



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

FRANKFORT, Ky. – State Auditor Mike Harmon has released the audit of the financial statement of the McCreary 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 McCreary 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 comments:

The fiscal court did not have proper purchase and procurement procedures. The findings below stem from a lack of adequate segregation of duties, improper accounting practices, and poor internal controls without oversight.

Of the 66 fiscal court disbursements that were tested for Fiscal Year 2015, the following deficiencies were noted:

- 11 expenditures were paid when budgeted funds were not available.
- Three purchase orders were not approved.
- One purchase order was approved after the disbursement had been made.

- Three checks issued did not clear within 45 days.
- 34 purchase orders were not issued for disbursements.
- One disbursement was not properly allocated.
- 12 disbursements did not have any supporting documentation.
- Three disbursements were paid using the statement amount without supporting documentation for those charges.
- 19 invoices were not paid within 30 days.
- One disbursement was overpaid \$27,499 and later refunded.
- Haul tickets do not have a signature of an individual receiving materials.
- Haul tickets are not maintained with the invoice. All road department invoices are reviewed by the supervisor then only the itemized statement is sent to the finance officer for payment.
- Haul tickets and road department invoices for paving cannot be traced to the fiscal court's approved bid.
- Of all the invoices tested, none were cancelled or marked as paid.

The State Local Finance Officer, given the authority by KRS 68.210, requires in the *County Budget Preparation and State Local Finance Officer Policy Manual* all expenditures to be accompanied by a purchase order and sufficiently documented. Additionally, KRS 65.140(2) states "Unless the purchaser and vendor otherwise contract, 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...." In addition, KRS 68.300 states "Any 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." Good internal controls dictate that proper supporting documentation is maintained to support disbursements.

We recommend the fiscal court maintain supporting documentation, such as haul tickets, with the original invoices and purchase orders, cancel actual invoices upon payment to prevent duplicate payments. Also, we recommend all invoices be accompanied by the signed haul ticket or packing slip showing receipt of the item purchased. In addition, we recommend the fiscal court pay all expenditures within 30 working days in compliance with KRS 65.140.

County Judge/Executive's Response: The new finance officer has reconciled many of these issues and has adjusted the procedures to enable us to move forward without these recurring problems. Efforts have been taken to strengthen purchase and procurement procedures to avoid similar issues in the future. Invoices submitted for payment are reviewed by at least two staff for accuracy. The purchase order system has been strengthened to ensure proper authorization by the department heads and judge executive office staff. All paid invoices are being marked paid once checks are written. The problems with the haul tickets for the Road Department have been fixed and are currently being processed correctly. We continue to have an issue with some invoices not being paid within 30 days. This problem will be minimized as much as possible but will not be able to be eliminated completely until additional revenue is secured.

The payroll account was not properly reconciled. The payroll revolving account did not reconcile to a zero balance as of June 30, 2015, and the remaining balance could not be readily explained. The remaining balance as of June 30, 2015 was \$82,723. Of this balance the auditor determined the county had outstanding liabilities of \$64,229 and outstanding checks of \$437, leaving an unexplained balance of \$18,057 for Fiscal Year 2015. In addition, the bank reconciliations were not reviewed by another employee to ensure accuracy.

The payroll account has not been properly reconciled since Fiscal Year 2011. In addition, reconciliations are not being reviewed. Balances at the end of each fiscal year have carried forward to the next fiscal year without explanation. The unreconciled payroll account could cause the fiscal court to have insufficient funds to meet payroll requirements or it could cause the fiscal court's liabilities to not be properly paid or not to be paid in a timely manner.

Per KRS 68.210 the State Local Finance Officer has the authority to require a uniform system of accounts. The *County Budget Preparation and State Local Finance Officer Policy Manual* lists "monthly bank reconciliation" as a requirement for all county officials. Since the payroll account is a "sweep account," only the funds necessary to pay employees and government agencies are transferred from other county funds. Therefore, each month the account should reconcile to zero.

We recommend the fiscal court properly reconcile the payroll account. Additionally, we recommend those bank reconciliations be reviewed by an independent employee to verify accuracy and completeness.

County Judge/Executive's Response: Due to the number of years (10+) of not being able to reconcile the payroll account and the unlikely ability to find the discrepancy from several years ago, it is agreed that the best way to move forward would be to transfer the long-term irreconcilable amount to other funds and begin at a zero balance. With the finance officer and the treasurer both currently using the same fiscal accounting software and balancing each month, this problem should be eliminated.

The fiscal court did not have sufficient controls over payroll. The fiscal court did not have sufficient controls over payroll as shown by the following deficiencies:

- 13 of 18 employees had a timesheet, but no supervisor approval was evidenced. And, one of those timesheets not signed by employee or supervisor.
- No timesheet was found for the finance officer.
- One employee's time was coded incorrectly. Per fiscal court minutes, the employee was hired for two positions, and as such the time/pay should have been divided between the two codes.
- One employee timesheet showed overtime earned, but no evidence of payment was found.
- The magistrates are on two committees as required, but no timesheets were found to substantiate retirement.

Weak internal controls over payroll have allowed the errors to go unnoticed or corrected. The lack of properly designed controls creates the possibility that employees will receive wages or benefits not actually earned, such as health insurance. In addition, by not properly coding wages, the fiscal court may have exceeded its approved budget for one or more line items.

Internal control procedures that are properly designed and implemented allow employees to detect misstatements in a timely manner while preventing misappropriation of assets or inaccurate financial reporting. The county administrative code SECTION 5.9 Classification of Employees (A)(1) "Full-Time Employee: An employee who works 40 hours per week on a regular scheduled basis." SECTION 5.24 (b) "Included timesheets must be signed by employee and supervisor in order to be considered valid and compensation authorized." Additionally, KRS 61.510(21) states, in part, "'Regular full-time positions,'...shall mean all positions that average one hundred (100) or more hours per month determined by using the number of months actually worked within a calendar or fiscal year."

We recommend all employees maintain a timesheet and all time sheets be approved by a supervisor or by the county judge/executive. Although magistrates are elected officials and as such not required to maintain timesheets, they should maintain them to ensure they receive proper credit for retirement. Further we recommend all employee wages be properly coded.

County Judge/Executive's Response: All issues have been corrected relative to this comment. The magistrates are elected officials and do not require a timesheet. The suggestion of verifying retirement with the use of time sheets has been discussed with them.

The fiscal court did not have sufficient internal control procedures over credit card disbursements. The fiscal court has not implemented proper internal control procedures over credit card disbursements. The deficiencies noted below stem from a lack of adequate segregation of duties, improper accounting practices and poor internal controls without oversight. Credit card disbursements had the following deficiencies:

- Two payments were paid without any supporting documentation.
- Finance charges of \$139 and other charges including late fees of \$234 were paid.
- An employee erroneously signed up for an online monthly service through checkfront.com, and the fiscal court made multiple payments totaling \$196.
- \$400 was overpaid by the emergency dispatch fund for conference registration fees.
- Four receipts for meals were not itemized.
- Two receipts were missing for a credit card payment.

The State Local Finance Officer, given the authority by KRS 68.210, requires in the *County Budget Preparation and State Local Finance Officer Policy Manual* that all disbursements to be accompanied by a purchase order, within budgeted amounts and sufficiently documented. KRS 65.140(2) states "Unless the purchaser and vendor otherwise contract, 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...." Good internal controls dictate that proper supporting documentation is maintained to support disbursements.

We recommend the fiscal court ensure proper accounting practices by implementing additional internal controls in the area of credit card disbursements, such as assigning an individual other than the finance officer to review all transactions to ensure that they have proper documentation, purchase orders, etc. This could be evidenced by the reviewer's initials and date on the credit card statement.

County Judge/Executive's Response: Steps have been taken to properly account for all credit card uses with proper documentation as we move forward. The credit card is utilized primarily for travel purposes by my office and the fiscal court, or in times of emergency when no other purchase procedure is allowable. Use of the card is very limited, by a limited number of individuals. Every effort is being made as possible to avoid finance charges and late fees. The erroneous monthly service mentioned in this report was already discovered and discontinued prior to the time of the actual audit, howbeit it was after the audit period.

Penalties and interest were incurred due to not paying invoices timely. The fiscal court incurred penalties and interest on disbursements, debt, and payroll as follows:

- Eight finance charges on credit card invoices totaled \$139.
- Six late payment fees on credit card invoices totaled \$234.
- Nine late payments on debt invoices incurred interest and penalties totaling \$692.
- Two miscalculations on 2015 Fiscal Year 941 payments to the IRS totaling \$1,225 were paid from 2016 Fiscal Year funds.
- The miscalculations noted above incurred interest and penalties totaling \$111.
- All insurance bills tested were paid late but did not incur penalties.
- For the Xerox copier lease, nine out of 12 payments were late but did not incur penalties or interest.
- The March 2015 payment to the Kentucky State Retirement System incurred penalties totaling \$2,000.

The payments of penalties and interest are due to invoices and payroll withholding not being remitted in a timely manner. The former finance officer did not ensure payments were made before the date due, and a total of \$3,065 of Fiscal Year 2015 funds and \$1,336 of Fiscal Year 2016 funds which could have been used for other purposes were instead used to pay penalties.

KRS 65.140(2) states "Unless the purchaser and vendor otherwise contract, 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." In addition, KRS 61.675(3)(b) states "If the agency fails to file all contributions and reports on or before the tenth day of the month following the period being reported, interest on the delinquent contributions at the actuarial rate adopted by the board compounded annually, but not less than one thousand dollars (\$1,000), shall be added to the amount due the system."

We recommend the fiscal court comply with KRS 65.140 and KRS 61.675 by ensuring all invoices are paid timely and ensuring all withholdings are paid to the proper agency in a timely manner to avoid unnecessary penalties and interest.

County Judge/Executive's Response: Sufficient cash flow remains an issue and payments are occasionally made later than 30 days. As mentioned in 2015-001, until additional revenue is secured, there will be times when payments made late. I believe the process implemented by this office and the staff, and internal changes that have been made, will minimize late payments and penalties.

The fiscal court did not comply with the United States Department of Agriculture (USDA) grant agreement. In June 2013, the McCreary County Fiscal Court was awarded a grant by the USDA through the Rural Business Enterprise Grant (RBEG) Program in the amount of \$75,000. In accordance with the grant agreement, the fiscal court is required to provide matching funds in the amount of \$20,000. The grant agreement further requires documentation of the commitment of the matching funds prior to any disbursement of the grant funds and stipulates that the matching funds will be applied to the project first or not less than pro-rata.

In June 2014, the fiscal court approved a loan for \$50,000 of which \$40,000 was obtained from this RBEG grant. The remaining \$10,000 was paid from the Revolving Loan Fund. The Revolving Loan Fund contains funds and repayments from previous RBEG grants and loans.

The fiscal court considered the funds obtained from repayments of the loans as unrestricted funds and used the funds as their matching portion. By using funds from the Revolving Loan Fund, the fiscal court has not actually put up any matching funds.

The grant agreement states, "It is clearly understood that matching Revolving Loan Funds (RLF) will remain in perpetuity along with Rural Business Enterprise Grant funds that are likewise designated and referred to as the fund. The fund will contain a permanent Federal Interest equivalent to the dollar amount invested." The agreement further states, "Should you choose or are no longer able to operate the Fund in accordance with current regulation not less than the original amount of the grant funding (less any approved loss reductions) will be returned to the Federal Government."

We recommend the fiscal court reimburse the Revolving Loan Fund for the matching funds from the Economic Development Fund previously expended and comply with the USDA grant agreement.

County Judge/Executive's Response: After discussions with USDA officials prior to utilizing the "revolved" monies as the match, we were informed that money loses its federal identity once it is received as payments from the original loan even though reporting should include that money to show the benefit and the multiplication value as it is loaned out to the other borrowers. We have not been able to obtain written documentation of this even though the USDA official restated what we were told before. Additionally, the money in the revolving loan fund comes from sources other than the USDA Rural Business Enterprise Grant. What was once separate loan accounts were combined into one account approximately four years ago. We therefore, still

believe we were justified in utilizing money from those funds to provide our “match” but will pursue discussions with the USDA and will correct the issue if our action is determined to be improper.

The fiscal court did not maintain accurate capital asset records. The audit adjustments to the fiscal court’s beginning balances are a result of adjustments made in the prior year audit not being made in the fiscal court’s capital asset records. These audit adjustments along with audit adjustments to current year additions are a result of a lack of oversight in this area.

By not maintaining an accurate list of capital assets, assets could be improperly stated, increasing the risk of material misstatement to the capital asset schedule, and assets can be insured that are no longer owned. The beginning balances in the fiscal court’s capital asset records had to be adjusted to match prior year audited amounts. These adjustments resulted in total increases of the beginning balances to land by \$1,049,409, other equipment by \$149,193, and infrastructure by \$2,224. The adjustments also resulted in total decreases of the beginning balances to buildings by \$407,863 and vehicles by \$29,878. In addition, adjustments to current year additions resulted in total decreases to buildings by \$60,000, other equipment by \$216,911, and vehicles by \$61,637. Adjustments to additions to construction in progress for buildings and other equipment resulted in total increases of \$27,000 and \$33,625, respectively.

KRS 68.210 gives the State Local Finance Officer the authority to prescribe a uniform system of accounts. Per the *County Budget Preparation and State Local Finance Officer Policy Manual*, capital asset records are necessary for proper valuation.

We recommend the employee(s) in charge of capital assets maintain accurate records throughout the year of any purchases and retirements of assets and provide periodic updates to the fiscal court. Records should also be changed for any audit adjustments agreed to by management. Purchases should be approved and records should include the date the asset was acquired, a description of the asset, the vendor name, the amount, salvage value, and useful life. Invoices and supporting documentation for asset acquisition 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. If possible, an inventory count on June 30 of each fiscal year should be conducted. We recommend the fiscal court provide the necessary oversight needed to insure accurate and complete records are maintained.

County Judge/Executive’s Response: We will make every effort to provide the necessary oversight to insure accurate and complete capital asset records are maintained, as recommended in this report

The fiscal court lacks segregation of duties over all accounting functions. The following issues were noted:

- The county treasurer prepares and deposits receipts, posts to the ledgers, prepares financial reports, and prepares the bank reconciliations.
- Items returned from the bank are handled by the county treasurer.

- The finance officer prepares a listing of bills for fiscal court's approval and prepares all checks.

A limited budget places restrictions on the number of employees the fiscal court can hire. When faced with a limited number of staff, strong compensating controls should have been in place to offset the lack of segregation of duties. Lack of oversight could result in the undetected misappropriation of assets and inaccurate financial reporting to external agencies such as the Department for Local Government.

A segregation of duties over various accounting functions, such as opening mail, collecting receipts, preparing bank deposits, preparing reports and reconciliations, or the implementation of compensating controls, when needed because the number of staff is limited, is essential for providing protection from asset misappropriation and inaccurate financial reporting. Additionally, proper segregation of duties protects employees in the normal course of performing their daily responsibilities.

To adequately protect against misappropriation of assets and inaccurate financial reporting, we recommend the fiscal court separate the duties involving the opening of mail, collecting and depositing of receipts, and preparation of reports and reconciliations. If that is not feasible due to a limited number of staff, strong oversight over these areas could occur and involve an employee who does not currently perform any of those functions. Additionally, we recommend the county judge/executive provide this oversight and document it on the appropriate source documents.

County Judge/Executive's Response: The limited number of employees responsible for the oversight of accounting in our office limits our ability to allow for best case scenario for the segregation of duties as the auditors would like. We have, however, taken steps to ensure that each accounting action is observed by at least two individuals at all times and by three most of the time. We continue to search for the best way possible to ensure compliance with state laws and auditing standards.

The fiscal court did not have sufficient controls over the loan program. The McCreary County Fiscal Court has been involved in a program from the United States Department of Agriculture (USDA) called the Rural Business Enterprise Grants-Revolving Loan Fund since approximately 1994 to present date. During this time period, the fiscal court was approved for various grants to encourage new employment opportunities in McCreary County by providing low cost financing to new and existing businesses. In June 2013, the McCreary County Fiscal Court was awarded an additional Rural Business Enterprise Grant for \$75,000. The additional award brought the grant total to \$585,000. The Rural Business Enterprise Grant funding will be used to recapitalize an existing revolving loan fund called SMART Works Loan Fund, which will continue to serve the small and emerging businesses located in McCreary County.

Per the grant application, the SMART Works Loan Fund will be directly administered by the Director and the Board of the McCreary County Office of Economic Development. The Director of Economic Development will be responsible for administering and marketing the SMART Works Loan Program and for the servicing of such loans to ensure proper management and timely payment of the interest and principal. Once the grant funds are re-paid from the borrower

to the SMART Works Loan Fund, the re-paid principal and interest will be used to make additional loans.

Upon reviewing the grant program, it was noted that proper documentation such as loan documents, liens, and payment schedules had not been properly maintained, and loan files had to be reconstructed to comply with the reporting requirements set by the grant agreement. In addition, the following issues were noted:

- The financial reports reflected that payments were made prior to the loans being entered into the financial program.
- The amounts entered into the financial program included the principal and the interest amounts, which indicate that interest is not being properly calculated on the outstanding balances of the loan based on payment dates.
- Deposits traced to the bank statement did not coincide with the dates the checks were received. One check was dated for September 1, 2014 but not deposited until January 13, 2015.

Per the documentation relating to the 34 loans made since June 2000:

- The total loans documented were \$1,586,245.
- Total uncollected loans were \$956,753.
- Six loans have been paid in full. Total loan amounts paid for these six loans were \$427,980.
- Nine loan recipients have filed bankruptcy. Total loan amounts were \$384,015, with payment of \$45,952 received and a remaining balance due of \$338,023.
- One loan is in litigation. Total loan amount was \$50,000, with payments of \$34,518 received and a remaining balance of \$15,842.
- Seven loans are considered active. Total loan amounts were \$300,087, with payments of \$78,279 received and a remaining balance of \$225,508.
- 11 loans are considered inactive. Total loan amounts are \$423,563, with payments of \$46,183 received and a remaining balance of \$377,380.
- Estimated uncollectable loans are \$807,578 or 84% of the uncollected loan balances.
- Four of 34 loans made went to a board member, county employee, or relatives of board members or county employees. These loans totaled \$200,268 of which only:
 - One loan is actively being paid (loan total is \$60,268 with a remaining balance due of \$14,005).
 - One loan recipient has filed bankruptcy (loan totaled \$50,000 with amount outstanding at time of bankruptcy being \$50,000).
 - Two loans have been turned over to the county attorney for action (loans total \$90,000 with a remaining balance due of \$84,474).
- Loans and payments were not reported to the credit bureau, which could allow the borrower to obtain additional loans.
- Payments, late payments, and non-payments were not being reported to the credit bureau.
- 14 of the 34 loans have been submitted by the fiscal court to the county attorney for legal action. Of these 14 loans, 11 loans were considered inactive, including the two loans made to county employees or relatives, and two loans had payments in fiscal year 2016.

These loans submitted to the county attorney represent \$563,379 in outstanding principal and interest.

The issues noted above reflect a lack of controls over the USDA loan program by the fiscal court and the Loan Board of Directors. Due to the weak controls and inadequate monitoring of the loan program, the fiscal court has foregone the ability to support viable business in the county that could have produced additional jobs and revenue for the fiscal court and the taxpayers.

The grant application states, “Records will include an accurate accounting of any principal repayments, interest, or other proceeds generated by the loan fund and will document expenses paid for with interest, or other proceeds generated by the loan will be documented for the grant audits.” In addition, the application states, “The SMART Works Loan Fund is administered by the McCreary County Fiscal Court and all funds and accounting functions are maintained by the county treasurer in accordance to Kentucky state law.”

We recommend the McCreary County Fiscal Court comply with the requirements of the grant application and ensure that all loans are properly made, documented, collected, and reported. Further, we recommend the fiscal court obtain an opinion from the county attorney regarding the legality of loans to related parties and board members and determine if any required disclosure is necessary. We also recommend the fiscal court ensure they meet the reporting requirements established by the USDA.

County Judge/Executive’s Response: The problems with loan program have plagued my administration since the beginning. Prior to my administration, the program was not managed by the Fiscal Court and not properly audited, so many of these instances were not revealed until recent audits. Since I have taken over management of this program, my staff has worked closely with the USDA to ensure we are properly managing the program. Loans are being issued by their standards, all proper paperwork is being completed, and loan documentation is secured. By action of the Fiscal Court, in an attempt to adequately resolve the outstanding and delinquent loans, we are working with the County Attorney’s Office to pursue resolution and/or enforcement of the collection of delinquent loans and are working with all amiable loan holders to renegotiate terms and ensure proper security documents are filed.

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

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