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

FRANKFORT, Ky. – State Auditor Mike Harmon has released the audit of the financial statement of the McCreary County Fiscal Court for the fiscal year ended June 30, 2020. 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 McCreary 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.

Finding 6 will be referred to the United States Department of Agriculture (USDA).

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:

Transfers were made before approval by the fiscal court: This is a repeat finding and was included in the prior year audit report as Finding 2019-001. The county treasurer made 47 interfund transfers during Fiscal Year 2020. Of the 47 transfers, three transfers received approval after the transfer was issued and made.

The county treasurer transferred funds before approval due to timing issues in an attempt to avoid late payment fees and penalties that would have incurred if she had waited until the next upcoming fiscal court meeting. By transferring funds before approval is received, the county treasurer circumvented the fiscal court's authority to decide how county funds are to be used.

KRS 68.290 states, "[t]he fiscal court may transfer money from one (1) budget fund to another to provide for emergencies or increases or decreases in county employment pursuant to KRS 64.530(4). The order of the fiscal court making the transfer shall show the nature of the emergency or personnel increase or decrease and the reason for making the transfer. The fiscal court shall not have any power to transfer money from any sinking fund or special fund raised for a specific purpose until the obligation or purpose for which the fund was raised has been satisfied."

According to page 73 of the Department for Local Government's (DLG) *County Budget Preparation and State Local Finance Officer Policy Manual*, "[a]ll transfers require a court order." Additionally, the McCreary County Fiscal Court's Administrative Code Section 4.4(H) states in part, "[t]he original appropriation and all amendments and transfers authorized by order of the Fiscal Court shall be entered."

We recommend that all transfers be approved by the fiscal court before the transfer is made. The approval should be clearly reflected within the fiscal court minutes.

County Judge/Executive's Response: Treasurer has taken the necessary measures to correct this issue by doing Anticipated Fund transfers.

The payroll revolving account was not properly reconciled: This is a repeat finding and was included in the prior year audit report as Finding 2019-002. The payroll revolving account did not reconcile to zero as of June 30, 2020, and the remaining balance could not be readily explained. According to the information available to auditors, the account balance as of June 30, 2020, was \$81,695. Of this balance, the county had outstanding checks of \$37 and outstanding liabilities of \$62,440, leaving an unexplained balance of \$19,218 for fiscal year 2020.

In addition, the employee benefits account, which primarily receives funds from the payroll account, did not reconcile to zero. According to the information available to auditors, as of June 30, 2020, the account had an unexplained balance of \$632 for Fiscal Year 2020. Auditors noted the finance officer verified that funds were deposited and checks or electronic withdrawals had cleared, but no evidence of a monthly bank reconciliation was found for these accounts. In addition, the account was overdrawn 17 times during the fiscal year which indicates a lack of oversight.

According to the finance officer, a new payroll account was opened in July 2018 and he thought this corrected the prior year issue since he transfers payroll funds according to the summary produced by the computer software.

The unreconciled payroll account could cause the fiscal court to have insufficient funds to meet payroll requirements, cause the fiscal court's liabilities to not be properly paid, or cause liabilities to not be paid timely.

Per KRS 68.210, the state local finance officer has the authority to require a uniform system of accounts. The *County Budget Preparation and State Local Finance Officer Policy Manual* includes monthly bank reconciliations as a minimum requirement for all county officials. Since the payroll and employee benefits accounts are revolving accounts, only the funds necessary to pay employees and government agencies should be transferred from other county funds. Therefore, each month the account should reconcile to a zero balance.

Good internal controls dictate that revolving accounts be reconciled to a zero balance. In addition, monthly bank reconciliations should be prepared and reviewed by someone independent of the reconciliation process.

We recommend the fiscal court properly reconcile the payroll revolving account and the employee benefits account to a zero balance monthly. Additionally, we recommend the bank reconciliations be reviewed by an employee independent of the reconciliation process. These reviews should be dated and initialed by both the preparer and the reviewer to document evidence of oversight, accuracy, and completeness.

County Judge/Executive's Response: Action has been taken to correct this.

The fiscal court did not have proper purchase and procurement procedures: This is a repeat finding and was included in the prior year audit report as Finding 2019-003. The fiscal court did not have proper purchase and procurement procedures as noted by the following deficiencies:

Of the 58 invoices tested:

- The county did not bid out two disbursements over $30,000.
- The county did not maintain bid files for four disbursements over $30,000.
- Thirty-two invoices tested did not have purchase orders.
- Nine invoices tested had purchase orders dated after receipt.
- Five invoices tested were paid past 30 working days of receipt.
- One invoice tested did not have any supporting receipts.
- Two invoices tested had sales tax paid.

The deficiencies are a direct result of the lack of adequate segregation of duties, improper accounting practices, and poor internal controls without sufficient management oversight. These deficiencies could have resulted in significant overpayments, misappropriations, inaccurate financial reporting, or penalties being assessed.

The state local finance officer, given the authority by KRS 68.210, requires in the *County Budget Preparation and State Local Finance Officer Policy Manual* all disbursements to be accompanied by a purchase order assigned in advance of the purchase to a fund with each disbursement to be sufficiently documented. In addition, good internal controls dictate that proper supporting documentation be maintained to validate disbursements.

The McCreary County Administrative Code Section 9.2(C) states, "[a]ny expenditure or contract for materials, supplies (except perishable meat, fish, and vegetables), equipment, or for contractual services other than professional, involving an expenditure of more than Thirty Thousand Dollars ($30,000) shall be subject to competitive bidding."

We recommend the fiscal court take the steps necessary to ensure they are in compliance with the state local finance officer and the McCreary County Administrative Code. We recommend all items over the $30,000 county bid threshold be properly bid out and that all supporting documentation, such as approved bid specifications and purchase orders, be maintained with the original invoices. We recommend all disbursements be assigned a purchase order before the purchase is made. We recommend all disbursements are paid within 30 working days of receipt, no sales tax is paid, and all disbursements have supporting receipts.

County Judge/Executive's Response: We have briefed all employees and staff on the need for and importance of Purchase Orders. I believe we have a good handle on the issue now. We sometimes must go back to vendors and remind them that we are tax exempt. We did make a mistake on the disbursements for the purchase of the two tractors. We did receive estimates from the only dealers in the area and went with the lowest, but we did not bid it out per the KRS as we should have. We have instituted guidelines so that this does not happen again.

The fiscal court did not have sufficient internal control procedures over credit card disbursements: This is a repeat finding included in the prior year audit report as Finding 2019-004. The fiscal court has not implemented proper internal control procedures over credit card disbursements. Credit card disbursements had the following deficiencies:

- Four credit card receipts were without an itemized detail of charges.
- Twenty-four of the 37 credit card charges tested were not supported with a purchase order.
- Two credit card charges included a purchase order dated after disbursement.
- Two credit card statements were paid in excess of 30 days, incurring a total of $78 in late fees and $36 in finance charges.
- Seven purchases were made included sales tax paid.
- One credit card charge was paid without sufficient supporting documentation.

The deficiencies noted above stem from a lack of adequate segregation of duties, improper accounting practices, and poor internal controls without oversight. The county treasurer and county judge/executive are relying upon the finance officer to ensure all invoices are valid without proper review of the supporting documentation before authorizing the disbursement. The lack of proper segregation of duties, improper accounting practices, and lack of oversight could result in misappropriation of assets, inaccurate financial reporting, or payment for personal purchases with public funds.

The state local finance officer, given the authority by KRS 68.210, requires in the *County Budget Preparation and State Local Finance Officer Policy Manual* that all disbursements be accompanied by a purchase order, within budgeted amounts, sufficiently documented, and paid within 30 working days. KRS 65.140(2) states in part, "[u]nless the purchaser and vendor otherwise contract, all bills for goods or services shall be paid within thirty (30) working days of receipt of a vendor's invoice[.]". Additionally, good internal controls dictate that proper supporting documentation is maintained to support disbursements and the county does not pay sales tax since they are a tax exempt entity.

We recommend the fiscal court take the steps necessary to ensure compliance with applicable statutes and proper accounting practices, by implementing additional internal controls in the area of credit card disbursements. This could be accomplished by assigning an individual other than the finance officer to review all transactions to ensure that they have proper documentation (such as a purchase order, itemized receipts, etc.) and to ensure sales tax is not part of the claim before being submitted for approval to the fiscal court. We further recommend that the authorized check signers ensure credit card disbursements are properly supported before authorizing the checks.

County Judge/Executive's Response: This is something we constantly try to stress to those using the card. Due to one monthly Fiscal Court Meeting to pay the bills and the billing procedures of the credit card company sometimes they do not post our payment in a timely fashion. We now are set up online to pay and this has eliminated late fees.

The fiscal court did not segregate duties over accounting functions: This is a repeat finding and was included in the prior year audit report as Finding 2019-005. A lack of segregation of duties exists over accounting functions. The county treasurer prepares and deposits receipts, posts to the ledgers, prepares financial reports, and prepares the monthly bank reconciliations. Items returned from the bank are handled by the county treasurer. The finance officer picks up mail from the post office then distributes to the proper department. The finance officer prepares a list of bills for the fiscal court's approval, prepares all checks, and makes adjustments to the appropriations ledger. The finance officer submits the financial statement electronically to the Department for Local Government (DLG). The finance officer maintains timesheets, prepares payroll, posts payroll to the ledgers, and transfers funds from the appropriate accounts to the revolving payroll account. In addition, the finance officer is responsible for employee benefits payments (health insurance, life insurance and payments to the employee benefit bank account).

According to the county judge/executive, a limited budget places restrictions on the number of employees the fiscal court can hire. The lack of oversight could have resulted in undetected misappropriation of assets and inaccurate financial reporting to external agencies such as DLG.

A segregation of duties over various accounting functions, collecting receipts, preparing bank deposits, and preparing reports and reconciliations, or the implementation of compensating controls, when needed because the number of staff is limited, 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.

We recommend the fiscal court segregate the duties involving collecting and depositing receipts and preparation of reports and reconciliations. If this is not feasible due to limited staff, strong oversight over these areas could occur and involve an employee that is not currently performing any of those functions. For example, the county judge/executive could provide this oversight and document his oversight by initialing the source documents.

County Judge/Executive's Response: Due to budgetary restraints, we cannot hire more staff.

The fiscal court did not have sufficient monitoring or internal controls over the revolving loan program: This is a repeat finding and was included in the prior year audit report as Finding 2019-006. Since 1994, the McCreary County Fiscal Court has utilized United States Department of Agriculture (USDA) grants to run a Rural Business Enterprise Grant (RBEG) program. The program is designed to encourage new employment opportunities within the county by providing low cost financing to new businesses. The fiscal court has made 41 loans, totaling $1,731,345 from Fiscal Year 1994 through Fiscal Year 2020. The following issues were noted for Fiscal Year 2020 as a result of reviewing the program:

- Thirty-five payments were listed in revolving loan records of eight businesses that could not be accounted for during the fiscal year. This resulted in the records of those businesses reflecting outstanding balances totaling $7,348 lower than actually owed.
- Seven payments were recorded in the receipts ledger during the fiscal year, but not reflected within the loan records of two businesses. This resulted in the records of those businesses reflecting outstanding balances totaling $553 higher than actually owed.

Due to weak controls and inadequate monitoring over the revolving loan program, amounts owed by businesses within the county were not accurately reported. Adequate monitoring and properly designed and implemented internal controls could allow early detection of possible non-paying borrowers. In addition, good internal controls dictate accurate records are maintained to support the activity of the program.

The USDA Application For Federal Assistance SF-424 states "[r]ecords will include an accurate accounting of any principal repayments, interest, or other proceeds generated by the loan fund and will document expenses paid for with interest, or other proceeds generated by the loan and will be documented for the grant audits."

We recommend the fiscal court properly monitor the activities of the revolving loan program. Additionally, we recommend the fiscal court comply with the requirements of the USDA Application For Federal Assistance SF-424 and ensure that all loans are properly made, documented, collected, and reported. This matter will be referred to the United States Department of Agriculture (USDA).

County Judge/Executive's Response: There will be better coordination between staff to ensure that this oversight is corrected.

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

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