



**Auditor of Public Accounts  
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**FOR IMMEDIATE RELEASE**

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

**FRANKFORT, Ky.** – State Auditor Mike Harmon has released the audit of the financial statement of the Nelson 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 Nelson 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 presented on 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. A qualified opinion was issued on the regulatory basis of accounting.

Nelson County’s Statement of Receipts, Disbursements, and Changes in Fund Balances - Regulatory Basis, includes the receipts and disbursements of the jail commissary fund, which did not maintain adequate accounting records, deposit all receipts, or properly account for all receipts. Since the jail commissary fund accounting records were not adequate and all receipts were not deposited or accounted for, the financial information presented for the receipts, disbursements, and fund balance of the Nelson County Jail Commissary Fund cannot be determined to be reasonably accurate.

In our opinion, except for the effects of the matters discussed in the “Basis for Qualified Opinion on Regulatory Basis of Accounting” paragraph, the financial statement referred to above presents fairly, in all material respects, the fund balances of Nelson County, Kentucky as of June 30, 2020, and its cash receipts and disbursements, for the year then ended, in accordance with the accounting practices prescribed or permitted by the Department for Local Government described in Note 1.

Findings 3 and 4 of the audit report will be referred to the Kentucky State Police and the Kentucky Office of the Attorney General.

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 Nelson County Fiscal Court did not follow the uniform system of accounts when preparing their original budget:** The Nelson County Fiscal Court budgeted total capital projects in budget series 8000 in five funds. The line item detail section of the budget included capital project subcategories that were not in the 8000 line item series. The county used the capital project subcategory totals on their fourth quarter report. In addition, the occupational license tax fund per the fourth quarter report presented budget in the 6200 budget series rather than the 6300 series on the approved budget. The county believed that since the subcategory detail was also approved by fiscal court that this was an acceptable practice.

The original budget did not follow the uniform system of accounts. Further, the fiscal court's fourth quarter report, which serves as their financial statement, did not reflect any expenditure line items exceeding budget appropriations even though they overspent their budget:

- General fund - protection to persons and property line item exceeded budgeted appropriations by \$111,869;
- Road fund - roads line item exceeded budgeted appropriations by \$1,265,808;
- Emergency medical service fund - protection to persons and property line item exceeded budgeted appropriations by \$400,950;
- Landfill fund - general health and sanitation line item exceeded budgeted appropriations by \$27,684; and
- Occupational license fee fund - airports line item exceeded budgeted appropriations by \$17,200.

The Department for Local Government (DLG) sets forth the Uniform System of Accounts for Kentucky counties within their *County Budget Preparation and State Local Finance Officer Policy Manual*. The chart of accounts within this system utilizes a nine number numerical code for expenditures to identify the specific type of expenditure being posted.

We recommend the Nelson County Fiscal Court utilize the Uniform System of Accounts when preparing their budget, ensuring the budget detail corresponds to the budget total summary. We further recommend the fiscal court monitor their budget to ensure expenditures do not exceed budgeted appropriations.

*County Judge/Executive's Response: The error is a result of terminology discrepancies between the County Judge, Treasurer, Fiscal Court, Department for Local Government and the Ky Auditors Office. The discrepancies have now been clarified and this finding is no longer an issue.*

**The Nelson County Fiscal Court did not have written collateral security agreements with two banks, resulting in \$2,133,161 in deposits being unsecured at year end:** The Nelson County Fiscal Court did not have written collateral security agreements with two banks resulting in

uncollateralized and unsecured deposits totaling \$2,133,161 on June 30, 2020. The banks purchased other banks in Nelson County with which the fiscal court did business with previously. The fiscal court did not obtain collateral security agreements after the banks changed ownership.

In order to ensure the validity of the pledges, a written agreement, approved by the bank's board of directors or loan committee, must be in place. Without the agreement, all funds in excess of FDIC are uncollateralized and in jeopardy should the financial institution cease operations.

KRS 41.240 requires security agreement and collateral for any amounts on deposit not otherwise covered by insurance through the Federal Deposit Insurance Corporation (FDIC). According to federal law, 12 U.S.C.A. § 1823(e), this agreement, in order to be recognized as valid by the FDIC, should be (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 the Nelson County Fiscal Court obtain written collateral security agreements with both banks in order to ensure adequate coverage of their deposits in these financial institutions.

*County Judge/Executive's Response: Due to various bank mergers and acquisitions, two of our local banks with whom we conduct business have changed names/ownership. The Fiscal Court had written agreements with the prior banks, and we have attempted to secure agreements from the new banks with no follow-up. Despite the non-written agreements, and based on reports provided to the Treasurer by the banks, all deposits were fully collateralized on June 30, 2020. The County Judge Executive and Treasurer will follow up with the banks in question to secure written agreements.*

Auditor's Reply: Pledges are not guaranteed without a written agreement in place.

**The Nelson County Jail did not have segregation of duties over the jail commissary fund:** The Nelson County Jail lacked adequate segregation of duties over the accounting functions related to the jail commissary fund. The former bookkeeper collected funds, issued receipts, posted transactions to the ledgers, and performed the monthly bank reconciliations. Checkout sheets were prepared by the former bookkeeper as well as making the deposits. In addition, two KISOK machines were reconciled by the former bookkeeper with no documentation by the jailer or other designee that the amount of cash was properly recorded and deposited. Deposits were not made daily and receipts issued were not accounted for in numerical sequence. For disbursements, the former bookkeeper prepared all checks and posted to the ledger with only one signature required on checks. There was no documentation that invoices or other supporting document was reviewed or approved before payment was made. Oversight by either the jailer or another employee was not documented for these activities.

The Nelson County Jailer stated he did not provide financial management oversight over jail commissary fund bookkeeping activities due to the former bookkeeper having over twenty-five years of experience. The jailer did not implement adequate policies and procedures to ensure effective internal controls including proper segregation of duties.

A lack of segregation of duties increases the risk of misappropriation of assets, errors, and inaccurate financial reporting. This material weakness in the internal control structure resulted in misappropriation of assets and errors that went undetected for several years. An employee at the jail discovered cash, checks, and money orders in various locations throughout the former bookkeeper's office. The former bookkeeper was placed on administrative leave and later fired. The employee who found the missing cash and checks prepared a detailed log that dated as far back as 2014 totaling \$20,501 that had not been properly recorded and deposited. In addition, she also found receipts books and logged missing deposits that totaled \$15,989. The case was reported to the Kentucky State Police on October 28, 2020.

Good internal controls dictate that the collection of receipts, recording of transactions, and financial reporting functions be segregated in order to reduce the opportunity for the misappropriation of assets and inaccurate financial reporting. Adequate segregation of duties would prevent the same person from having a significant role in receiving cash, recording transactions, and reporting financial information. If segregation of duties is not possible, implementation of strong compensating controls is essential for providing protection from asset misappropriation and inaccurate financial reporting.

We recommend the jail segregate duties where possible. If segregation of duties is not possible, the jailer should offset the lack of adequate segregation of duties by implementing compensating controls, such as periodically performing surprise cash counts, reviewing the bank reconciliations, and comparing the daily deposits to the daily checkouts and the receipts ledger, reconciling any differences. In addition, there should be a comparison of the monthly reports to the receipts and disbursements ledgers for accuracy by someone other than the preparer. Initialing and dating the bank reconciliations, bank deposits, daily checkout sheets, receipts and disbursements ledgers, and reports can document this review. This matter will be referred to the Kentucky State Police and the Kentucky Office of the Attorney General..

*County Jailer's Response: Due to the prior bookkeeper being employed and responsible for the accounting of the Nelson County Jail for twenty-five years, the Jailer did not realize that there was an issue of segregation of duties. The jail will make all feasible efforts to segregate duties. We will have two deputies initial all receipts, deposits and daily checkouts. Since we are a small facility, we will implement compensating controls in addition to the segregation of duties, to ensure full accuracy and integrity of all accounting.*

*County Judge/Executive's Response:*

- *Segregation of duties is a challenge to accomplish in a small facility with minimum staff, but cross training should also be implemented.*
- *On the question of "missing cash": is there proof that cash is missing or is this simply a case of sloppy bookkeeping?*

Auditor's Reply: Due to the lack of adequate controls, there were funds that could not be accounted for. The Kentucky State Police were notified to investigate and determine whether the funds are missing.

**The Nelson County Jail did not properly account for daily receipts or prepare required annual financial report for the jail commissary account, resulting in a qualified opinion on the financial statement:** When we started the audit of the Nelson County Jail commissary fund the jailer informed us of issues relating to receipts. He informed us that they found cash and checks throughout the office from as far back as 2014 that had not been deposited totaling \$20,501. Also the jailer found receipt forms where no funds were attached and where they could not determine the funds had been deposited or accounted for from January 1, 2019 through July 30, 2020 totaling \$15,989. Auditors tested receipts collected for the months of November 2019 and January 2020. Based on this review, it was noted that receipts, including cash removed from kiosk machines, were not deposited daily as required resulting in only nine deposits being made for the two months tested. Testing indicated that the cash was held for up to three days but could be as much as 20 days before being deposited.

For the months tested, auditors noted that the bookkeeper used pre-numbered receipts from various receipts books. These receipts were not batched daily or put in numerical sequence. The January 13, 2020 deposit tested had receipts attached that were for the previous four months of September, October, November, and December 2019. Once a jail staff employee put the receipts books in numerical sequence, auditors found that there were receipts missing for the two months tested. It was determined that 18 receipts were missing for fees and cash collected for home incarceration program, drug testing, and work release programs.

In addition, the annual financial statement was not prepared or presented to the county treasurer as required by the Department for Local Government's (DLG) *Budget Preparation and State Local Finance Officer Policy Manual*. The jailer was not in compliance with the statute that states the jailer shall keep books of accounts of all receipts and disbursements from the canteen and shall annually report to the county treasurer on the canteen account.

The jail failed to implement effective controls over the accounting of the jail commissary to ensure proper fiscal management over the account including appropriately segregating duties. There was no management oversight in place over inmate and commissary accounting functions to ensure receipts are batched and deposited daily. The Nelson County Jail had not implemented effective policies and procedures to properly outline requirements for various accounting functions.

The lack of management oversight, supervision, proper internal controls, and review resulted in missing cash, fees collected not being deposited, and inadequate accounting and reporting. Improper accounting for fees collected resulted in the county not being paid accurate fees due from the jail on a timely basis as required. The failure to prepare the annual financial statement resulted in the auditors not being able to have financial information needed to obtain sufficient appropriate audit evidence. The lack of financial information prevented the performance of audit procedures necessary to ensure the accuracy of amounts for the accounts and overcome the fraud risk associated with the financial information not provided to us. Furthermore, due to the lack of accurate accounting information and commissary financial statement, we were unable to obtain sufficient appropriate audit evidence to conclude that the county's financial statement was free from material misstatement.

KRS 68.210 gives the state local finance officer the authority to prescribe a uniform system of accounts. Pursuant to KRS 68.210, the state local finance officer has prescribed minimum accounting and reporting standards in DLG's *County Budget Preparation and State Local Finance Officer Policy Manual* which are to be used by jailers for jail commissary funds maintained pursuant to KRS 441.135. This manual includes the following accounting and reporting guidance:

“DAILY CHECK-OUT SHEET - Daily deposits are required. At the end of each business day the Jailer or assigned personnel should separate individual receipts into categories listed on the check-out sheet. The total of each category should be entered on the appropriate space provided. The amount deposited line should equal the amount of money on hand at the end of each day less start-up cash. A maximum of fifty dollars shall be used for start-up for the next business day. All daily detail (deposit form, cash receipts, etc.) should be attached to the form. If the total daily deposit is correct, post to the Jail Commissary Fund Receipts Journal.”

“JAIL COMMISSARY RECEIPTS JOURNAL - Receipts should be posted to this journal on a daily basis. The total amount category should agree with the amount deposited line on the Daily Check-Out Sheet.”

KRS 441.135(2) states, in part, “[t]he jailer shall keep books of accounts of all receipts and disbursements from the canteen and shall annually report to the county treasurer on the canteen account.”

We recommend the Nelson County Jailer implement strong oversight, internal controls, supervision, and review to ensure receipts are batched and deposited daily. The Jailer should comply with the applicable statutes by maintaining required records. The Jailer should submit an accurate annual commissary report to the County Treasurer at year-end that includes all receipts and disbursements and reconciles to the receipts and disbursements ledgers. This matter will be referred to the Kentucky State Police and the Kentucky Office of the Attorney General.

*County Jailer's Response: Due to the prior bookkeeper being employed and responsible for the accounting of the Nelson County Jail for twenty-five years, the Jailer did not realize that deposits were not being done daily in accordance with policy. The Annual Financial Report was not completed by the prior bookkeeper for the end of the fiscal year. This employee became under investigation and is no longer employed at the Nelson County Jail. Due to open investigations, this was not completed. The Jailer will implement the policy to deposit all funds daily and will have the employee in that position complete the annual financial statement as required.*

*County Judge/Executive's Response: For the past two years, the Jail did not provide Fiscal Court with proper receipts or reimbursements.*

**The jailer failed to properly implement controls over the inmate trust account:** The Nelson County Jailer failed to implement controls over the inmate account. This account is an agency trust account used to maintain funds deposited by or on behalf of inmates. Funds deposited by inmates are reduced for allowable jail costs and fees as well as inmate purchases from the jail commissary. At the time of an inmates' release, if the inmate owes no additional amounts, the amount remaining in the inmate's account is refunded to the inmate upon their release.

The following deficiencies were noted:

- No management oversight over the removal, deposit, and recording of cash from kiosk machines;
- Inmate monies were not separate from commissary profit account funds;
- Daily checkout sheets to account for all inmate fund deposits were not prepared;
- Receipts collected from inmates were not properly recorded to inmate accounts;
- Disbursements from the inmate account were not reviewed by a person independent of the accounting function; and
- Refunds issued to inmates upon release was not properly accounted for or reviewed by a person independent of the accounting function.

The jailer failed to properly implement internal controls and provide sufficient management oversight over the kiosk accounting process, daily deposits, inmate reports maintained, refunds made to inmates upon release, separate accounting for jail inmate trust bank account, and proper financial statement reporting. The lack of internal controls over the accounting functions for the inmate trust account allowed undetected errors and alleged fraud to occur. In addition, the lack of segregation of duties over this process increased the risk of misappropriation of assets, errors, fraud, and inaccurate financial reporting.

Good internal controls dictate that the collection of receipts, recording of transactions, and financial reporting functions be segregated in order to reduce the opportunity for the misappropriation of assets and inaccurate financial reporting. Adequate segregation of duties would prevent the same person from having a significant role in receiving cash, recording transactions, and reporting financial information. KRS 68.210 gives the state local finance officer the authority to prescribe a uniform system of accounts. The Department for Local Government's (DLG) *County's Budget Preparation and State Local Finance Officer Policy Manual* requires jailers to maintain monthly cash reconciliations, daily checkout sheets, and disbursement ledgers. The DLG requirements assist jailers in ensuring that records are complete and accurate.

We recommend that the jailer implement procedures to strengthen controls over the inmate account and associated accounting functions which include the following:

- Kiosk machines withdrawals should be performed by two people and a daily checkout sheet should be prepared that accurately accounts for the funds removed and documented by signatures of both.
- Receipts should be deposited daily and deposit tickets should be prepared and reviewed by an independent person to ensure the amount of the deposit agrees to the daily checkout sheet and cash and checks listed per the deposit ticket.
- After the deposit ticket is prepared and reviewed, a person other than the one taking deposit to the bank should agree the deposit to the daily checkout sheet and receipts ledger. This should be documented by initialing deposit, daily checkout, and receipts ledger. The deposit ticket should be attached to the daily checkout sheet after review. At a minimum, on a monthly basis, a person independent of the accounting function should review deposits and compare to the inmate fund in the accounting system to ensure accuracy.

- The inmate account is considered a trust account and should reconcile to zero each month. Bank reconciliations should be performed monthly and reviewed by a person independent of the accounting process.
- All disbursements should be reviewed by a person independent of the accounting function. The jailer should implement procedures to require the inmates to sign a receipt documenting the return of their fund balance upon release.

*County Jailer's Response: Due to the prior bookkeeper being employed and responsible for the accounting of the Nelson County Jail for twenty-five years, the Jailer did not realize that there was an issue with the inmate trust account. The Jailer will ensure that there are two people to oversee all accounting functions, from daily deposits, daily checkouts, bank reconciliations, inmate refunds etc.*

*County Judge/Executive's Response: We agree with the findings.*

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

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