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Harmon Releases Audit of Metcalfe County Sheriff's Fee Account

FRANKFORT, Ky. – State Auditor Mike Harmon today released the audit of the 2020 financial statement of Metcalfe County Sheriff Lonnie Hodges. State law requires the auditor to annually audit the accounts of each county sheriff. In compliance with this law, the auditor issues two sheriff's reports each year: one reporting on the audit of the sheriff's tax account, and the other reporting on the audit of the fee account used to operate the office.

Auditing standards require the auditor's letter to communicate whether the financial statement presents fairly the receipts, disbursements and excess fees of the Metcalfe County Sheriff in accordance with accounting principles generally accepted in the United States of America. The sheriff's financial statement did not follow this format. However, the sheriff'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 all 120 sheriff 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 comment:

The Metcalfe County Sheriff's Office lacks adequate segregation of duties over financial reporting, reconciliations, disbursements, and payroll: This is a repeat finding and was included in the prior year audit report as Finding 2019-001. The Metcalfe County Sheriff's Office lacks adequate segregation of duties over financial reporting, reconciliations, disbursements, and payroll. The sheriff's office manager/bookkeeper collects receipts, prepares deposits, prepares daily checkout sheets, prepares and signs checks, and prepares payroll. In addition, she posts to the receipts and disbursements ledgers, prepares financial statements and monthly reports, and reconciles the monthly bank statements. No reviews of the financial statement, receipts ledger,

disbursements ledger, and bank reconciliations were documented by the other office staff or the sheriff. The sheriff has instituted review processes over disbursements and payroll such as documented reviews of invoices, payroll check stubs, payroll direct deposits, timesheets by other office staff or the sheriff, and dual signatures on all checks with one signature being the sheriff; however, reviews of invoices, payroll check stubs, and payroll direct deposits are not regularly documented by other office staff or the sheriff.

The lack of segregation of duties occurred because the sheriff failed to segregate incompatible duties. The sheriff stated he cannot hire additional employees to allow segregation of duties due to budget limitations. A lack of oversight resulted in the following:

- The disbursements ledger and annual settlement did not agree to the payroll records.
- The fourth quarter financial report did not foot and cross foot.
- The calculated excess fees per annual settlement of \$192,952 were \$1,309 less than the amount paid of \$194,261.
- Multiple problems with payroll as discussed in audit Finding 2020-002.

In addition, a lack of oversight could result in undetected misappropriation of assets or inaccurate financial reporting to external agencies such as the Department for Local Government (DLG).

Adequate segregation of duties over financial reporting, reconciliations, disbursements, and payroll would prevent the same person from having a significant role in multiple accounting functions, such as preparing deposits, preparing payroll, preparing and signing checks, posting to the receipts and disbursements ledgers, preparing monthly and quarterly reports, and preparing monthly bank reconciliations. The sheriff can implement oversight when duties cannot be segregated.

We recommend the sheriff's office segregate duties over financial reporting, reconciliations, disbursements, and payroll. If segregation of duties is not feasible due to lack of staff, then strong oversight over those areas should occur and involve an employee not currently performing any of those functions. Any oversight should be documented.

County Sheriff's Response: The official did not provide a response.

The Metcalfe County Sheriff's Office lacks adequate controls over payroll: The Metcalfe County Sheriff's Office lacks adequate controls over payroll to ensure payroll is recorded and reported accurately. During calendar year 2020, controls over payroll failed to discover posting errors to payroll categories on the annual settlement and the disbursements ledger, garnishments withheld but not paid, errors in calculating net pay and employee withholdings, errors in reporting wages to retirement, and errors to sick and compensatory leave balances. Due to the lack of controls over payroll, the following control deficiencies and noncompliances concerning payroll occurred:

- Part-time and one deputy gross salary was overstated by \$6,001 on the annual settlement.
- Employer's share retirement - KLEFPF of \$3,825 was not reported on the fourth quarter financial report or annual settlement.

- Paychecks in the amount of \$19,003 for February 2020 were not recorded on disbursements ledger under correct salary categories.
- Four adjustments in amount of \$1,527 and 17 reclassifications in amount of \$9,162 were necessary to reconcile the disbursements ledger to the payroll journal reports.
- Garnishments for two pay periods totaling \$600 withheld from an employee's paychecks were not paid to the creditors. This amount represents four payments that were not made.
- An employee was overpaid \$143 one pay period due to a calculation error.
- Retirement withholdings (\$60) were miscalculated for pay period August 15, 2020 to August 28, 2020 for one full-time employee because the computer program did not withhold any retirement.
- Retirement withholdings (\$339) were miscalculated for pay period August 20, 2020 to September 11, 2020 for five full time employees because the computer program withheld a flat dollar amount instead of calculating retirement withholding using applicable percentage of five or six percent.
- FICA withholdings (\$254), city occupational tax withholdings (\$50), and county occupational tax withholdings (\$33) were miscalculated for the end of calendar year 2020 starting with pay period beginning August 29, 2020 for five full-time employees because they were not calculated on gross wages due to an error in the computer program.
- FICA withholdings (\$2,983), city occupational tax withholdings (\$585), and county occupational tax withholdings (\$390) were not properly withheld on sheriff's salary because they were not calculated on gross wages in pay periods he made contributions to deferred compensation.
- One part time employee tested worked an average of 101 hours per month during calendar year 2020 and his wages were not reported to fiscal court to be reported to County Employees Retirement System (CERS). Since he is considered retired reemployed, retirement would not be withheld from his paycheck but his wages should be reported to the fiscal court to be reported to CERS and employer's share retirement paid on his wages by the fiscal court.
- Two full-time employees did not earn correct amount of sick leave. Instead of earning 48 hours for the calendar year per sheriff's policy, they only earned four hours and 40 hours.
- Compensatory time was calculated wrong for one deputy for pay period tested. Deputy received credit for 12 hours of compensatory time for a holiday when the holiday was his regular day off. He should have received only eight hours of compensatory time for the holiday since he did not work per the sheriff's policy.
- Compensatory time used by three deputies for pay period tested was not deducted from compensatory time. Compensatory time used not deducted was eight hours, 16 hours and 18.50 hours.
- Employee's share of dental insurance withholdings of \$13 were not correctly withheld from the bookkeeper's paycheck for pay period tested.

Rather than implement a strong internal control system to monitor the payroll process, the sheriff relied on individual employees to perform specific functions of payroll without sufficient oversight to ensure accuracy of work performed. In addition, the bookkeeper stated that the deductions for full-time employees got messed up after she downloaded updates to the payroll program resulting in retirement withholdings being sheltered from FICA and occupational taxes by mistake. The bookkeeper also stated that the sheriff's office was advised that deferred compensation was not

subject to FICA or occupational taxes. By not ensuring that payroll amounts recorded on the quarterly financial reports reconcile to the payroll records, payroll amounts were reported incorrectly and withholdings were inaccurate. The lack of oversight could result in the undetected misappropriation of assets or inaccurate financial reporting to external agencies such as Department for Local Government (DLG) and the fiscal court. In addition, weak internal controls allowed noncompliance with state statutes and the sheriff's personnel policy.

Strong internal controls over payroll and timekeeping are vital in ensuring that payroll amounts are recorded, reported, and withheld properly. Strong internal controls are vital in ensuring the amounts recorded and reported for payroll by the sheriff's office accurately reflect the financial activity of the sheriff's office. These controls should include an individual independent of the accounting function reviewing the financial reports and comparing amounts reported to the amounts on the payroll records to ensure withholdings are calculated correctly. In addition, the reviewer should ensure the sheriff is in compliance with federal requirements, state statutes, and his personnel policy.

KRS 78.510(21) and 78.610(1) requires employees who work an average of 100 hours or more per month to have a percentage of gross wages withheld for retirement. The percentage, five or six percent, is based on date of membership in Kentucky Public Pensions Authority (KPPA). While employees who are classified as retired reemployed are not required to have retirement withheld from their wages, their wages are required to be reported to KPPA and the employer is required to pay the employer contribution on those wages.

Internal Revenue Service (IRS) Publication 15 requires FICA to be withheld from wages before retirement withholdings and deferred compensation are deducted. Commonwealth of Kentucky entered into a Memorandum of Agreement with the IRS to require starting January 1, 2017, FICA to be withheld before employee contributions to retirement are deducted from wages. Additionally, City of Edmonton and Metcalfe County Fiscal Court occupational tax ordinances require occupational tax be withheld on gross wages.

The sheriff's policy and procedure manual states sick time "is accumulated for all employees with full-time status at a rate of 2 hours per pay period, with a maximum accumulation of 48 hour per calendar year." In addition, the sheriff's manual states compensatory time "may be redeemed by the employee at any time if reasonable advanced notice is given and scheduling allows. A compensatory time total shall be maintained by the Office Manager each pay period." The manual also states "employees with full-time status are awarded holidays as designated and approved by the Commonwealth of Kentucky. Full-time sworn employees who are usually required to work designated holidays will be compensated with compensatory time at a rate as follows: a. If the holiday falls on an employee's regular scheduled day off (RDO), the employee will be compensated for 8 hours of compensatory time. b. If the holiday falls on an employee's regular scheduled workday, the employee will be compensated for 12 hours of compensatory time."

We recommend the sheriff's office implement stronger internal controls over the payroll process to ensure payroll is posted correctly on the disbursements ledger and amounts reported on the quarterly financial report and annual settlement are accurate. We also recommend the sheriff's office pay garnishments of \$600 withheld from employee's paychecks to the proper creditors. We

additionally recommend that payroll reports be reviewed to ensure correct amounts are paid for all withholdings, correct amounts are withheld for retirement, FICA, and occupational taxes, correct amounts are reported to fiscal court for retirement wages, compensatory balances and leave balances are properly maintained, and correct amounts are withheld for insurance. In addition, we recommend the sheriff's office file corrected payroll reports with KPPA, IRS, City of Edmonton, and Metcalfe County Fiscal Court for calendar year 2020 and collect necessary amounts from employees for withholdings.

County Sheriff's Response: The official did not provide a response.

The Metcalfe County Sheriff did not have a pledge agreement: The sheriff's bank account balances exceeded the \$250,000 FDIC coverage provided by his bank and the additional FDIC coverage provided under the insured cash sweep deposit placement agreement (ICS agreement). He did not have a pledge agreement. On December 31, 2020, the sheriff's bank balances were \$1,385,403. FDIC coverage through his bank and the ICS agreement was \$1,146,789, leaving \$238,614 unsecured.

The sheriff and bookkeeper were unaware the bank was no longer providing pledges for the bank accounts not covered by the ICS agreement.

Custodial credit risk is the risk that in the event of a depository institution failure, the government's deposits may not be returned. \$238,614 of the sheriff's deposits were at risk with no agreement with the bank and no amount pledged.

The Department for Local Government (DLG)'s *County Budget Preparation and State Local Finance Officer Policy Manual* requires deposits of public funds with federally insured banking institutions. The DLG Manual strongly recommends perfected pledges of securities covering all public funds except direct federal obligations and funds protected by federal insurance. In order to be perfected in the event of failure or insolvency of the depository institution, this pledge or provision of collateral should be evidenced by an agreement between the sheriff and the depository institution, signed by both parties, that is (a) in writing, (b) approved by the board of directors of the depository institution or its loan committee, which approval must be reflected in the minutes of the board or committee, and (c) an official record of the depository institution.

We recommend a pledge agreement be obtained from the bank for the bank accounts not covered by the ICS agreement or additional bank accounts be included in the ICS agreement. If the bank is unable or unwilling to do this, then uncovered accounts should be moved to another bank that will meet the requirements.

County Sheriff's Response: The official did not provide a response.

The sheriff's responsibilities include collecting property taxes, providing law enforcement and performing services for the county fiscal court and courts of justice. The sheriff's office is funded through statutory commissions and fees collected in conjunction with these duties.

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

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