



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

FRANKFORT, Ky. – State Auditor Mike Harmon has released the audit of the financial statement of the Powell 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 Powell 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 non-compliance 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 jail and ambulance funds have deficits totaling \$444,929. The county has deficit fund balances in the jail and ambulance funds totaling \$444,929. These deficits are due to transfers due back from funds where restricted moneys were used inappropriately and disbursements the county encumbered over their available cash balances.

	<u>Jail</u>	<u>Ambulance</u>	<u>Total</u>
Cash Balance	\$ 20,289	\$ 4,723	\$ 25,012
Interfund Payables	(453,028)		(453,028)
Encumbrances	(7,946)	(8,967)	(16,913)
Fund Balance	<u>\$ (440,685)</u>	<u>\$ (4,244)</u>	<u>\$ (444,929)</u>

In past years the county transferred restricted money from the road and the Local Government Economic Assistance (LGEA) funds to the general and jail funds. The General Fund repaid the Road Fund a portion of the money in fiscal year 2015. A schedule of unpaid transfers is as follows:

Due From	Due To	6/30/2014 Balance	Increase/ (Decrease)	6/30/2015 Balance
Jail	Road	\$ 253,028		\$ 253,028
Jail	LGEA	200,000		200,000
General	LGEA	70,987		70,987
General	Road	33,630	(20,000)	13,630
		<u>\$ 557,645</u>	<u>\$ (20,000)</u>	<u>\$ 537,645</u>

The Department for Local Government requires a listing of all encumbrances at year end so that the fiscal court doesn't encumber, or obligate, funds in excess of available balances. KRS 68.110 forbids expenditures (encumbrances) in excess of revenue and KRS 68.300 prohibits expenditures in excess of budgeted amount.

The Road Fund and LGEA Fund are restricted monies and can only be spent on allowable expenditures. Under the regulatory basis of accounting, fund balances are not adjusted for the unpaid liability on the financial statement, however the liability is still owed.

We recommend that the fiscal court establish a plan of action to repay the interfund payables and eliminate the deficit fund balances.

County Judge/Executive's Response: As stated in my previous audits, these debts were incurred prior to this administration. I would like to also point out the fact that this administration has actually started to pay down on these.

The fiscal court lacks adequate segregation of duties over receipts, disbursements, and record-keeping functions. The fiscal court has a lack of segregation of duties over receipts, disbursements, and record keeping functions which increases the risk that fraud, errors, or misstatements may occur and go undetected for a significant period of time. Typically when one person is in charge of these functions, strong compensating controls are needed. The treasurer posts receipts, posts some disbursements, and prepares bank reconciliations and reports. The finance officer posts other disbursements and completes payroll. There does not appear to be any review of receipts or disbursements after they are initially input into the computer system.

We recommend the following procedures be implemented to strengthen internal controls over these various functions:

- An independent person should list all receipts and agree them back to the treasurer's receipts ledger. Also, the employee opening the mail should keep a listing of all checks received for that day, detailing the date received, the check amount, who it is from, and what the check is for. The person can document this by initialing the receipts ledgers and verifying the receipts are posted to the correct account codes.
- An independent person should open bank statements and review them for unusual items, such as debit memos and overdraft charges. The person can document this by initialing the bank statement.
- An independent person should review the treasurer's bank reconciliations for accuracy and agree them to book balances for all funds. The person completing this review should initial the bank reconciliation to document that a review was performed.
- An employee independent of check writing and posting duties should match purchase orders to checks and invoices. The employee who signs the checks should cancel the purchase orders and invoices to ensure invoices are not paid twice. Also, the employee should ensure the check numbers agree to the check register and vouchers and the disbursements are posted to the appropriate account code.

County Judge/Executive's Response: We will continue to work to improve in these areas. I'm confident that we've already made significant strides in addressing these items with the change in office staff.

Internal controls over transfer station receipts should be improved. During our audit, we noted a lack of internal controls over transfer station receipts. Good internal controls over cash receipts help safeguard assets from employee theft, robbery, and unauthorized use. Good internal controls also enhance the accuracy and reliability of accounting records by reducing the risk of errors, intentional mistakes, and misrepresentations in the accounting process. Our review of the cash receipt process for the transfer station revealed weaknesses in internal controls that should be addressed. The Powell County Transfer Station collects money from customers for garbage disposal. Based on inquiry, all transfer station employees use one cash register receipt tape on site at the transfer station to document the total amount of funds received each day. These cash register receipt tapes have only the total collected each day when brought to the treasurer. However, the transfer station does not deliver the daily collections to the treasurer on a daily basis. And collection monies are delivered to the treasurer without a copy of the individual receipts. In addition, the treasurer does not post receipts daily or make daily deposits. Numerous days are posted and deposited together.

Due to the high volume of cash transactions, we recommend the county implement the following procedures:

- All monies and a copy of the receipts should be given to the treasurer.
- The treasurer should review all receipts to check for missing receipt numbers and recompute receipts and moneys collected each day. On a regular basis, the treasurer and transfer station employee should agree his receipt log to her total deposited for each day to ensure all transfer station collection receipts are accounted for properly.

- The treasurer should post receipts and make daily deposits.

County Judge/Executive's Response: I agree that ideally each customer should have a receipt presented to them. The majority of the customers don't want one as they are often for amounts less than a dollar. With the larger number of citizens served each day with limited staff that is also overseeing inmates it makes it difficult to provide each customer with a receipt.

The fiscal court should review all invoices prior to payment. The fiscal court did not approve all disbursements prior to payment. We noted 18 instances totaling \$20,680 in which the county did not properly approve invoices prior to payment. Fiscal court approval of all claims is important to ensure all claims are proper and decreases the risk that funds will be misappropriated. Guidance regarding fiscal court approval is outlined in KRS 68.275(2), which states, "The county judge/executive shall present all claims to the fiscal court for review prior to payment..." We recommend that the judge/executive ensure that all claims are presented to and reviewed by the fiscal court prior to payment.

County Judge/Executive's Response: When I questioned what these were, I was told they were primarily invoices such as ones to Delta Gas. If this is the case they should be covered by the preapproved line that enables the treasurer to pay utilities. I don't think each utility company has to have its own separate line but can be grouped under utilities which would mean this finding may not exist.

The fiscal court lacks adequate segregation of duties over the payroll function. A lack of adequate segregation of duties exists over the payroll function. The payroll clerk enters the information necessary to process the payroll into the computer system, prepares the documentation, including the checks, to transfer monies from the county's funds into the payroll revolving account, posts the payroll disbursements to the appropriations ledger, reconciles the payroll bank account, and prepares and pays withholding reports.

Segregation of duties over payroll functions of cash transfers, preparation of checks, disbursements posting, and reconciliation of bank records to source documents, or implementation of compensating controls when limited by staff size is essential for providing protection from asset misappropriation and/or fraudulent financial reporting. Additionally, proper segregation of duties protects employees in the normal course of performing their daily responsibilities.

Because one employee handled all payroll functions and oversight was not provided, the following occurred:

- The fiscal court did not file accurate and timely 941 forms. (Comment 2015-006)
- Two employees received \$3,000 each in lump sum payments. (Comment 2015-007)
- One employee was not working the required 40 hours per week to be considered full-time; however, they received full-time county benefits. (Comment 2015-008)
- Overtime computations were not correct for two employees. (Comment 2015-009)
- Payroll computations were not correct for four employees. (Comment 2015-010)
- Leave balances were not maintained properly. (Comment 2015-011)

- Two regular full-time employees were not participating in the retirement system. (Comment 2015-012)
- Dental insurance for four individuals continued to be paid after termination. (Comment 2015-013)

To adequately protect against misappropriation of assets and/or fraudulent financial reporting, we recommend the fiscal court separate the duties of entering the information necessary to process the payroll into the computer system, preparing the documentation, including the checks, to transfer monies from the county's funds into the payroll revolving account, posting the payroll disbursements to the appropriations ledger and reconciling the payroll bank account. If these duties cannot be segregated due to limited staff or limited budget, then strong oversight should be provided to the employee responsible for these duties.

County Judge/Executive's Response: The previous payroll clerk was the employee responsible for all the items that are mentioned here. That employee is no longer on staff and I am confident that the issues which led to these findings have been corrected.

The fiscal court did not file accurate and timely 941 forms. We noted the fiscal court did not file accurate and timely 941 Forms for Fiscal Year 2015 with the Internal Revenue Service as required by IRS Publication 15. Form 941 is used to summarize and reconcile all FICA, Medicare, and federal tax withholdings based on the entity's payroll records. The failure to file these forms in a timely manner will likely result in penalties from the IRS and is indicative of improper payroll procedures and poor financial management practices. A former payroll clerk did not file accurate and timely 941 Forms which has resulted in the county owing taxes, penalties, and interest to the IRS for calendar year 2015 and previous years. The county is currently appealing the penalty and interest amounts of the liabilities due the IRS.

We recommend the treasurer ensure complete, accurate and timely 941 Forms are filed quarterly with the Internal Revenue Service.

County Judge/Executive's Response: This is the responsibility of the payroll clerk. It wasn't till recently that it came to our attention that the previous employee had failed to file these. That employee is no longer in the employment of the county and the current payroll clerk is already working with the appropriate people to get these issues resolved.

Employees should not receive lump sum salary payments. During Fiscal Year 2015, two employees received an extra one-time salary payment of \$3,000 each for administrative support of the CSEPP program and an additional \$1,569 was paid for matching of FICA and retirement. No county employee should receive a lump sum salary payment. Any additional salary the fiscal court deemed necessary should have been included in gross wages for these employees and paid on a biweekly basis. These lump sum salary payments were made in FY 2014 and FY 2015 and may have occurred in other years.

Usually payroll account codes are on the preapproval list so the fiscal court would not necessarily have to individually approve salary payments. However these payments were posted under office costs account code requiring fiscal court approval. We reviewed the fiscal court

orders and could not find any approval of additional salary. Since these employees were checks signers for the payroll account, it would have been easy to pay this amount without any oversight.

We recommend the fiscal court cease the practice of making lump sum payments to employees. Furthermore, the fiscal court should ensure the county financial personnel cannot pay themselves additional funds without any oversight.

County Judge/Executive's Response: This issue has also been addressed. One of the two employees, who did this, is no longer an employee and the remaining has been addressed by the court on the issue. It should also be noted that there has been more securities put in place to prevent this from being able to be accomplished in the future.

Part-time employees should not receive full-time benefits. According to the fiscal court's Policy and Procedures Manual, a regular part-time employee is defined as an employee who works less than 40 hours a week, but on a regularly scheduled basis. We noted one employee that did not work an average of 40 hours a week. However, the employee was considered full-time and received full-time county benefits. The employee averaged 32 hours per week, or four 8 hour shifts, including leave time taken and holiday pay. All employees should work the regularly scheduled hours and take leave for hours not worked or leave without pay. If employees do not work the 40 hours per week as required, they should not receive any fulltime benefits.

The fiscal court should review the Policy and Procedures Manual and determine if this employee is really full-time and should be entitled to all benefits. The fiscal court should require supervisors or department heads to adhere to the guidelines set forth by the Policy and Procedure Manual and ensure full-time employees are working scheduled hours unless leave is available and are working at least 40 hours per week.

County Judge/Executive's Response: It is my understanding that this pertained to a jail employee. Those employees are not under the direct supervision of the Fiscal Court so I would defer a comment to that employee's supervisor.

The fiscal court should pay overtime properly. During our testing of payroll, we found that two employees were not paid the correct amount for overtime worked during the fiscal year ending June 30, 2015. KRS 337.285(1) states no employer shall employ any of his employees for a work week longer than forty (40) hours, unless such employee receives compensation for his employment in excess of forty (40) hours in a work week at a rate of not less than one and one-half (1-1/2) times the hourly wage rate at which he is employed. KRS 337.285(2) has exceptions to this provision, which includes employees exempt from the overtime provision of the Fair Labor Standards Act. However, these employees do not appear to be exempt from being paid overtime at a rate of one and one-half times her hourly rate. We recommend the county pay the correct amount of overtime to all employees.

County Judge/Executive's Response: It was explained to us that this was an EMS employee and that the time was not reported correctly to the payroll clerk. We will work with current EMS director to prevent instances such as this from happening in the future.

Payroll computations were not correct for four employees. In our test of payroll we noted four instances where the payroll computations were not calculated correctly. In each instance the employee received less than wages due. One employee handled all payroll functions and oversight was not provided. When limited by staff size, strong oversight and compensating controls should be provided over the payroll function. Payroll computations should be rechecked or reviewed. We recommend that an independent person review the payroll preparation to ensure the payroll amounts are calculated correctly.

County Judge/Executive's Response: It was explained to us that this was another example of where the previous payroll clerk miscalculated payroll. To my knowledge the new payroll clerk has corrected all issues that previously existed and is accurately and correctly performing the job requirements of that position.

Leave balances are not maintained properly. Leave balances are not being maintained properly for county employees. The department heads do maintain separate leave balance sheets for each employee. However, leave balance hours maintained by the payroll clerk that are included on the employee's paystubs are not accurate. Jail employees do not have any leave balances on their paystubs. During review of payroll stubs, leave balances exceeded the amount allowed to be carried over for calendar year. The county should ensure that accurate records are kept for all leave earned and leave taken.

Based on the administrative code full-time employees earn vacation leave after one year of service and as follows: 1 to 5 years – 40 hours or 5 days, 6 to 15 years – 80 hours or 10 days and 15 and thereafter – 120 hours or 15 days. They also earn 8 hours or 1 sick day a month. The employee can only carry over 10 days or 80 hours each year of vacation time, any additional time is lost. Sick leave can be accumulated for 60 days or 480 hours; however, they can only be paid out 240 sick leave hours upon terminating employment.

If employees' leave balances are not accurate and not maintained properly at year end, an employee could be compensated for more or less hours worked during the year or use leave that they are not entitled to. We recommend the county require the payroll clerk maintain accurate leave balances for each employee. Furthermore, department heads could maintain a leave balance sheet for each of their employees and reconcile these to the county's records on a regular basis to help ensure accuracy. We recommend the county have all employees sign a statement noting all leave balances at the beginning of each year to ensure accuracy.

County Judge/Executive's Response: I would also credit this to the past payroll clerk. Our current clerk now has and maintains all leave balances as do department heads. These balances are also now included in our payroll software and are reflected on checks, which allow employees to review totals each payroll.

The fiscal court should ensure all eligible employees participate in retirement. During our payroll testing we found that two ambulance employees were working over 100 hours per month and not receiving retirement benefits. KRS 78.510(21) says a regular full-time position shall mean all positions that average one hundred (100) or more hours per month, determined by using the number of hours actually worked in a calendar year or fiscal year. Not withholding retirement for employees that work an average of 100 hours a month could result in penalties assessed by the Kentucky Retirement System and expose the county to potential future liabilities. Each department head should determine that all employees averaging over 100 hours per month are participating in the retirement system by contacting the payroll clerk and informing the fiscal court. We recommend the county correct this issue by ensuring employees receive the proper retirement benefits.

County Judge/Executive's Response: The policy procedure manual that was in place had stated that an employee had to average these totals for a year to become eligible for these benefits. If changes are needed we will make the necessary changes to the Policy & Procedures manual.

Insurance premiums were paid for former employees and officials. We found that two employees and two officials no longer associated with the fiscal court were not removed from the dental insurance invoice, and the county continued to pay for their insurance premiums months after their employment/tenure ended. The county paid excess premiums totaling \$764 for the four individuals during Fiscal Year 2015. It is indicative of poor financial management practices to incur expenses that are not necessary and that are for the benefit of former employees and officials. Good internal controls require reconciling insurance invoices on a regular basis, especially when there is a change in employment status.

We recommend the fiscal court ensure that former employees and officials are removed from the insurance policies.

County Judge/Executive's Response: This too is the responsibility of the payroll clerk to audit each insurance bill with the payrolls to ensure that each charge to the county is accurate and matches the coverage that employee has selected. Evidently the previous person in this capacity failed to adequately do this or this would not have occurred. Our current clerk is checking monthly insurance bill to make sure they are accurate and that any changes that have been made are reflected.

Fiscal court should maintain complete and accurate capital asset schedules. During the review of capital assets, we noted the fiscal court did not maintain a capital asset schedule, nor did they maintain a list of capital asset additions, retirements and disposals. Because a capital asset schedule was not maintained, additions were not accounted for properly. The Department for Local Government (DLG) requires counties to maintain capital asset records (see DLG County Budget Preparation and State Local Finance Officer Policy Manual pages 55-60) as well as a description of the asset, historical cost, date of acquisition, and useful life of the asset. Not maintaining an accurate list of capital assets could cause capital assets to not be insured or insurance to be paid for an asset the county no longer owns.

The auditor noted that annual inventories were not being performed. In order to strengthen the county's internal controls over capital assets and infrastructure, and to comply with DLG's

policy manual, we recommend a schedule of additions be maintained as assets are purchased to simplify the process of updating the capital asset schedule. The schedule should include the date the asset is acquired, a description of the asset, the vendor name and the amount. Invoices for asset acquisition and invoices for all other disbursements should be kept on file in a manner that allows retrieval of the original invoice for review and verification as needed by management and auditors. Furthermore, the capital asset listing should be monitored and maintained on a regular basis.

As new assets are acquired they should be added to the listing. As equipment is retired or disposed of it should be removed from the listing. The assets added or deleted should also include capital assets purchased or disposed of by the sheriff and county clerk. The fiscal court should reconcile all annual inventory reports to the additions, retired assets, and surplus list to ensure accurate accounting of capital assets. We also recommend that the county implement policies that will identify and track additions, retirements, and disposed assets for the purpose of the capital asset schedule. These procedures will ensure that fixed assets are properly stated.

County Judge/Executive's Response: The treasurer is responsible for this task. It has been made very clear to this employee that this needs to be corrected. It should also be noted that there are being updates to our current software that will simplify this process.

The detention center lacks adequate segregation of duties. A lack of segregation of duties exists over the accounting function at the detention center due to a limited number of staff. One employee collects money, prepares deposits, makes deposits, prepares monthly reports, remits monthly reports along with inmate fees to the county treasurer, reconciles the bank account and makes payments from the bank account.

Segregation of duties over accounting functions of cash collection, cash disbursements and reconciliation of bank records to source documents or implementation of compensating controls when limited by staff size is essential for providing protection from asset misappropriation and/or fraudulent financial reporting. Additionally, proper segregation of duties protects employees in the normal course of performing their daily responsibilities.

We recommend the jailer separate the duties involving the collection of cash, deposit of cash, disbursement of cash and reconciliation of cash, and also provide strong oversight to offset any lack of segregation of duties:

- The jailer, or his designee, could periodically compare a daily bank deposit to the daily checkout sheet and receipts ledger.
- The jailer could require dual signatures on all checks, with one being the jailer's.
- The jailer, or his designee, could compare bond fees, booking fees, and housing fees recorded on daily checkout sheets or the receipts ledger to computer generated reports and monthly disbursements to the fiscal court. Any variances should be reconciled.
- The jailer, or his designee, could perform reconciliations of beginning inventory on hand to purchases, sales, and ending inventory on hand. Alternatively, the jailer could periodically recount physical inventory available for sale. The jailer's count should be compared to the ending inventory on hand balance. Any variances should be reconciled.

- All reviews should be documented by initialing deposit slips, bank statements, invoices, and other monthly reports.

County Jailer's Response: We will continue to work on this issue.

The fiscal court should improve cash management practices relating to the single audit compliance requirements for CSEPP.

Federal Program: CFDA #97.040 Chemical Stockpile Emergency Preparedness Program

Federal Agency: U.S. Department of Homeland Security

Compliance Area: Cash Management

Amount of Questioned Costs: \$0

The fiscal court received federal funds for a reimbursement grant from the Chemical Stockpile Emergency Preparedness Program (CSEPP). The cash management requirement includes a provision that all federal funds received prior to the expenditures being paid must be paid out within a timely manner. Since the grant agreement does not specify a certain number of days, county personnel stated that the oversight agency previously recommended three to five working days as the time frame for determining if a payment was timely. Of the 14 items tested, for funds received in advance, we found six instances totaling \$400,608 that were not paid within five days. The longest period was 46 working days from the receipt of the federal funds to the date of payment.

We recommend the fiscal court and the CSEPP Coordinator improve controls related to the CSEPP federal program and comply with cash management requirements.

County Judge/Executive's Response: Last year's audit as well as this finding has made us aware of some deficiencies in our CSEPP director's job performance. These issues have been discussed and are now hopefully resolved and if not the appropriate actions will be taken to correct them. We have also added additional oversight of his activities with a new CSEPP financial officer.

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

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