



Auditor of Public Accounts
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Harmon Releases Audit of Outgoing Leslie County Sheriff's Tax Settlement

FRANKFORT, Ky. – State Auditor Mike Harmon today released the audit of the sheriff's settlement-2014 taxes for outgoing Leslie County Sheriff Paul Howard. State law requires the auditor to annually audit the accounts of each county sheriff. In compliance with this law, the auditor issues two sheriff's reports each year: one reporting on the audit of the sheriff's tax account and the other reporting on the audit of the fee account used to operate the office.

Auditing standards require the auditor's letter to communicate whether the sheriff's settlement presents fairly the taxes charged, credited and paid in accordance with accounting principles generally accepted in the United States of America. The sheriff's settlement is prepared on the regulatory basis which is described in the auditor's opinion letter. Regulatory basis reporting for the sheriff's settlement is an acceptable reporting methodology, and this reporting methodology is followed for all 120 sheriff settlements in Kentucky.

Our auditors were unable to obtain the required management representation letter from the former sheriff, and as a result, the audit report presents a qualified opinion. Except for the lack of representation letter, the sheriff's financial statement fairly presents the taxes charged, credited and paid, for the period, April 16, 2014 through December 31, 2014 in conformity with the regulatory basis of accounting.

The audit report will be referred to the Attorney General and Leslie County Attorney.

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 former sheriff's office lacked adequate segregation of duties over receipts, disbursements, and reconciliations. The former sheriff's office had a lack of adequate segregation of duties over the receipts and disbursements processes, and reconciliations. These control deficiencies were present because two office clerks' duties included receiving tax payments from taxpayers, entering tax payments in the computerized system, preparing the daily deposit, and preparing the daily checkout sheet. These employees also had the authority to prepare disbursement checks for refunds. The office manager's duties included receiving tax

payments from taxpayers, entering tax payments in the computerized system, preparing the daily deposit, preparing the daily checkout sheet, preparing the monthly tax reports, preparing disbursement checks, and performing the monthly bank reconciliations. While the former sheriff has stated in prior audits he reviewed monthly reports and bank statements, this review is not documented. As a result, compensating controls were not sufficient to mitigate the effects of the lack of adequate segregation of duties previously described. This internal control weakness has resulted in the deficiencies described in comments 2014-002, 2014-003, and 2014-004.

To adequately protect against misappropriation of assets and inaccurate financial reporting, the former sheriff should have separated the duties involving collecting tax payments from customers, preparing deposits, preparing daily checkout sheets, preparing monthly tax reports, preparing disbursements, and reconciling the bank account. In addition, proper segregation of duties protects employees in the normal course of performing their daily responsibilities. If that was not feasible due to a limited number of staff, strong oversight over these areas should have occurred and involved an employee not currently performing any of those functions.

If the former sheriff chose to implement compensating controls, the former sheriff should have documented his oversight on the appropriate source documents. The following are examples of other controls the former sheriff could have implemented:

- The former sheriff, or his designee, could have periodically recounted and deposited cash receipts. This could have been documented by initialing the daily checkout sheet and deposit slip.
- The former sheriff, or his designee, could have periodically compared batched totals, to the daily tax collection report and to the deposit slip, resolved any discrepancies, and documented the review by initialing the deposit ticket.
- The former sheriff, or his designee, could have compared total tax collections per the monthly reports to the totals per daily collection reports, resolved any discrepancies, and documented his review by initialing the reports.
- The former sheriff could have examined checks prepared by the office manager and compared checks to the monthly tax reports, resolved any discrepancies, and documented the review by initialing and dating the monthly tax reports.

Former Sheriff's Response: No Response.

The former sheriff did not provide necessary records to auditors. Despite various methods of contact with the former sheriff and his employees, he did not provide all necessary records to document the collection of 2014 taxes from April 16, 2014 through December 31, 2014. In order to perform audit procedures, records were obtained from outside sources. For example, the county clerk provided a copy of the former sheriff's official receipt, bank statements were obtained from the bank, and a copy of the delinquent list used to support uncollected tax bills turned over to the incoming sheriff was obtained from the Department of Revenue. No bank reconciliations were provided or could be located. KRS 134.215 states, in part, "[a]n outgoing sheriff, as soon as his or her successor has been qualified and inducted into office ... shall ... [d]eliver to his or her successor all books, papers, records, and other property held by virtue of his or her office." KRS 64.830 includes the same requirements. Based on information provided, the former Sheriff removed a portion of accounting records from the sheriff's office at the end of his term. As a result, these records had to be obtained from third parties and modified procedures were implemented to verify the accuracy of remaining financial records. The former sheriff should have ensured compliance with statutes by providing necessary records to auditors.

We will refer this finding to the Office of the Attorney General.

Former Sheriff's Response: No Response.

The former sheriff's office did not record all tax payments received. The former sheriff's office did not record all tax payments received. As a result, the uncollected taxes transferred to the incoming sheriff were not accurate. The following were noted:

- Four tax bills were partially exonerated. Taxpayers properly paid the balance due; however, the balance due was included on the transfer receipt. The face amount of these bills totaled \$1,731.
- A cash payment for one tax bill was manually recorded on the triplicate green bill on December 5, 2014 and entered in the tax collection software. The payment was then deleted from the tax collection software. The face amount of this bill was \$662.
- Payment for 36 bills was manually recorded on triplicate green bills during November and December. However, no payments for these bills were recorded in the former sheriff's tax collection software during the former sheriff's term. These bills were identified in April 2015, and payment was recorded as being received by the Incoming sheriff. The face amount of these bills totaled \$11,402. No corresponding deposit for collection of these bills could be identified.
- Nine bills were certified as delinquent and turned over to the county clerk by the incoming sheriff. However, taxpayers subsequently provided documentation to the county clerk to verify payment was made to the former sheriff's office during November or December. The face amount of these bills totaled \$2,780.

KRS 68.210 gives the State Local Finance Officer the authority to prescribe a uniform system of accounts. This uniform system of accounts, as outlined in the *County Budget Preparation and State Local Finance Officer Policy Manual*, requires deposits be made daily and properly documented by a daily checkout sheet. Further, effective internal controls require deposits, deposit reports and checkout sheets should be prepared daily, and should agree to both manual and computerized batches of receipts. KRS 134.191 requires the sheriff to provide monthly reports and distribute funds to each district for which the sheriff collects taxes by the tenth day of each month.

Further, KRS 134.215(2)(a) requires, “[a]ll unpaid tax claims and tax claims upon which partial payments have been accepted in the possession of the sheriff upon the date of expiration of his or her term shall be turned over to the incoming sheriff, who shall collect and account for them as provided by law.” Effective internal controls require this transfer receipt, as noted in KRS 134.215(2)(b), to be accurate and exclude any bills for which payments have been received.

The former sheriff's office lacked adequate segregation of duties and internal controls over receipts did not operate effectively (see comment 2014-001 for additional details). No internal controls to verify the accuracy of the transfer receipt appear to have been implemented. As a result of these weaknesses in internal controls, tax collections were not properly recorded, a portion of monies received was not properly deposited, and tax collections were not reported or distributed to districts on monthly reports. In total, the former sheriff's transfer receipt incorrectly included 50 tax bills, totaling \$16,575, to the incoming sheriff.

Since collection of some of these bills cannot be traced to a deposit to the former sheriff's official tax account, these misstatements contribute to the deficit in the former sheriff's official tax account. The former sheriff should have implemented internal controls to ensure all tax payments were properly recorded and deposited intact on a timely basis. The uncollected tax bills included on the transfer receipt should have been verified for accuracy.

Former Sheriff's Response: No Response.

Daily deposit reports did not agree to bank deposits and deposits were not prepared daily. Material weaknesses related to deposit and daily checkout procedures were identified that resulted in discrepancies in the former sheriff's tax records. These weaknesses allowed the following to occur:

- A review of five daily batches and daily checkout sheet documentation noted deposit report collections did not agree to daily deposits on three days. Details of these differences are as follows:
 - On December 2, 2014, a check for \$22 was included within the deposit, but no corresponding tax bill was marked paid.
 - On December 2, 2014, a bill for \$65 was marked paid in the tax collection software; however no check was included in the deposit detail. The manual green bill identified payment on December 1, 2014; however, the checkout sheet was dated December 3, 2014.
 - On December 3, 2014, payment of \$22 was received by check for a bill previously marked paid on November 10, 2014 in cash. The overpayment was not recorded, and a check was not issued to the taxpayer.
- For the five consecutive deposit test periods, tax bills were not batched daily and deposits were not made intact. This is documented as follows:
 - Two checkout sheets were dated December 2, 2014, while three were dated for December 3, 2014. Deposits for four batches cleared on December 3, 2014, and one cleared on December 4, 2014.
 - Manual green receipts were marked paid from November 26, 2014 through December 2, 2014.
 - A large number of green bills were marked paid on Sunday, November 30, 2014.
 - The daily checkout sheet for batch #32, dated December 2, 2014, included checks dated November 1 through November 22, 2014. The daily checkout sheet for batch #34, dated December 3, 2014, included checks dated November 22 through November 30, 2014. Both deposits cleared on December 3, 2014.

Further review of the former sheriff's daily deposit reports, in comparison to daily deposits, noted deposits did not agree to amounts recorded paid in the tax collection software on 46 of 62 deposits. It was not feasible for auditors to perform a review and reconciliation of every day of tax collections; therefore, it was not possible to identify the nature and source of every overage and every shortage. Such a review could have increased the former Sheriff's deficit in the official tax account.

KRS 68.210 gives the State Local Finance Officer the authority to prescribe a uniform system of accounts. This uniform system of accounts, as outlined in the *Instructional Guide for County Budget Preparation and State Local Finance Officer Policy Manual*, requires deposits be made daily and properly documented by a daily checkout sheet. Further, effective internal controls over deposit, deposit report, and checkout sheet preparation require deposits, deposit reports and checkout sheets be prepared daily, and accurately record all collections, such as overpayments. Deposits and checkout sheets should agree to daily deposit reports in order to prevent recording errors or undetected deposit shortages. The lack of adequate segregation of duties with weak internal controls for daily reconciliations allowed the findings above; it also allowed the deficit described in comment 2014-005 to occur without detection. The former sheriff should have strengthened internal control procedures to ensure deposits, checkout sheets, and deposit reports were prepared daily and properly reconciled. The former sheriff's monthly reconciliation procedures should have included comparisons of daily bank deposits and checkout sheets to daily deposit reports.

Former Sheriff's Response: No Response.

There is a deficit of \$12,754 in the former sheriff's 2014 official tax account. The former sheriff has a deficit of \$12,754 in his official 2014 tax account. As previously described in comments 2014-001, 2014-003, and 2014-004, weakness in internal control procedures did not detect discrepancies in daily and monthly accounting records, in which deposits do not appear to have been made intact and collections were not accurately reported to taxing districts. As collector of property taxes, the former sheriff assumed full responsibility for all tax collections and complete distribution of these collections to the proper taxing districts. The former sheriff should have implemented controls to ensure tax collections were processed in a manner that produced reliable accounting records. These controls should have included depositing collections intact, in a timely manner, and performing reconciliations of daily batches to daily deposits, deposit reports generated from the tax collection software, daily checkout sheets and monthly tax reports. In order to properly distribute 2014 tax collections, we recommend the former sheriff eliminate the deficit in the 2014 tax account with a deposit of \$12,754 from personal funds. We will refer this finding to the Office of the Attorney General and Leslie County Attorney.

Former Sheriff's Response: No Response.

The former sheriff incorrectly calculated commissions and withheld commissions from the school board for December collections. The former sheriff did not remit commissions to the Leslie County Board of Education for December collections. The former sheriff's office calculated school commissions at four percent of gross collections, withheld the incorrectly calculated commission amount of \$11,509, and remitted net collections to the school board. The incorrectly calculated four percent commissions were paid to the former sheriff's fee account. However, for the December through January 3 collection period, the Leslie County Superintendent had fixed the former sheriff's tax commission rate at one and one-half percent.

As a result, the school did not receive the gross amount of tax collections, and the former sheriff's fee account was overpaid commissions. Since the incorrect percentage was used to calculate commissions, the school also did not receive all tax collections due.

KRS 160.510 requires the sheriff, as tax collector, to pay to the school board's depository "the amount of school tax collected up to and including the last day of the preceding month." There is no exception in this statute, or in any other statute, for the sheriff to first deduct his commissions from the school taxes collected before remitting the total amount of taxes collected to the school's depository. Once the sheriff has remitted the taxes to the school, the school then returns to the sheriff his commission. Benson v. Board of Education, 748 S.W.2d 156 (Ky. App. 1988) and OAG 82-587 reinforce and support this interpretation of KRS 160.510. The former Sheriff's office lacked adequate segregation of duties, which allowed commissions to be inaccurately calculated and improperly withheld without timely detection. The former Sheriff should have implemented internal controls to ensure compliance with statute. Effective internal controls would also have verified commission amounts paid to the fee account were accurate.

Former Sheriff's Response: No Response.

The incorrect tax rate was used to calculate school taxes. The incorrect tax rate was used to calculate school taxes on tax bills. The correct rate set by the Leslie County Board of Education was \$0.565 per \$100 of assessment. However, the tax bills reflected an incorrect rate of \$0.566 per \$100 of assessment. Although it is the responsibility of the county clerk to prepare the tax bills, the former sheriff's office did not implement internal controls to verify tax bills reflected the correct rates so that taxes were accurately calculated. As a result, taxpayers were erroneously charged \$0.001 cents, per \$100 of assessment. Effective internal controls would have required the former sheriff's office to verify the accuracy of all tax bills subject to collection. The former sheriff's office should have implemented internal controls to verify tax bills reflected the correct tax rates.

Former Sheriff's Response: No Response.

The former sheriff has not resolved unsettled 2013 tax liabilities and deficit. The 2013 tax liabilities have not been properly settled because the former sheriff's has not deposited personal funds to eliminate the 2013 tax account deficit of \$80,666. According to KRS 134.191(3), "At the time of making the report, the sheriff shall pay to the county treasurer or other officer designated by the governing body of a county, to the department, and to any other district for which the sheriff collects taxes, all funds belonging to the county, the state, or the district that were collected during the period covered by the report." Effective internal controls would require the former sheriff to settle receivables and liabilities identified through audit procedures in a timely manner. The former sheriff's failure to deposit personal funds has resulted in taxing districts and the former sheriff's fee account not receiving funds due in a timely manner.

Cash in Bank	\$ 29,353
Liabilities:	
Taxes Due Districts-	
Kentucky State Treasurer	\$ 5,996
Leslie County Fiscal Court	17,073
Leslie County Board of Education	54,032
Leslie County Library	11,879
Leslie County Health Department	4,222
Leslie County Extension Office	12,416
Leslie County Soil Conservation	48
Commissions Due 2014 Fee Account	<u>4,353</u>
Total Liabilities	<u>110,019</u>
Total Fund Deficit as of October 30, 2015	<u>\$ (80,666)</u>

We recommend the former sheriff deposit personal funds to cover the deficit, so the remaining liabilities can be paid. We will refer this finding to the Office of the Attorney General and Leslie County Attorney.

Former Sheriff's Response: No Response.

The former sheriff has not resolved unsettled 2012 tax receivables, liabilities, and deficit. The 2012 tax receivables and liabilities have not been properly settled. The former sheriff's unresolved 2012 tax account deficit is \$5,035. According to KRS 134.191(3), "At the time of making the report, the sheriff shall pay to the county treasurer or other officer designated by the governing body of a county, to the department, and to any other district for which the sheriff collects taxes, all funds belonging to the county, the state, or the district that were collected during the period covered by the report." Effective internal controls would require the former sheriff to settle receivables and liabilities identified through audit procedures in a timely manner.

The former sheriff's failure to deposit personal funds has resulted in taxing districts, taxpayers, and the former sheriff's fee account not receiving funds due in a timely manner.

Assets

Cash in Bank (All Tax Accounts)		\$	(8)
Receivables Due:			
Kentucky State Treasurer (regular)	\$	5,828	
Board of Education (regular)		1,280	
City of Hyden (regular)		75	
2011 Tax Account (improper transfer)		614	
2013 Tax Account (improper transfer)		1,007	8,804
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Total Assets			8,796

Liabilities

Taxes Due Districts-			
Kentucky State Treasurer (gas & oil)	\$	105	
County (regular)		103	
County (gas & oil)		128	
Board of Education (gas & oil)		489	
Library (regular)		81	
Library (gas & oil)		112	
Health (regular)		32	
Health (gas & oil)		35	
Extension (regular)		54	
Extension (gas & oil)		59	
Soil Conservation (gas & oil)		12	1,210
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Refunds Due Taxpayers			9,378
Overpayments Due Taxpayers			1,445
Commissions Due 2013 Fee Account			1,716
Interest Due Board Of Education			82
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Total Liabilities			13,831
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Total Fund Deficit as of July 31, 2014		\$	<u>(5,035)</u>

We recommend the former sheriff collect the receivables identified above and deposit personal funds to cover the deficit, so the remaining liabilities can be paid. We will refer this finding to the Office of the Attorney General and Leslie County Attorney.

Former Sheriff's Response: No Response.

The former sheriff has not resolved unsettled 2011, 2010, 2009, 2008, 2007, and 2006 tax receivables, liabilities, and deficit. The consolidated 2011, 2010, 2009, 2008, 2007, & 2006 tax receivables due, liabilities owed, and deficits have not been properly resolved. The former sheriff's consolidated deficit for these tax cycles is \$17,082. According to KRS 134.191(3), "At the time of making the report, the sheriff shall pay to the county treasurer or other officer designated by the governing body of a county, to the department, and to any other district for which the sheriff collects taxes, all funds belonging to the county, the state, or the district that were collected during the period covered by the report." Effective internal controls would require the former sheriff to settle receivables and liabilities identified through audit procedures in a timely manner. The former

sheriff's failure to deposit personal funds has resulted in taxing districts, taxpayers, and the former sheriff's fee account not receiving funds due in a timely manner.

Cash in Bank		\$	18,658
Receivables:			
Commissions Due From 2008 Fee Account	\$	2,832	
Commissions Due From 2010 Fee Account		385	
Kentucky State Treasurer (regular)		852	
Leslie County Fiscal Court		885	
Leslie County Health Department		176	
Leslie County Extension Office		84	
Leslie County Soil Conservation		5,484	
Uncollected Franchise Bill		760	
Uncollected Returned Check		620	
Due From Taxpayers		3,780	\$ 15,858
Total Assets			34,516
Liabilities:			
Taxes Due Districts-			
Leslie County Board of Education	\$	9,403	
Leslie County Library		3,428	
City of Hyden		268	
Refunds Due Taxpayers		32,194	
Overpayments Due Taxpayers		489	
Add On Fees Due 2009 Fee Account		1,115	
Advertising Fees Due 2009 Fee Account		294	
Interest Due 2009 Fee Account		9	
Erroneous Reimbursement Due 2009 Fee Account		149	
Commissions Due 2011 Tax Account		955	
Interest Due 2011 Tax Account		160	
Add-On Fees Due 2012 Fee Account		628	
Commissions Due 2012 Fee Account		1,114	
Interest Due 2012 Fee Account		169	
Commissions Due 2013 Fee Account		56	
Interest Due 2014 Fee Account		13	
Improper Transfer Due 2012 Tax Account		614	
Interest Due School Board		540	
Total Liabilities			\$ 51,598
Total Fund Deficit as of October 31, 2015			\$ (17,082)

We recommend the former sheriff collect the receivables identified above and deposit personal funds to cover the deficit, so the remaining liabilities can be paid. We will refer this finding to the Office of the Attorney General and Leslie County Attorney.

Former Sheriff's Response: No Response.

The former sheriff’s office did not distribute interest earnings. The former sheriff’s office did not distribute interest to the school district. KRS 134.140 requires the sheriff to pay monthly “that part of his investment earnings for the month which is attributable to the investment of school taxes.” KRS 134.140 allows the remaining monthly interest to be transferred to the sheriff’s fee account to pay the lawful expenses of his office. The lack of adequate segregation of duties and weak internal controls within the former sheriff’s office (as described in comment 2014-001) allowed this instance of noncompliance to occur and not be detected. As a result, the school and the fee account did not receive interest income. The former sheriff should have implemented internal controls to ensure compliance with KRS 134.140 by paying the amount of interest due to the school and fee account on a monthly basis.

Former Sheriff’s Response: No Response.

The sheriff’s responsibilities include collecting property taxes, providing law enforcement and performing services for the county fiscal court and courts of justice. The sheriff’s office is funded through statutory commissions and fees collected in conjunction with these duties.

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

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