventory of property and equipment shall be conducted on or before June 30. Physical counts must be compared to the master asset inventory listing. Resulting differences must be reconciled, explained

and documented.” Furthermore, the manual states “[a] fixed asset record should be prepared for each acquisition that meets the useful life and threshold limits. Deletion, sale, or disposal of fixed assets must be approved by the authorized personnel and documented accordingly.”

In order to strengthen internal controls over capital assets, we recommend the fiscal court maintain a complete and accurate capital asset schedule to comply with the Department for Local Government requirements. Procedures should be implemented that will identify and track additions and deletions for the purpose of the capital asset schedule with adequate supporting documentation and any additions or deletions should be reconciled to the department inventory records annually for insurance coverage.

County Judge/Executive’s Response: Created new Capitalization plan.

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

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