Auditor of Public Accounts
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Harmon Releases Audit of Livingston County Fiscal Court

FRANKFORT, Ky. – State Auditor Mike Harmon has released the audit of the financial statement of the Livingston County Fiscal Court for the fiscal year ended June 30, 2016. 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 Livingston 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 the internal control over financial operations and reporting.

The audit contains the following comments:

The fiscal court lacks adequate segregation of duties over accounting processes. There is a lack of segregation of duties over cash, receipts, payroll, capital assets reporting, and preparation of the financial statement. The treasurer performs all accounting functions over cash and receives, posts, and reconciles revenues; prepares payroll; as well as prepares the quarterly financial statement. The treasurer also performs the monthly bank reconciliations. Updates to the capital asset listing are performed by the treasurer. The treasurer also handles tourism tax collections. Testing of tourism tax testing revealed no tourism tax returns for 11 of 36 items tested and two instances of receipt of money with no tax return to validate the amount received. There was no documentation that the treasurer shared this information with the fiscal court and there is no independent review of tourism tax returns.

The treasurer is statutorily required to perform the duties listed above, and there is no oversight of these duties. The fiscal court does not require an independent listing of funds received in the mail or review of the activities performed by the treasurer.

The lack of internal controls allowed the following undetected errors:

- Transfers are not completed timely. (See Finding 2016-002)
- The fiscal court's payroll revolving account has a negative reconciled balance of $6,681 at June 30, 2016. (See Finding 2016-003)
- The fourth quarter financial statement ending cash balances do not reconcile to bank balances. (See Finding 2016-004)
- Errors noted in federal tax payments due to improper deductions to gross wages. (See Finding 2016-008)
- Errors noted in retirement withholdings and payments. (See Finding 2016-009)

The segregation of duties over these tasks is essential for providing protection from asset misappropriation and helping prevent inaccurate financial reporting. Additionally, proper segregation of duties protects employees in the normal course of performing their daily responsibilities. When proper segregation of duties cannot be achieved, compensating controls can be implemented to provide an effective alternative. Additionally, due to the nature of revolving accounts, the payroll fund should reconcile to zero.

To prevent the deficiencies noted above, we recommend the fiscal court implement stronger internal controls. Controls such as a thorough review of the receipts ledgers, bank reconciliations, and payroll by someone independent of the accounting function can help detect misstatements and errors that have occurred. This review should include tracing transactions posted to the receipts ledger to actual bank statement transactions. It should also include agreeing fund balances between the quarterly report and bank reconciliations, checking for mathematical accuracy, and verification of bank reconciliation amounts. Payroll withholding reports should agree to CERS retirement reports and 941 federal tax deposit reports. Capital asset additions and deletions ledgers should be reviewed and compared to invoices. Once the ledgers and reconciliations are deemed accurate, the reviewer should document such, and submit the review to the fiscal court for approval. By implementing such procedures, the fiscal court can strengthen its internal control system.

County Judge/Executive's response: We (the staff) have already instituted a process to correct the "Lack of Adequate Segregation Of Duties" as defined by the Auditors.

Cash transfers are not properly approved prior to transfer. Cash transfers totaling $961,700 were approved after funds had been spent. Cash transfers were booked at the end of each month and then approved at the following month's fiscal court meeting.

The treasurer maintains all budget funds in one checking account. The treasurer does not book the cash transfers until after the checking account is reconciled at the end of each month.

Budgeted funds can have negative fund balances and cash balances presented to the fiscal court include transfers not yet approved by fiscal court. Since the cash of all funds is combined into one bank account, other funds cash is used to pay bills. Some of these funds being spent are not available to spend because the cash transfer has not been approved by the fiscal court.

KRS 68.210 gives the State Local Finance Officer the authority to prescribe a uniform system of accounts. According to the *County Budget Preparation and State Local Finance Officer Policy Manual*, "[a]ll transfers require a court order." This means that court orders are to be obtained prior to cash transfers being made. Additionally, good internal controls dictate that cash transfers be approved by fiscal court prior to being made so that fiscal court is aware that cash is being moved from one fund to another.

We recommend the fiscal court require the treasurer to obtain fiscal court approval for cash transfers prior to funds being spent, monitor cash balances to eliminate negative fund balances, and book cash transfers when approved.

County Judge/Executive's response: The Treasurer was trained to do cash transfers at the end of the month and done so for the last 11 years without issue. We started in July making sure transfers occurred before the checks were issued.

The fiscal court lacks proper oversight of the payroll account. The payroll account had a negative reconciled balance of $6,681 at June 30, 2016. This was due in part to insufficient funds being transferred from operating funds to cover payroll costs. There are no internal controls verifying payments to and from the payroll account. There is no review of the payroll account activity to verify transactions were properly handled and recorded. Individual operating fund disbursements and ending balances were misstated on the fourth quarter financial statement as well as the county having a liability for the payroll account deficit. Good internal controls require oversight by the fiscal court of the payroll account to protect employees while performing required duties and to protect county assets against misappropriation. The payroll account is a revolving account and should reconcile to zero. We recommend the fiscal court implement internal controls over the payroll account that include oversight of payroll receipts and disbursements.

County Judge/Executive's response: We instituted further processes and additional checks to catch any payroll errors that might occur.

The fiscal court did not properly reconcile each fund. The fourth quarter financial statement ending cash balances and reconciled bank balances do not agree. Funds are allowed to carry negative balances until the treasurer books transfers. Payroll errors and error corrections were not reconciled to the fund financial statements until the treasurer completed the 2016 treasurer's settlement. Adjustments were not made to accounting records to correct the issues, the treasurer just noted the underlying issues on the treasurer's settlement. There are no internal controls over financial statement preparation to ensure amounts reported are correct and agree to underlying financial records. These errors caused several adjustments to cash balances. There was no evidence the treasurer determined that there was sufficient budget or fund balance in the fund prior to writing checks. Additionally, cash balances from restricted funds are comingled with unrestricted and are used to offset negative cash balances. Audit costs increase when accounts are not properly reconciled and when quarterly amounts submitted to the Department for Local Government (DLG) are incorrect.

KRS 68.210 gives the State Local Finance Officer the authority to prescribe a uniform system of accounts. The DLG's *County Budget Preparation & State Local Finance Officer Policy Manual* requires the treasurer to countersign checks only if the following conditions exist:

- Claim reviewed by the fiscal court
- Sufficient fund balance and adequate cash in the bank to cover the check
- Adequate free balance in a **properly budgeted** appropriation account to cover the check

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. . . .The county treasurer shall be liable on his official bond for the amount of any county warrant willfully or negligently signed or countersigned by him in excess of the budget fund out of which the warrant is payable."

If the checking account is not properly balanced, there is no way to know if the conditions listed above have been met. Additionally, good internal controls dictate a review of bank reconciliation records to determine if amounts reported are accurate and activities recorded are allowable.

We recommend the fiscal court consider separate checking accounts for each fund in order to separate restricted funds from unrestricted funds, require sufficient fund balances be documented prior to disbursing funds, and establish a review process for cash reconciliations that determine amounts reported to fiscal court and DLG are correct.

County Judge/Executive's response: Separation of checking accounts is not required by law. We have used this philosophy for 15 years and it works very well for us. We have instituted a process to prevent paper negative balances. I still remember how bad separate checking accounts were and have no reason to change our current operation. We are one of the strongest, financially sound counties in the state of Kentucky.

Auditor's Reply: The recommendation to separate bank accounts was to suggest a practical solution to help the county improve its financial management. At a minimum, the fund balances should be reconciled regularly. There was no evidence the treasurer determined there was sufficient budget or fund balance in the various funds prior to writing checks. Additionally, transfers were done after approval was given for paying expenses, which is in violation of the Department for Local Government's (DLG) *County Budget Preparation And State Local Finance Officer Policy Manual.*

The fiscal court did not maintain proper records for the public properties corporation fund and county library bond fund. The fiscal court is financially accountable and legally obligated for the debt of the public properties corporation (PPC) fund and the county library bond fund. However, the fiscal court did not maintain receipts and disbursements ledgers, and did not prepare financial statements for the PPC fund and the county library bond fund. Failure to maintain proper records for these funds occurred due to lack of internal controls and management oversight. The lack of accounting records and related financial statements resulted in noncompliance with the Department for Local Government (DLG) reporting requirements. Additionally, the county library bond fund was understated in the prior year by $5,812.

KRS 68.210 gives the State Local Finance Officer the authority to prescribe a uniform system of account. The DLG *County Budget Preparation and State Local Finance Officer Policy Manual* prescribes the minimum requirements for handling public funds, including monthly bank reconciliations and books of original entry for receipts and expenditures. In addition, good internal controls dictate that county funds be accounted for properly and reviewed on a regular basis. This would include receipts and disbursements ledgers, as well a financial statement for each of these funds.

We recommend the fiscal court prepare and maintain receipts and disbursements ledgers for the PPC fund and the county library bond fund. We also recommend the fiscal court require the preparation of accurate year-end financial statements for those funds in order to ensure compliance with DLG requirements and also to ensure fiscal debt responsibilities will be met.

County Judge/Executive's response: Prior Auditors have had the Treasurer do a spreadsheet showing the breakdown of the funds. We assumed this to be the correct presentation of accounting records for these funds. Treasurer was unaware anything else was required. As soon as we have full understanding of what is required we will comply.

Auditor's Reply: A spreadsheet was not provided to the auditors during the audit. The information provided was a bank trace and it did not include all months. The requirements promulgated by DLG include receipts and disbursements ledgers, and a financial statement for each of the funds.

The fiscal court lacks adequate internal controls over debt reporting. The debt balance on the liabilities section of the June 30, 2016, quarterly financial statement has a difference of $3,336,599 when compared to the confirmed ending debt balances at June 30, 2016. Bond debt of $3,380,000 was omitted from the liabilities section of the quarterly report and the financing obligations debt balance was overstated by $43,401 on the liabilities section of the quarterly report. The treasurer was unaware that the 2015 Public Properties Corporation Bonds did not fully pay off the 2007 Public Properties Corporation Bonds. No one reviews the quarterly financial statements prior to submission to the Department for Local Government (DLG). The liabilities section of the June 30, 2016, quarterly financial statement was materially misstated.

KRS 68.210 gives the State Local Finance Officer the authority to prescribe a uniform system of accounts. The DLG *County Budget Preparation and State Local Finance Officer Policy Manual* requires financial records, including a schedule of liabilities, to be maintained. The schedule of liabilities should include the principal amount outstanding at the time of the report. Additionally, good internal controls require accurate information be presented so that the fiscal court can make informed financial decisions, such as budget preparation or making large purchases.

We recommend the fiscal court review debt schedules and ensure the amount reported by the treasurer is accurate.

County Judge/Executive's response: We were confused about the part of the debt that was not paid off during the refinancing. We now understand this part of the refinancing bond issue and will report it on the 4th quarter report.

The fiscal court did not adhere to bidding requirements, monitor small projects, or maintain adequate documentation for items purchased at state contract price. The fiscal court failed to advertise for bids on metal culverts and spent $30,474 on metal culverts from one vendor. Additionally, the fiscal court received a bid for a waterline project in the amount of $39,579. Costs paid for the project in fiscal year end June 30, 2016 were $57,598. There was no documentation of approval of change orders or project overruns. The waterline project was overspent because of lack of monitoring. The fiscal court paid for a sheriff vehicle in the amount of $30,290 utilizing state contract price, but failed to keep documentation of the actual master agreement or build list documenting the cost of the vehicle. One asphalt vendor's invoices failed to list which asphalt type the county was being charged for, and listed only the road name, unit cost, and quantity.

There were no monitoring internal controls in place that:

- determined if the fiscal court was billed in accordance with accepted bids for small projects,
- matched invoice charges to material bid amounts, or
- required adequate documentation of state price contracts.

These deficiencies could result in inaccurate reporting and misappropriation of assets. Furthermore, the fiscal court is in violation of KRS 424.260, which requires the advertisement for bids.

KRS 424.260(1) states "[e]xcept where a statute specifically fixes a larger sum as the minimum for a requirement of advertisement for bids, no city, county, or district, or board or commission of a city or county, or sheriff or county clerk, may make a contract, lease, or other agreement for materials, supplies except perishable meat, fish, and vegetables, equipment, or for contractual services other than professional, involving an expenditure of more than twenty thousand dollars ($20,000) without first making newspaper advertisement for bids."

We recommend the fiscal court establish adequate oversight of small projects and require adequate documentation of costs for items purchased from state contracts. Additionally, the fiscal court should review invoices for large purchases to determine charges for materials and related costs and require material bids for all items exceeding $20,000 in accordance with KRS 424.260.

County Judge/Executive's response: As Judge Executive I take full responsibility for both the metal culverts purchase & the City of Grand Rivers overcharge. We stopped bidding culverts because the price was extremely high, we found if we quoted the culverts each time there was significant savings. We will now monitor and purchase from different vendors to keep cost below the $20,000.00 bid requirement. We will closely monitor contracts with city's to insure this does not happen again. The sheriff is responsible for documentation relating to purchase of sheriff vehicles.

Auditor's Reply: The fiscal court should ensure that culverts are bid any time the cumulative total of the materials are expected to exceed $20,000. Spreading these purchases among different vendors does not alleviate this requirement. Additionally, since the fiscal court paid for a sheriff's vehicle, it is required to maintain all appropriate documentation to support the purchase.

There is a lack of internal controls over payroll. No one reviews payroll related data processed and posted by the county treasurer. This includes amounts remitted to employees, due from other funds, retirement calculations, and employer tax calculations. Additionally, timesheet verifications did not catch the errors noted below. There is insufficient oversight of payroll records.

Due to the lack of oversight of payroll records, the following issues were noted:

- Three employee timesheets were not signed/approved by the supervisor.
- Three employee timesheets were not signed by the employee.
- Three timesheets were not signed by either the employee or supervisor.
- Two employees' pay rate increases were not approved through the fiscal court.
- One new hire was not approved through the fiscal court.
- One employee was paid the wrong rate for fiscal year 2015-2016.
- For two employees tested, deferred compensation was deducted from gross wages, making the FICA calculation incorrect.
- Four form 941, Employer's Quarterly Federal Tax Return payments were paid late.

KRS 64.530(1) states, "the fiscal court of each county shall fix the reasonable compensation of every county officer and employee except the officers name in KRS 64.535 and the county attorney and jailer." Strong internal controls are essential in ensuring that payroll is properly processed and that employees and form 941 payments are properly paid.

We recommend the fiscal court strengthen internal controls to ensure each employee and appropriate supervisor sign off on the timesheet. We recommend the fiscal court fix the reasonable compensation for every county employee as stated in KRS 64.530. We also recommend that the fiscal court strengthen internal controls over payroll by monitoring time records and payroll deductions.

County Judge/Executive's response: Employees are supposed to sign their time sheets and turn them back in, we suspect this did not happen. We believe the step increase from our pay plan, *which fiscal court approved, is what the auditor is referring to as a un-approved pay rate increase. Because this increase is part of the fiscal court approved pay plan, we do not receive additional court approvals. If this is correct we request this section of the finding be removed from the audit. No fines were issued for late 941 payment, therefore we believe they were all made on time. We have corrected all other issues.*

Auditor's Reply: Approval for pay rate changes should be documented in the fiscal court orders in accordance with KRS 64.530. The pay rate changes noted above were made by a department supervisor after the salary list was approved. There was no documentation in the fiscal court minutes authorizing the pay rate increase. Even if no fines were issued for late 941 payments, the 941s were late and should be submitted timely.

The fiscal court failed to correctly pay retirement to CERS. The fiscal court did not correctly pay retirement benefits to the County Employee Retirement System (CERS) monthly. This condition occurred due to lack of oversight by the fiscal court and there was no comparison of retirement on the payroll summary to payments made to CERS. Out of 12 months tested, all 12 months contained errors in the retirement amounts. Twelve employees have contributions made in CERS, but amounts are not on their payroll summaries. Six employees have payroll deductions for retirement, but these amounts do not show in CERS reports.

KRS 78.625 states:

> (1) [t]he agency reporting official of the county shall file the following at the retirement office on or before the tenth day of the month following the period being reported:
> (a) The employee and employer contributions required under KRS 78.610, 61.565, and 61.702;
> (b) The employer contributions and reimbursements for retiree health insurance premiums required under KRS 61.637; and
> (c) A record of all contributions to the system on the forms prescribed by the systems.
> (2)(a) If the agency reporting official fails to file at the retirement office all contributions and reports on or before the tenth day of the month following the period being reported, interest on the delinquent contributions at the actuarial rate adopted by the board compounded annually, but not less than one thousand dollars ($1,000), shall be added to the amount due the system.

Strong internal controls are essential in ensuring that payroll is properly processed and that employees' retirement is properly paid. We recommend the fiscal court implement a review of retirement deductions each month before finalizing payment of retirement.

County Judge/Executive's Response: Corrections have been made and processes are in place to prevent this from happening in the future.

The fiscal court did not have adequate controls over reporting of capital assets to ensure accuracy. The fiscal court lacks adequate controls over reporting and valuation of capital assets.

The master capital asset list provided to the auditors was inaccurate. The beginning asset balance did not match the prior year audited ending balances. In addition, not all capital assets were added to the county's asset schedule. The fiscal court has not adequately monitored and tracked capital assets as required by the Department for Local Government. The capital asset list provided is materially misstated due to the beginning total asset amounts not agree the prior year auditor's ending balances. This was due to current year infrastructure assets being added to the beginning number. The Annual Inventory Master List was missing two assets purchased throughout the year for a total of $13,000.

Strong internal controls over capital assets are necessary to ensure accurate financial reporting as well as to protect assets from misappropriation. Additionally, KRS 68.210 gives the State Local Finance officer the authority to prescribe a system of uniform accounts for all counties and county officials. The *County Budget Preparation and State Local Finance Officer Policy Manual* states:

> For purposes of internal control, an asset inventory listing must be maintained for all asset purchases/donations above a reasonable dollar amount, and have a useful life of greater than one year. The asset inventory listing should provide the following detail:
>
> - Property Tag number
> - Asset description
> - Serial number – if applicable
> - Quantity – if applicable
> - Cost (or [fair market value] of donated asset at date of donation)
> - Date of acquisition
> - Date of disposal (track all disposals for entire fiscal year)
> - Property location (by department, building & room number)
> - Manager/individual responsible
>
> The Asset Inventory Listing will include assets reported on the Capital Asset Listing, with the exception of infrastructure assets.

The manual further states "[a]n 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." The asset inventory listing should be updated for all additions, disposals, and property location changes, etc. Authorization must be given to appropriate accounting personnel for asset record and asset inventory listing modifications."

In order to strengthen the county's internal controls over capital assets, we recommend the county reconcile asset purchases and disposals with the general ledger. The county should also reconcile the schedule to the physical inspection of county assets at the end of each year and make comparisons to the county's list of inventoried assets and insurance policy.

County Judge/Executive response: Out of hundreds of capital assets, we inadvertently left two items off. Human error, still a very high percentage of correct items on capital assets documentation. We will try to be 100% correct in the future.

Auditor's Reply: If adequate internal controls were instituted and functioning, the errors noted above could have been avoided.

The audit report can be found on the auditor's website.

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