



Auditor of Public Accounts  
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**FOR IMMEDIATE RELEASE**

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**Harmon Releases Audit of Mercer County Fiscal Court**

**FRANKFORT, Ky.** – State Auditor Mike Harmon has released the audit of the financial statement of the Mercer 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 Mercer 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 did not expend Local Government Economic Assistance (LGEA) funds in compliance with requirements.** The Mercer County Fiscal Court had nine disbursements during Fiscal Year 2016 from the Local Government Economic Assistance (LGEA) Fund. Of the nine disbursements, one was not in compliance with allowability requirements established by statute. The disbursement was for parking lot paving at a county owned building, which is not considered an allowable use of LGEA funds.

The county did not recognize that this was not an acceptable use for the funds. This resulted in funds being expended in a manner that is not compliant with state statute.

KRS 42.455 outlines acceptable uses for LGEA funds. Mercer County does not receive coal impact funds, only mineral severance funds. One hundred percent of expenditures for mineral severance funds must be directly related to the priority categories of public safety; environmental protection; public transportation (including mass transit, streets, and roads); services for the poor, aged, and handicapped; industrial and economic development; and vocational education. The Department for Local Government's *County Budget Preparation and State Local Finance Officer Policy Manual* provides distinction between allowable and non-allowable expenditures by account codes.

We recommend the fiscal court improve procedures over the expending of LGEA funds to ensure that purposes are compliant with KRS 42.455. Compliance can be checked by reviewing criteria found on page eight of the *County Budget Preparation and State Local Finance Officer Policy Manual* produced by the Department for Local Government.

*County Judge/Executive's response: The Fiscal Court was unaware that paving a county parking lot was not an appropriate expenditure of LGEA funds. We have used these funds to pave at our park in the past (which was allowed) and did not realize this would be any different. In the future we will get the projects approved through the Department for Local Government prior to performing any work.*

Auditor's Reply: For clarification, the pavement at the park referred to in the County Judge/Executive's response was related to a recreational purpose, which is an acceptable use of LGEA funds.

**The fiscal court did not have an effective purchase order system.** During Fiscal Year 2016, the fiscal court issued purchase orders when sufficient budget appropriation was not available to cover the requested expense. Inquiry with staff indicated that the budget appropriation amount was not amended prior to issuing the purchase order, but rather amended just prior to the fiscal court meeting where the claim will be paid. By transferring budget appropriation after the invoice is received, the claim was already obligated to the court.

In addition, 58 of 125 invoices did not have purchase orders, with examples of purchases being fuel, maintenance and groundwater monitoring for landfill, and services for veterinarian, HVAC, and mapping. Also, the fiscal court has not implemented the purchase order system for utilities or payroll.

The cause appears to be a lack of understanding of when a purchase order is needed and the necessity of sufficient appropriation in each line, rather than the fund as a whole. This is neither compliant with purchasing requirements for counties, nor an effective implementation of internal control. Management is unable to determine where potential issues with spending are before the expense is already incurred, creating the opportunity for waste, fraud, or abuse.

KRS 68.210 requires the State Local Finance Officer to create a system of uniform accounts for all counties and county officials. The *County Budget Preparation and State Local Finance Officer Policy Manual* outlines requirements for handling of public funds, including required purchasing procedures for counties. These requirements prescribe that, "[p]urchase requests

shall not be approved in an amount that exceeds the available line item appropriation unless the necessary and appropriate transfers have been made.”

Good internal controls for purchase requests exceeding budget appropriations would lead to discussions with both the county treasurer and county judge/executive as to whether the purchase order will be issued, the necessity and appropriateness of a budget transfer to cover the expense, and if other issues need to be addressed related to spending. Purchase orders should be issued for all goods and services utilized by the fiscal court. The Department for Local Government issued a memorandum on August 4, 2016, in which it “highly recommends” implementation of issuing purchase orders for payroll and utilities. This control allows the fiscal court to ensure that sufficient budget allocation is available for all expenses.

We recommend that the fiscal court improve procedures over purchase orders to ensure they are obtained for all purchases of goods and services and not approved in an amount that exceeds the available line item appropriation unless the necessary and appropriate transfers have been made.

*County Judge/Executive’s response: The invoices that did not have purchase orders were from vendors who provide services or goods for the Mercer County Fiscal Court where specific amounts could not be determined until the work or product was delivered. The corrective action plan is for the Finance Officer in charge of purchase orders estimate the charges and produce a purchase order for all invoices. The Finance Officer will be instructed to begin producing purchase orders for utilities and payroll. She will also be instructed to consult with the County Treasurer about making the appropriate transfer if line item appropriations will not support the purchase order amount and the proper transfer will be made if the purchase is deemed necessary.*

**The fiscal court did not have adequate controls in place over payroll.** The Mercer County Fiscal Court lacks segregation of duties over payroll processing. The finance officer is responsible for handling payroll for the fiscal court. All timecards are turned into the finance officer, who enters employee time into the payroll system and processes the payroll. The employee is also responsible for entering new employees, removing terminated employees, maintaining personnel files, and posting payroll to the disbursements ledgers.

The fiscal court operates with limited staff and has not implemented compensating controls to address the limitation. When controls procedures are performed by the same employee and no compensating controls are in place, the risk for material misstatement significantly increases due to undetected error or fraud. The employee could change pay rates, create fictitious employees, or adjust leave time, all without detection.

Good internal controls dictate that adequate controls and segregation of duties would prevent one individual from having a significant role in the payroll process.

We recommend the fiscal court implement adequate controls over payroll by segregating the duties over the handling of payroll or by implementing compensating controls. One example of a good compensating control is having an independent county employee compare payroll data to

payroll reports for accuracy. The independent person should then sign off on the payroll reports that this compensating control was completed.

*County Judge/Executive's response: With limited staff it is extremely hard to provide the amount of segregation that this government office needs to have; however, we have begun to work on this by having the Tax Administrator cross-train with the Payroll Clerk. She will compare the payroll data to payroll reports for accuracy. She will then sign off on the payroll report.*

**The fiscal court did not implement adequate segregation of duties over receipts and reconciliations.** This is a repeat finding and was included in the prior year audit report as finding 2015-006. Receipts are received by the finance officer, who prepares a receipt log that is given to the treasurer and county judge/executive. The treasurer prepares the deposit tickets, records to ledgers and takes deposits to the bank. Occupational tax receipts are received, processed, and the bank deposit is created by the occupational tax administrator. The deposit is given to the treasurer for review and posting to the receipts ledger. The treasurer performs reconciliations on all accounts.

The fiscal court operates with limited staff and has not implemented compensating controls to address the limitation. Inadequately segregated duties significantly increase the risk of and provide the opportunity for undetected financial misstatements, errors, and fraud.

Good internal controls dictate that the same employee should not handle, record, and reconcile receipts and disbursements. When segregation of duties is not possible due to limited staff size, officials can implement compensating controls to mitigate associated risks. An example of a compensating control is:

- The county judge/executive could review bank reconciliations, initialing the reconciliation to document the review.

We recommend the fiscal court implement a system of adequately segregated duties over receipts and reconciliations. If duties cannot be adequately segregated due to limited staff size, we recommend the fiscal court implement compensating controls to mitigate risks.

*County Judge/Executive's Response: The Fiscal Court will start requiring the Finance Officer review the Treasurers reconciliations. If everything is in proper order, she will sign off and date.*

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

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