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

FRANKFORT, Ky. – State Auditor Mike Harmon has released the audit of the financial statement of the Perry County Fiscal Court for the fiscal year ended June 30, 2015. 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 Perry 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 internal control over financial operations and reporting.

The audit contains the following comments:

The fiscal court lacks adequate oversight over financial management practices: Numerous deficiencies were noted in the county's internal control structure over their financial management practices which resulted in numerous and pervasive audit comments, listed below:

- The Fiscal Court Did Not Comply With Competitive Bidding Requirements (Finding 2015-002)
- The Fiscal Court Did Not Pay Invoices Timely (Finding 2015-003)
- The Fiscal Court Did Not Accurately Report Debt On The Quarterly Financial Statement (Finding 2015-004)

- The Fiscal Court Did Not Properly Budget For And Record All Debt Related Disbursements (Finding 2015-005)
- The Fiscal Court Did Not Use Coal and Mineral Severance Monies as Required by KRS 42.455 (Finding 2015-006)
- The Fiscal Court Did Not Distribute Coal Severance Grants As Directed By The Grant (Finding 2015-007)
- The Fiscal Court Encumbered Expenses Beyond Their Current Resources (Finding 2015-008)
- The Fiscal Court Does Not Have Adequate Controls Over Payroll Procedures (Finding 2015-009)
- The Fiscal Court Has Not Established Adequate Controls Over The Public Properties Corporation Bond Fund And Justice Center Corporation Fund (Finding 2015-010)
- Credit Card Expenditures Could Not Be Appropriately Validated And Were Not Properly Documented (Finding 2015-011)

Management overrode or did not follow established internal control procedures, administrative code policies, and compliance requirements.

These internal control deficiencies and noncompliance issues affect the entity as a whole and greatly increase the possibilities that the internal control system would not detect a financial misstatement, errors, or fraud.

Adherence to internal control procedures, including strong oversight, and statutes give the fiscal court the ability to provide financial information that is complete, accurate, and free of misstatements.

We recommend the fiscal court review the deficiencies and noncompliance issues as noted and take appropriate action to correct each finding.

County Judge/Executive's Response: The Fiscal Court will review the deficiencies and non-compliance issues as noted and take appropriate action to correct each finding.

The fiscal court did not comply with competitive bidding requirements: The Perry County Fiscal Court did not comply with competitive bidding requirements. One vendor was paid $26,030 for the purchase and installation of window air conditioning units in the courthouse. These invoices split the project by separating the purchase of air conditioning units totaling $13,445, installation of the units totaling $10,055, and additional units and work in courthouse offices that totaled $2,530. These three transactions individually fell under the $20,000 bidding threshold, but exceeded the threshold in the aggregate. In addition to this project, the following purchases were noted:

- $29,013 paid for cleaning supplies
- $20,585 paid for auto supplies
- $165,955 paid for diesel fuel
- $21,999 paid for tires and auto repairs. The vendor paid for these transactions also constitutes a related party transaction.

- $77,741 paid for contract labor and miscellaneous supplies
- $44,338 paid for heavy machinery parts, repairs, and maintenance

While individual items purchased did not exceed the $20,000 bid threshold, they did exceed the threshold in the aggregate. When the fiscal court can reasonably anticipate spending over $20,000 in a fiscal year, competitive bids should be solicited to achieve the best price.

The Perry County Fiscal Court knew the bidding requirements but decided to proceed as though each purchase was separate. Competitive bidding ensures that the county procures materials and services at the best price available. By limiting competition, the county may not get this benefit.

KRS 45A.365(1) states that "[a]ll contracts or purchases shall be awarded by competitive sealed bidding, which include the use of a reverse auction," unless certain exceptions apply such as purchases less than $20,000. According to the Administrative Code, "[a]ll purchases of items of like or similar nature in excess of $20,000 in a fiscal year shall be advertised for bids[.]"

We recommend that the fiscal court follow the requirements of KRS 45A.365 and the county's administrative policy. Purchases of $20,000 or more should be competitively bid.

County Judge/Executive's Response: The Fiscal Court understands the bidding requirements set forth in KRS Chapter 424 and will comply with those provisions. The Fiscal court will make every attempt to obtain the best price possible for the goods and services purchased.

The fiscal court did not pay invoices timely: Twenty-four invoices totaling $656,218, and two health insurance invoices totaling $227,053, were not paid within 30 days. Due to cash flow issues and lack of adequate oversight by management, the fiscal court did not pay invoices within 30 days. Funds could be misused or invoices could go unaccounted for resulting in late payments and accrued interest. KRS 65.140(2) states, "all bills for goods or services shall be paid within thirty (30) working days of receipt of a vendor's invoice except when payment is delayed because the purchaser has made a written disapproval of improper performances or improper invoicing by the vendor or by the vendor's subcontractor." KRS 65.140(3) allows, "[a]n interest penalty of one percent (1%) of any amount approved and unpaid shall be added to the amount approved for each month or fraction thereof after the thirty (30) working days which followed receipt of vendor's invoice by the purchaser." We recommend the fiscal court comply with KRS 65.140 by paying invoices within 30 working days and implement proper controls to ensure all invoices are paid timely.

County Judge/Executive's Response: The Fiscal Court experienced a significant decrease in revenue which caused cash flow issues and financial strain. The Fiscal Court has worked to decrease expenditures and increase revenue by implementing an occupational license.

The fiscal court did not accurately report debt on the quarterly financial statement: The debt schedule presented with the fourth quarter report (which also serves as the year-end financial statement) inaccurately reported debt obligations. The fourth quarter report did not include the Perry County Justice Center Bonds (with an outstanding principal balance of $3,445,000), a financing obligation for the purchase of dump trucks (with an outstanding principal balance of

$269,804), a financing obligation for land purchase and demolition (with an outstanding principal balance of $1,115,000), or a financing obligation for the purchase of mowers (with an outstanding principal balance of $133,901). In addition, the principal balance is incorrectly reported on two other debt issues listed on the fourth quarter report.

KRS 68.210 gives the state local finance officer the authority to prescribe a uniform system of accounts The uniform system of accounts is outlined the in the *County Budget Preparation and State Local Finance Officer Policy Manual*, which requires all county debt be reflected properly on the quarterly financial statement. The treasurer knew these requirements but failed to include all county debt. Due to these errors and omissions, long-term debt was understated by $5,027,500.

We recommend the fiscal court ensure the correct amounts are shown on all financial statements presented to the public and the Department for Local Government (DLG). We further recommend the county review all aspects of the quarterly reports before signing and submitting them to DLG.

County Judge/Executive's Response: The Perry County Justice Center Bonds are a debt obligation that is paid directly by the Administrative Office of the Courts, although Perry Fiscal Court is legally obligated to pay the debt in the event of a default. Since this obligation is paid by AOC directly, the Treasurer has not reconciled that account in the normal quarterly reports. The Treasurer will maintain a separate ledger and report that information as part of all quarterly reports in the future.

The fiscal court did not properly budget for and record all debt related disbursements: The Perry County Fiscal Court did not budget or record lease purchases in the amounts of $269,804 for the purchase of dump trucks and $155,937 for the purchase of mowers used by the road department.

The county treasurer was not aware that these transaction should be reflected on the county's financial statements. These transactions did not run through the fiscal court's bank account and were not included in the fiscal court's budget process or reflected on the fiscal court's fourth quarter financial report. As a result, the fiscal court failed to properly budget and record $425,741 in debt related receipts and disbursements for the fiscal year.

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." KRS 68.280 states, "[t]he fiscal court may make provision for the expenditure of receipts unanticipated in the original budget by preparing an amendment to the budget, showing the source and amount of the unanticipated receipts and specifying the budget funds that are to be increased thereby." Because the fiscal court failed to amend the budget according to KRS 68.280, it was not in compliance with state statutes.

We recommend the fiscal court comply with KRS 68.300 and KRS 68.280 by budgeting all county disbursements and amending the budget as necessary to reflect unanticipated receipts and disbursements, including those handled by a third-party lender.

County Judge/Executive's Response: The Perry County Fiscal Court will make all necessary budget amendments to reflect unanticipated receipts and disbursements including those handled by third party lenders.

The fiscal court did not use coal and mineral severance monies as required by KRS 42.455: The Perry County Fiscal Court did not use 30 percent of the annual coal severance receipts for coal haul roads, or the remaining 70 percent of coal severance and 100 percent of mineral producing funds in priority categories as designated by KRS 42.455. In addition, the fiscal court transferred $592,000 from the Local Government Economic Assistance (LGEA) fund to the general fund to be used in priority categories. However, only $281,261 in transferred funds was spent in allowable categories. The fiscal court spent $310,739 in excess of the allowable amount, therefore that amount is due back from the general fund to the LGEA fund.

The fiscal court did not monitor coal severance or mineral severance receipts to determine what should be used on coal haul roads or in priority categories as outline in the applicable statute.

The Perry County Fiscal Court did not use LGEA funds properly and is in violation of KRS 42.455. The fiscal court did not sign the certification of compliance for LGEA funds due to these issues. Furthermore, this created a $310,739 liability due back to the LGEA fund for expenditures in unallowable categories spent from the general fund.

According to KRS 42.455, money received for coal producing counties for coal severance should be spent 30 percent on coal haul road maintenance and 70 percent on priority categories such as protection to persons and property, welfare of the community, and environmental accounts. Also, 100 percent of mineral severance should be spent in these priority accounts in the same manner. No funds received from coal severance should be used for expenses related to the administration of government. Also, KRS 42.460 states, "(t)he audit report shall include a certification of compliance that the funds were expended for the purpose intended."

We recommend the Perry County Fiscal Court follow guidelines set forth by KRS 42.455 to ensure that coal severance funds are used in accordance with statute. Furthermore, we recommend the general fund reimburse the LGEA fund $310,739 for the transfer in excess of the allowable amount.

County Judge/Executive's Response: The Fiscal Court will comply with all guidelines set forth in KRS in the amount of $310,739 to be taken from the General Fund.

The fiscal court did not distribute coal severance grants as directed by the grant: The Perry County Fiscal Court did not pass through coal severance grant funds in the amount of $181,523 to the subrecipient in a timely manner. The fiscal court deposited the funds into the coal severance fund on July 21, 2014, and transferred $182,000 to other county funds, to be spent by these funds on July 25, 2014, instead of distributing the funds to the subrecipient. The county subsequently distributed the amount to the subrecipient on January 20, 2015.

The treasurer knew the requirements of the grant but decided to use the funds for county operations and pay the subrecipient at a later date. The transfer and use of these grant funds for county expenditures kept the distribution from being made to the subrecipient as was intended.

As set forth in the Memorandum of Agreement for the grant, performance of each of the terms and conditions of the agreement shall be carried out in a timely manner.

We recommend the fiscal court disburse coal severance grant funds as intended according to the Memorandum of Agreement.

County Judge/Executive's Response: The Fiscal Court will disburse all Coal Severance Grants as required by KRS 42.455.

The fiscal court encumbered expenses beyond their current resources: The fiscal court had negative unencumbered fund balances in the general fund and the road fund at year-end. On June 30, 2015, the unencumbered fund balance of the general fund was ($5,997) and the unencumbered fund balance of the road fund was ($60,208).

The fiscal court does not monitor purchase orders and encumbers expenses that are in excess of current financial resources. As a result, the fiscal court will not have available funds for county operations and will have negative fund balances.

The state local finance officer under the authority of KRS 68.210 requires that purchase orders be utilized in order to maintain adequate accounting controls. A properly implemented purchase order system allows the fiscal court the ability to know fund balances available at all times and ensures that the budget is not overspent.

We recommend the fiscal court monitor purchase orders to ensure that encumbrances do not cause negative fund balances.

County Judge/Executive's Response: The Fiscal Court will monitor purchase orders to ensure that encumbrances do not cause negative fund balances.

The fiscal court does not have adequate controls over payroll procedures: The fiscal court has deficiencies in internal controls over payroll. The deficiencies listed below occurred because the fiscal court lacked proper oversight over the payroll function. During our review of payroll, we noted that timecards were not being properly completed. Of the 15 timesheets tested, we noted the following:

- Timecards tested did not indicate the amount of time taken for lunch and/or breaks.
- Timecards for two employees were not signed by a supervisor.
- Timecards for five employees were not signed by the employee.

The fiscal court did not monitor or review functions over payroll adequately. As a result, the fiscal court may pay employees for time not worked or may not be in compliance with statutes and the administrative code.

Good internal controls dictate that all employees, except those statutorily exempt from this requirement, maintain and submit timesheets for payroll processing. Timesheets should be signed by both the employee and the supervisor to document agreement with hours listed.

We recommend the fiscal court reevaluate their controls over payroll to determine the controls that would best address the findings listed above.

County Judge/Executive's Response: The Fiscal Court has reevaluated its controls over payroll process to ensure that time cards are completely fully and accurately and that all time cards are signed by the employee and a supervisor.

The fiscal court has not established adequate controls over the Public Properties Corporation Bond Fund and Justice Center Corporation Fund: The treasurer did not maintain adequate controls over the Public Properties Corporation Bond Fund or the Justice Center Corporation Fund.

The treasurer knew the requirement, but did not agree with it and decided not to reconcile bank statements or prepare financial statements for the Public Properties Corporation Bond Fund or the Justice Center Corporation Fund.

The fiscal court is not aware of the transactions that are occurring relating to the receipts and disbursements of the unbudgeted funds.

These are unbudgeted funds of the fiscal court. The fiscal court is financially accountable and legally obligated for the debt of the Public Properties Corporation Bond Fund and the Justice Center Corporation Fund. The fiscal court should require that proper records be maintained for these unbudgeted funds.

We recommend the county treasurer reconcile these accounts and prepare a financial statement for the Public Properties Corporation Bond Fund and the Justice Center Corporation Fund.

County Judge/Executive's Response: The Public Properties Corporation Bond Fund and the Justice Center Corporation Fund obligations is paid by the Administrative Office of the Court, although the Perry County Fiscal Court is legally obligated for the debt. The Treasurer will reconcile these accounts and prepare financial statements for the funds.

Credit card expenditures could not be appropriately validated and were not properly documented: The fiscal court has credit card expenditures that could not be properly validated and were not properly documented. This credit card was for the use of the county judge/executive. Auditors chose five credit card statements totaling $4,975 to test. The statements reflected $60 in finance and late charges, $71 in unsupported gas charges and $143 for two meals not supported by a sufficiently detailed invoice. Auditors asked the treasurer to see if travel vouchers existed to support expenditures related to meals and travel; we were told there are no such files.

The lack of oversight by the fiscal court over the use of credit cards allowed the county judge/executive to make charges that did not qualify as a public purpose for the county.

The fiscal court was not in compliance with the county's administrative code. Additionally, due to lack of proper support, taxpayer funds could have been used for purposes other than for the benefit of the public.

Strong internal controls dictate that there be procedures in place that reconcile monthly credit card receipts submitted by the county judge/executive to the credit card statement. All receipts for credit card transactions should be attached to the statement and filed for preparation of the claims list. Once the statement is received and all receipts related to that statement are attached to the credit card statement, a detailed list of transactions should be included on the claims list presented to the fiscal court for approval. A travel voucher/mileage log should be maintained to support gas expenses if a personal vehicle is used for county business. Also, travel vouchers should be maintained to support meals, hotel use, and other travel-related expenditures. All receipts for such expenses should be attached to the vouchers with the signature of the county judge/executive to substantiate and provide adequate documentation. In addition, Section 554(A) of the county's administrative code states that, subject to budgetary limitations, any officer or employee of the county incurring expenses for approved travel on behalf of the county shall be reimbursed for allowable out-of-county travel expenses. Subsection 2 of this section state a per diem will be paid at a rate of $25.00 per day, unless staying out of town overnight or after 7:00 p.m., in which case the rate shall be $50.00 per day for those days when the employee is required to be out of town overnight or after 7:00 p.m. Meal costs in excess of allowed per diem may be paid under special circumstances provided receipts are provided. Furthermore, Section 5.54(C) requires the Request for Reimbursement Form to be completed (including required receipts) and submitted to the county judge/executive within thirty (30) days after returning from travel.

We recommend the fiscal court apply best practices when exercising its responsibilities. We recommend all employees of the county abide by the adopted travel policies set forth by the fiscal court. We also recommend the fiscal court have more control of credit card usage and require documentation of the reason the card was used with supporting documentation attached.

County Judge/Executive's Response: The Fiscal Court will ensure that all credit card expenditures are properly validated and documented. The Fiscal Court will ensure that all employees act in compliance with the County's Administrative Code.

The county judge/executive failed to report related party transactions: In an initial related party questionnaire given to the county judge/executive (signed by him on October 18, 2016), the county judge/executive did not disclose any related party transactions between the Perry County Fiscal Court and himself or any related parties.

While performing audit procedures, auditors determined that he may not have disclosed some related parties and another questionnaire was given to him. When the county judge/executive finished the new questionnaire, he disclosed two related parties that had not been previously disclosed.

According to the county judge/executive, he did not understand that related parties include any business relationships that he may have. Also, the fiscal court does not have adequate controls in place to identify, track, and disclose related parties and related party transactions. Related party transactions can constitute an opportunity for management to engage in fraudulent activities or fraudulent financial reporting.

Governmental Accounting Standards Board (GASB) Statement No. 56 establishes specific accounting and disclosure requirements for related-party relationships, transactions, and balances to ensure users of the financial statement understand their nature and actual and potential effects on the financial statement. Related party transactions involving family, personal, financial, or business relationships are not necessarily illegal; however, they must be disclosed in the notes to the financial statements.

We recommend the county judge/executive gain an understanding about related party transactions and ensure that all related parties are fully disclosed.

County Judge/Executive's Response: The county judge/executive did not provide a response.

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

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