



Auditor of Public Accounts
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Edelen Releases Audit of Harlan County Fiscal Court

FRANKFORT, Ky. – State Auditor Adam Edelen has released the audit of the financial statements of the Harlan County Fiscal Court for the fiscal year ended June 30, 2013. State law requires annual audits of county fiscal courts.

Recent changes in auditing standards require the auditor’s letter to communicate whether the financial statement presents fairly the receipts, disbursements and changes in cash and cash equivalents of the Harlan County Fiscal Court in accordance with generally accepted accounting principles in the United States. The report found that the financial statement of the Fiscal Court 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 should follow bid requirements on all disbursements over \$20,000. During our test of disbursements, we noted the Fiscal Court paid for repairs to the geothermal heating and air system at the Detention Center in the amount of \$72,526. The Fiscal Court did not advertise or accept bids for this expense, and the need for repairs was not declared an emergency. By review of invoices, we noted services were performed over a period of two months, which indicates sufficient time was available to advertise for bids and obtain cost estimates.

KRS 424.260(1) states “no county may make a contract, lease, or other agreement for materials, supplies, or contractual services other than professional, involving an expenditure of more than

twenty thousand dollars (\$20,000) without first making newspaper advertisement for bids.” Internal controls did not operate effectively to identify a liability in excess of the bid threshold. As a result, the County may have overpaid for services. We recommend the Fiscal Court ensure compliance with KRS by advertising for and obtaining bids for disbursements over \$20,000.

Former County Judge/Executive’s response: The geothermal system failed during a July 4th Holiday weekend. This was midway between fiscal court meetings. The inmate population was on the verge of needing to be transported elsewhere. The system vault area was dug up and repaired when a failure occurred again. We had to look inside the building for answers. We could not and still do not have a maintenance contract. This was addressed several times in court meetings as an emergency but not recorded as such. Harlan County Fiscal Court will comply with the procurement procedure for projects \$20,000 or more.

The Fiscal Court should consult with the County Attorney and Energy and Environment Cabinet to determine proper disposition of landfill escrow funds. During our review of the County landfills, we noted one landfill is no longer operational. The Fiscal Court received notification from the Energy and Environment Cabinet and the Kentucky Division of Waste Management, in a letter dated June 5, 2012, of a Construction Quality Assurance Report/Documentation to provide assistance with long term post-closure operation and maintenance. A subsequent letter on September 9, 2013 informed the Fiscal Court of their responsibilities for termination, and maintenance of the landfill and its structures. As of audit date, the landfill has not been officially closed, but is considered non-operational. 401 KAR 48:310(6) states, “the owner or operator of each solid waste site or facility shall provide closure care as required under Section 3 of 401 KAR 48:060, Section 13 of 401 KAR 48:090, and Section 3 of 401 KAR 48:170 for the required period following the cabinet’s acceptance of closure.” There is a remaining balance of \$43,063 in an escrow account for the purpose of landfill closure. Failure to maintain the landfill can result in Notice of Violations from Division of Waste Management or other state or federal agencies. In order to avoid future environmental violations and possible penalties, the County should ensure proper closure of the landfill.

We recommend the Fiscal Court consult with the County Attorney and the Energy and Environment Cabinet to determine proper disposition of the remaining funds and perform the necessary procedures to properly close the nonoperational landfill.

Former County Judge/Executive’s response: Currently, the state maintains control of the landfill in question and the County will follow the guidance and directives received from the state to ensure proper closure of the landfill and in turn allowing the county to receive the funds placed in escrow.

The Fiscal Court should improve internal controls over financial reporting. During the course of the audit, we identified the following weaknesses over financial reporting:

- The General Fund had a negative ending fund balance of \$1,334,479. The County uses one bank account for multiple funds. As a result, restricted fund monies were utilized for General Fund disbursements, in which adequate General Fund monies were not available.
- Receipt and disbursement ledgers were not maintained for the Justice Center Public Properties Corporation Refunding Revenue Bonds – 2010 Series Fund bank accounts.

- The Treasurer was unaware of the bank account used for the Detention Center General Obligation Bond – 2013 Series Fund. As a result, bond proceeds of \$5,215,603 and principal payments of \$5,249,215 were omitted from the financial statement prepared by the Treasurer.
- Principal payment of \$140,000 and interest payment of \$117,566 were not properly processed through the Fiscal Court’s Detention Center General Obligation Bond – 2004 Series Fund bank account. Although the payments were remitted in a timely manner, the bank erroneously processed the payment. The Fiscal Court received credit for this payment; however, the Treasurer did not detect the error. No reconciliations were performed for payments made by the County and payments processed through bond bank accounts.
- Breakdown of receipts and disbursements by fund of a general purpose checking account was not performed on a monthly basis. Although the Treasurer prepared monthly breakdowns by funds, these schedules were prepared at the request of auditors. Without monthly breakdowns, and comparisons to receipts and disbursement ledgers, the Treasurer could not have reliably verified ending cash fund balances.
- No cash transfers were approved by the Fiscal Court.
- The Quarterly Financial Report for the period ending June 30, 2013 was not submitted to the Department for Local Government (DLG).
- Monthly financial reports to show summary of receipts and disbursements by fund were not presented to the Fiscal Court monthly.
- General Fund disbursements exceeded the budgeted appropriations on six line items for a total of \$1,621,285, Jail Fund disbursements exceed budgeted appropriations on one line item by \$65,017, and Local Government Economic Development (LGED) Fund disbursements exceeded budgeted appropriations on six line items for a total of \$718,154.

The weaknesses over financial reporting noted above meant fiscal court did not have accurate financial data to use for analysis when making financial decisions.

KRS 68.360(1) states, “[t]he county treasurer shall balance his books on the first day of each month, so as to show the correct amount on hand belonging to each fund on the day the balance is made, and shall within ten (10) days file with the county judge/executive and members of the fiscal court a monthly statement containing a list of warrants paid by him during the month, showing all cash receipts and the cash balance at the beginning and at the end of the month, certifying that each warrant or contract is within the budget appropriation.”

KRS 68.210 states, in part, “the administration of the county uniform budget system shall be under the supervision of the state local finance officer who may inspect and shall supervise the administration of accounts and financial operations and shall prescribe and shall install, by July 1, 1985, a system of uniform accounts for all counties and county officials... He may require all officials of all local governments and local taxing districts to submit such financial reports as he may deem proper. He may investigate, examine, and supervise the accounts and operations of all local governments and local government officers.”

KRS 68.020(1) states, in part, “[t]he county treasurer... shall disburse such money in such manner and for such purpose as may be authorized by appropriate authority of the fiscal court.”

Per KRS 68.300, “any appropriation made or claim allowed by the fiscal court in excess of any budget fund shall be void.” These findings are the result of inadequate segregation of duties over receipts, cash transfers, and bank reconciliations, as described in comment #2013-05.

We recommend the Fiscal Court strengthen internal controls over financial reporting to ensure financial reports are accurate and complete, and submitted to the Fiscal Court and DLG in a timely manner. This can be achieved by performing monthly reconciliation procedures in which the Treasurer verifies bank statements are available for all accounts, receipt and disbursement ledgers are prepared for all funds including debt accounts, and receipts and disbursements by bank accounts are reconciled to receipt and disbursement ledgers for each fund.

Former County Judge/Executive’s response: The general fund ended in a negative balance due to the cash balance from a bond fund being shown separately from the county financial statement, although in prior years it was shown on the financial statement, which was incorrect. Those funds were used to reimburse the general fund but were not received until fiscal year 2014 and eliminated any negative fund balance. This was pointed out to audit staff who agreed they understood what took place and the funds were available to reimburse the County’s General Fund, but that we still must show these funds separately. Therefore, it appeared as though the general fund had a negative balance even though the county had the cash in the bond fund to reimburse the general fund. Also, the county now has processes in place to monitor each bond fund for correct payment processing by the bank as all bond funds are accounted for separately from the financial statement and have a monthly reconciliation performed each month. At the time, the treasurer was only reconciling the transaction detail of each bond account and stating revenues and disbursements as a total shown on the financial statement. After working with audit staff, we realized additional information needed to be included on those statements and have followed the direction of audit staff. Additionally, all financial reports are being done timely and will be approved separately and included with the minutes, including all cash transfers to ensure that all monthly reports can be properly recognized. We will ensure that all line items do not exceed their budget appropriations by doing budget amendments in a timely manner.

The Treasurer should ensure the Schedule of Expenditures of Federal Awards is complete and accurate. Although the Treasurer prepared a Schedule of Expenditures of Federal Awards (SEFA); our procedures determined the SEFA was not complete and accurate. There were three grants, totaling \$48,146, omitted from the schedule prepared by the Treasurer. Further, the SEFA incorrectly included non-federal expenditures, did not identify the awarding Federal Agencies, and did not include the Catalogue of Federal Domestic Assistance (CFDA) numbers for each program.

The Single Audit Act of 1984, as amended, established requirements for audits of federal grant funds under OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* in which any entity that expends more than \$500,000 in federal awards is required to undergo a Single Audit. Harlan County was required to have a Single Audit for the fiscal year ended June 30, 2013. However, if auditors had not identified the omission of federal expenditures reported on the SEFA, the County may have been at risk for losing federal funding in the future.

It appears the Treasurer was not aware of all sources of Federal funding because several different individuals, in different departments, are responsible for applying for and administering grant documents. We recommend the Treasurer ensure a complete and accurate SEFA is prepared. The SEFA should include the following, if applicable:

- A listing of Federal programs by Federal agency
- Provide total Federal awards expended for each individual Federal program and the Catalogue of Federal Domestic Assistance (CFDA number or other identifying number when the CFDA information is not available.)

Former County Judge/Executive's response: The treasurer did not receive all documentation necessary to complete the SEFA, however we will attempt to obtain all necessary documentation by again making all departments aware that all documentation for federally funded grants awarded is to be turned into the Treasurer's office to ensure the SEFA is correct.

The County lacks adequate segregation of duties over receipts, cash transfers and bank reconciliations. A lack of segregation of duties exists over receipts, cash transfers and bank reconciliations. The County Treasurer is responsible for preparing deposits, posting to the receipts ledger, recording cash transfers between funds, preparing monthly bank reconciliations, and preparing quarterly financial reports. No documented compensating controls were identified to offset this material weakness. As a result, errors in financial reporting occurred and were not detected or corrected in a timely manner (see comment #2013-03). To adequately protect assets from misappropriation and/or inaccurate financial reporting, duties involving deposit preparation, recording of receipts, transfers of monies between funds, and the bank reconciliation process should be separated. Additionally, proper segregation of duties protects employees in the normal course of performing their daily responsibilities. Compensating controls may also be implemented to reduce the risks associated with a lack of adequate segregation of duties. We recommend the duties over receipts, cash transfers and bank reconciliations be separated. The Fiscal Court can also strengthen internal controls by implementing the following compensating controls:

- An independent employee could prepare a list of all receipts for comparison to the Treasurer's deposits and receipt ledger. This list should include details such as the date received, the check or cash amount, who it is from, and the purpose. The comparison of the receipt list to the Treasurer's records should be documented.
- An independent employee could open and review bank statements for unusual items; while paying particular attention to transfers between funds by check.
- An independent employee could review the Treasurer's bank reconciliations for accuracy and compare reconciled balances to ending fund balances. This review should be documented on the bank reconciliation.

Former County Judge/Executive's response: The County has attempted to add controls to effectively segregate the duties of any one employee. Currently, one employee picks up the mail, while yet another opens the mail and turns over any checks received to the treasurer's office. The deposits are received and prepared by an employee of the treasurer's office, and then taken to the bank by yet another employee. Additionally, a separate employee then posts the deposits to the ledgers. All cash transfers are being approved by fiscal court at the court meeting separately, and recorded with the minutes. Additionally, all bank reconciliations will be reviewed in the county judge executive's office once completed by the treasurer.

Lack of effective monitoring has resulted in lost revenues of \$391,919. While reviewing state payments to the Fiscal Court, we noted five payments to the County for controlled intake/other care and support due to the Jail Fund, totaling \$488,215, were not received or deposited. These payments for August, October, November and December 2012 and January 2013 were either escheated/voided, or redeposited by the Commonwealth of Kentucky. In January 2014, the Fiscal Court was notified of unclaimed property of \$96,296 for October 2012. The County received these funds in February 2014.

Effective internal controls require monthly monitoring to ensure recurring revenues are received and deposited in a timely manner, and recurring expenses are paid timely. Monthly comparisons of budgeted receipts to actual receipts and reconciliations should identify instances in which the County has not received monies due. Weak or absent monitoring procedures resulted in lost revenues of \$391,919 during the fiscal year.

We recommend the Fiscal Court strengthen internal controls over monitoring to ensure monthly reviews are performed, and budgeted amounts are regularly compared to actual receipts. Any variances should be investigated and resolved. The Treasurer should contact the Kentucky State Treasurer to determine if lost Jail Fund revenues can be obtained.

Former County Judge/Executive's response: The County has already been in contact with Department of Corrections and Kentucky State Treasurer and is in the process of obtaining all funds that were not received.

The Fiscal Court should improve internal controls over payroll procedures. During our review of the County's payroll processing, we noted several deficiencies in the documentation, preparation, and presentation of payroll items. The following issues were noted during payroll testing:

- Salaried employees do not prepare timesheets
- Salaried employees' vacation and sick leave is not maintained or monitored by the Fiscal Court
- Jail timesheets are not signed by the employee or the supervisor
- Sheriff's Department timesheets are not always signed by employees
- A policy for medical co-pays and insurance deductible reimbursement up to \$500 per employee is not reflected in the Administrative Code

Good internal controls dictate that all employees, except those statutorily exempt from this requirement, maintain and submit timesheets for payroll processing. To further strengthen internal controls, timesheets should be signed by employees and by the employees' immediate supervisor for verification and attestation of the accuracy of time reported. Lack of proper internal controls for payroll increases the risk that incorrect payroll information will be processed by the County and that these errors will not be identified and corrected.

We recommend the Fiscal Court implement the following internal control procedures to ensure the proper documentation, preparation, calculation, and presentation of payroll related items:

- The Fiscal Court should require all employees to submit timesheets and timesheets be signed by the employee and the supervisor in order to confirm the validity of hours worked.
- The Fiscal Court should ensure that vacation and sick leave time is applied consistently and that documentation is maintained for all employees.
- The Fiscal Court should ensure that all employee benefits are applied consistently and reflected in the Administrative Code.

Former County Judge/Executive's response: The County will implement policies and procedures for record keeping of salary employees' sick and vacation time and require that all staff clock in and out in all departments. We are looking to update equipment to allow us to track all time accurately by all employees. The practice of reimbursing employees' deductibles was ceased as of fiscal year 2014.

The Fiscal Court should improve internal controls over waste removal collections. The County has entered into a written agreement with a waste removal company for the collection of residential and commercial solid waste throughout Harlan County. Per the agreement, the County should withhold ten percent (10%) of the residential fees collected and remit the remaining balance to the waste removal company.

Rather than collecting these residential waste collection fees, the County has entered into verbal agreements with six utility districts in which the utility districts collect residential payments for waste removal on behalf of the County. These districts are permitted to retain a 6.5% commission from gross collections, and then remit the remainder to the County. Since the districts retain 6.5% for commissions, the County should withhold the remaining 3.5%, for a total of 10%, before remitting the remaining balance to the waste removal company. However, during fiscal year 2013, the County did not withhold 3.5% of waste collection fees before paying the waste removal company. As a result, the County did not retain revenues of \$44,244.

Further inquiry determined the utility districts do not provide monthly collection reports or lists of delinquent residents to the County. As such, the County cannot verify the amount of gross residential garbage removal fees collected by the districts, or the amount of garbage removal fees remitted to the County. Lack of delinquent lists prevents the County from effectively monitoring uncollected revenues. Lack of internal controls to document waste removal collection processes, and financial reporting allowed these findings to occur without detection.

We recommend the Fiscal Court enter into written agreements with the utility districts detailing recordkeeping requirements for waste collections, monthly financial reports, and delinquent listings. The Treasurer should ensure the County's 3.5% commission be withheld from waste removal collections, prior to remitting payment to the waste removal company. The Fiscal Court should consult with the County Attorney regarding collection of lost revenue erroneously paid to the waste removal company. When procedures are implemented to create a list of delinquent customers, the Fiscal Court should provide the listing to the County Attorney for potential collection efforts, as necessary.

Former County Judge/Executive's response: The County did not retain the revenues of 3.5% in Fiscal Year 2013, however, in Fiscal Year 2014, the county agreed with the waste removal company to withhold additional revenues due the vendor to make up the difference of lost revenues for 2013. The county

currently withholds 3.5% of revenues before disbursing to the vendor. The County is also in the process of setting up computer software to help effectively monitor at least 4 of the utility districts. This software will allow us to bill the districts each month based on what they have collected throughout the month. It will also give us a true accounting of what customers are delinquent and the total delinquencies for those districts.

The Fiscal Court should attempt to resolve potential Industrial Development Authority Board receivable. During the course of the audit, we determined there is an unresolved issue related to the Industrial Development building property loan. Although an agreement, dated May 22, 2009, “reduced to writing” the intent and practice of the Fiscal Court and the Industrial Development Authority (IDA) Board, it is unclear if both parties have come to an agreement regarding the account receivable.

This agreement does not specify amount due, remaining debt principal or interest outstanding, or estimated monthly debt payment amounts. Without a clear conclusion regarding this issue, neither party knows for certain the amount owed, or due, and therefore, cannot accurately budget accordingly. Not resolving the issue also complicates matters such as insurance liability and any lease agreements held with tenants. We recommend the Fiscal Court consult with legal counsel, and communicate with the IDA Board to resolve this issue. Conclusions should be documented through updated agreements and reflection in both the Fiscal Court minutes and IDA Board minutes.

Former County Judge/Executive’s response: The County will work with legal counsel to resolve this issue, and make sure all decisions are clearly reflected in the minutes of both organizations.

The Fiscal Court should review insurance policy. During our review of the County’s insurance policy, we noted the assets of the Tucker-Guthrie Airport, Sleepy Hollow Golf Course, the Harlan County Industrial Development Authority Board, and the Harlan County Outdoor Recreation Board Authority (HCORBA) are included on the County’s insurance policy. Effective internal controls should ensure taxpayer funds are used to only insure County assets. Per inquiry with the County’s insurance provider, the County cannot legally insure items it does not own. As a result of this oversight, the County may have paid higher insurance costs than necessary. In order to obtain complete and accurate insurance coverage and to avoid overpaying premiums, we recommend the Fiscal Court review the insurance policy and remove assets that are not owned by the Fiscal Court.

Former County Judge/Executive’s response: The County will review the insurance policy and contact component units to determine insurance liabilities and inform them of their duties to maintain their own insurance policies.

The Fiscal Court should consult with County Attorney regarding leased flood plain properties. During our review of the County’s flood plain properties, we determined the Fiscal Court has leased hundreds of properties to individuals for purposes such as gardening, parking, or additional yard space. However, auditors noted several agreements for other purposes, such as a recreational fish area, a recreational area for kids, an RV park, and a paint ball range. While many agreements are written and signed, management also informed auditors verbal agreements exist.

Good internal controls require written lease agreements to document mutual understanding of the use of identified properties. Despite the written lease agreements on file, there is a potential risk of damages and liability issues that may occur from leasing flood plain properties for such purposes. Further, written agreements do not appear to be filed in an orderly fashion and an inventory of flood plain properties noting those with written agreements, with verbal agreements, or unused is not maintained. As a result of these conditions, the Fiscal Court cannot adequately assess the overall impact or potential risk to the County.

We recommend the Fiscal Court consult with the County Attorney to assess this risk and determine if the Fiscal Court should lease flood plain property. In addition, the Fiscal Court should improve internal controls to require a listing of flood plain properties be maintained and updated accordingly.

Former County Judge/Executive's response: The County will consult with County Attorney, while also preparing a new, standardized form for all leased tracts of flood plain properties to ensure proper use of the properties and also to minimize any risk associated with the County.

The Jail Commissary lacks adequate segregation of duties over disbursements and bank reconciliations. A lack of segregation of duties exists over jail commissary disbursements and bank reconciliations. The commissary bookkeeper may prepare checks for disbursements, sign checks, as well as perform the monthly bank reconciliations. The Jailer may also prepare and sign disbursements. Checks are typically signed by the person preparing them. To adequately protect assets from misappropriation and/or inaccurate financial reporting, duties involving disbursement preparation, and reconciliations should be separated. Additionally, proper segregation of duties protects employees in the normal course of performing their daily responsibilities. We recommend the Jailer separate duties of disbursement preparation, check signing, and performance of the bank reconciliation. If these duties cannot be segregated due to limited number of staff or budget, strong oversight should be provided by the Jailer or his designee.

Any compensating controls performed should be documented. The following are examples of other controls the Jailer could implement:

- Dual signatures could be required for disbursements. The check preparer should not be a co-signer for disbursements.
- The Jailer, or his designee, could complete bank reconciliations or review the bookkeeper's reconciliation for accuracy. This could be documented by initialing the bank reconciliation.

Former County Judge/Executive's response: The jailer will work to resolve these issues.

Former Jailer's response: Due to limited budget, the detention center cannot hire just a treasurer for the Jail. Jail Administration has many titles and duties because of this limited budget. Jailer will begin to review reconciliations, and the Jail will implement dual signatures.

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

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