



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

FRANKFORT, Ky. – State Auditor Adam Edelen has released the audit of the financial statements of the McCreary County Fiscal Court for the fiscal year ended June 30, 2014. 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 McCreary 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 improve purchase and procurement procedures. Auditors tested sixty (60) of the fiscal court's disbursements, the following was noted:

- Four (4) disbursements were paid using the statement amount without supporting documentation for those charges.
- Five (5) invoices were not paid within thirty working days.
- Two (2) payments did not have supporting documentation or purchase order.

- Six (6) checks to the Road Department for fuel were voided but no evidence was found of re-issue. Supporting documentation from the Road Department show these to be a valid invoices.
- Two (2) fuel invoices did not have a purchase order number.
- Haul tickets do not have a signature of an individual receiving material.
- 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 finance officer for payment.
- Of all the invoices tested, none were cancelled / marked 'Paid'.

These findings stem from a lack of adequate segregation of duties, proper accounting practices and internal controls. These deficiencies increases the risk that misstatements of financial activity and/or fraud will occur and go undetected by the Fiscal Court. Without proper procedures in place to mitigate this risk, Fiscal Court is exposing public resources to potential misstatements and/or fraud.

The State Local Finance Officer, given the authority by KRS 68.210, requires all expenditures to be accompanied by a purchase order and sufficiently documented. And 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.

We recommend 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. We also 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 disbursements within thirty (30) working days in compliance with KRS 65.140. Furthermore, we recommend the Fiscal Court ensure all checks which are valid liabilities be re-issued if stale more than six months.

County Judge/Executive's response: 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. From this point, all paid invoices are being marked paid. The checks to the Road Department referenced in this comment have been reissued, correcting this problem. Haul tickets are currently being processed correctly.

The Fiscal Court should strengthen internal controls over payroll account reconciliations.

The payroll revolving account did not reconcile to a zero balance as of June 30, 2014, and the remaining balance could not be readily explained. The remaining balance as of June 30, 2014 was \$60,109, of this balance the auditor determined the county had outstanding liabilities of \$53,502 and outstanding checks of \$2,092 leaving an unexplained balance of \$4,515.

The unreconciled payroll account could cause the county to have insufficient funds to meet payroll requirements or it could cause the county liabilities to not be properly paid or not to be paid in a timely manner.

The payroll account was not properly reconciled for the entire fiscal year and outstanding liabilities have not all been paid timely, as fiscal court owes occupational tax withheld for the third and fourth quarter of fiscal year 2014 totaling \$10,310.

The payroll revolving accounts are clearing accounts and should reconcile to a zero balance at the end of each month which does require the inclusion of outstanding receivables and liabilities. As a result of the weaknesses noted above, reconciled ending balances were not accurate.

We recommend internal controls over the payroll account bank reconciliations be strengthened to ensure receivables as well as obligations for accrued liabilities are reflected on the bank reconciliation and ending reconciled bank balances are accurate. Bank reconciliations should then be reviewed by an independent employee to verify accuracy and completeness. We further recommend the unpaid liabilities for occupational tax totaling \$10,310 be paid to the Occupational Tax Office.

County Judge/Executive's response: I internally discussed with auditors the issues with the payroll account not reconciling. With changes in personnel and with both the county treasurer and finance officer now utilizing the same fiscal management software, this issue will be corrected and I will monitor to ensure it does not repeat.

The Fiscal Court should strengthen internal controls over payroll. During the test of payroll the following issues were noted:

- The workweek for each department starts and stops on different days and times.
- Wages are paid to employee prior to completion of the work week wages are being issued for.
- Wages for one employee was miscalculated by \$100 per 20 pay periods causing the employee to be over paid by \$2,007 by the end of the pay period 11/28/14.
- Fiscal Court has approved multiple employees as salaried: five (5) of the employees tested did not submit time sheets.
- Fiscal Court approved additional position/duties for two employees however their timesheets did not reflect the hours to support the additional positions.
- Authorizations for all employee withholdings were not maintained in the personal files.
- One (1) county employee is receiving insurance benefits from Aflac that they are not paying for. The month tested indicated the monthly amount paid by Fiscal Court is \$69.
- Six (6) employees are receiving insurance benefits from Delta Dental they are not paying for. The month tested indicated the monthly amount paid by Fiscal Court is \$221.
- Actual hours do not allow employees time for lunch.
- Timesheets do not reflect in/out and lunch periods.
- Taxes were withheld for insurance premiums which are pre-taxable per the IRS.

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 benefits or wages not actually earned and would not be detected in a timely manner and disbursements may not be for the correct amounts.

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.

KRS 337.320 states “(1) Every employer shall keep a record of: (a) The amount paid each pay period to each employee; (b) The hours worked each day and each week by each employee; and (c) Such other information as the commissioner requires.

Section 3 of the Constitution as clarified by OAG 77.448 states “is unequivocal on the point that public emolument to any person must be based on the consideration of public services. By the strongest implication this means "public services actually rendered." It does not mean "public services to be rendered."

KRS 337.060 Unlawful for employer to withhold wages -- Exceptions -- Specified deductions from wages prohibited states “No employer shall withhold from any employee any part of the wage agreed upon. This section shall not make it unlawful for an employer to withhold or divert any portion of an employee's wage when the employer is authorized to do so by local, state, or federal law or when a deduction is expressly authorized in writing by the employee to cover insurance premiums, hospital and medical dues.”

803 KAR 1:070. Executive, administrative, supervisory or professional employees; salesmen. states “Section 3. General Rule for Administrative Employees. (c) Whose primary duty includes the exercise of discretion and independent judgment with respect to matters of significance.... (a) To qualify for the administrative exemption, an employee’s primary duty shall include the exercise of discretion and independent judgment with respect to matters of significance. The exercise of discretion and independent judgment shall involve the comparison and the evaluation of possible courses of conduct, and acting or making a decision after the various possibilities have been considered. The term "matters of significance" refers to the level of importance or consequence of the work performed. (b) The phrase "discretion and independent judgment".... whether the employee has authority to commit the employer in matters that have significant financial impact; whether the employee has authority to waive or deviate from established policies and procedures without prior approval; whether the employee has authority to negotiate and bind the company on significant matters;”

The McCreary County Administrative Code states the hours of operation is 8:00 am to 4:30 pm however the office is not actually opened until 8:30 which does not provide the employees sufficient hours to work an eight (8) hour day and also receive an actual lunch period.

We recommend payroll checks only be released after work weeks have been completed or fiscal court institute a interval between the date timesheets are turned in and the date wages are paid. Wages should be paid based on what the fiscal court approved. Also, the county should implement procedures to ensure that correct amounts are withheld from employees' payroll checks for insurance benefits; reviewing and reconciling all insurance invoices to the payroll records prior to payment to ensure premiums are not paid on employees unless they are being withheld from an employee's wages. The reviews should be completed by an individual other than the payroll officer. In addition, the payroll officer should ensure that pretax insurance premiums are not being taxed. Reviews should be completed by an individual other than the payroll officer. We recommend the workweek for each department starts and stop on the same dates and times We recommend the county comply with KRS 337.320(1)(a), (b), and (c) by requiring that timesheets or timecards be maintained for all employees. These should be signed by the employees and then reviewed and signed by the employees' immediate supervisors. We also recommend that signed authorizations be maintained in the employee personnel files for all additional withholdings, and the county complies with the McCreary County Administrative Code with employees clocking in and out for lunch. In addition, the court should review the job descriptions of the employee's assigned additional work to ensure accuracy and support of the additional wages. Fiscal court should also establish a plan to collect the over payments made to the employee in error and implement controls to ensure only authorized wages are being paid. Furthermore, we recommend Fiscal Court obtain a legal opinion from the county attorney as to whether the salaried employees are qualified to be considered a salaried employee under the labor laws.

County Judge/Executive's response: A plan to standardize workweeks in all departments and to allow for a two-week holding back for all employees will be accomplished as soon as possible. This will alleviate the issue with pay before work has actually been performed and negate the need for amended timesheets. The clerical error that resulted in one salaried employee being overpaid has been corrected and the proper controls implemented to prevent re-occurrence. Salaried employee status is currently being reviewed and will be administered properly once determined. The two employees that are performing additional duties due to the closing of the jail will have their job descriptions updated to include those duties to justify their additional pay. Controls have been implemented to ensure that all employees that are receiving supplemental insurance are indeed charged for that payment. We are implementing measures to ensure that all employees have adequate time for lunch while still working the required amount of time for which they are paid. Timesheets have been implemented which document proper lunch, etc. Other recommended controls will be implemented.

The Fiscal Court should ensure proper procedures over leave records. During the review of payroll the following issues were noted with leave:

- Leave time is not being properly charged.
 - One employee tested took three days vacation but was not charged vacation which will allow the employee to take additional days off with pay.
- Negative leave balances were noted for sick time.
 - One employee tested took 16 hours sick leave but was only charged for 12 hours which will allow the employee to take an addition four (4) hours off with pay.

- One employee consider to be salary had a negative sick balance of 5 hours per the employee benefit proof list, however his pay stub does not reflect any earned, used or leave balances.
- Negative leave balances were noted for vacation time.
 - One employee had a negative vacation leave balance of 80 hours. This allowed the employee to be paid for hours not worked or benefits not yet earned.
- Employee were allowed to be in two different leave codes at the same time; which is the same as selling leave which is not allowed by the counties policy.
 - One employee was schedule to work but took vacation time and was also paid holiday pay although the employee did not actually work that day. This allowed the employee to increase her gross pay by selling vacation time which is not allowed by the counties policy.

Lack of adequate internal controls and review of payroll prior to issuance has allowed the leave balances to be improperly recorded without being detected.

The counties policy states “Employees that are required to work on any holiday will be compensated for that holiday time at the employees regular rate of pay up to eight (8) hours for each day worked that has been officially declared a holiday in addition to any time physically worked during that holiday period.” The policy further states “No employee will be permitted to take vacation leave that has not been earned.”

We recommend the fiscal court comply with the county’s personnel policy and implement additional internal controls such as a comparison of the timecards/sheets to the payroll report and the leave summary report prior to the payroll being issued. The review could be documented by signing or initially the payroll and leave report.

County Judge/Executive’s response: The county administrative code clearly states how all leave time is to be administered, documented and utilized by employees. All employees understand this policy, sign affirmation that they understand the policy and the finance officer is charged with administering this policy. Again, I have implemented changes within my office to ensure that employee leave time is accurately issued, monitored and charged when used by the employee.

The Fiscal court should improve internal control procedures over credit card disbursements. Auditors reviewed all twelve months of credit card disbursements. During the review we noted the following:

- Four (4) statements which did not have itemized invoices attached.
- One (1) statement in which the itemized invoices did not agree to the amount paid.
- One (1) payment was made electronically but no check number was found nor was evidence of any supporting documentation.
- A late payment fee and finance charges were assessed (see comment 2014-006).

These findings stem from a lack of adequate segregation of duties, proper accounting practices and internal controls. These deficiencies increases the risk that misstatements of financial activity and/or fraud will occur and go undetected by the Fiscal Court. Without proper

procedures in place to mitigate this risk, Fiscal Court is exposing public resources to potential misstatements and/or fraud.

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

County Judge/Executive's response: 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. I will exercise more control over who is authorized to use the credit card and ensure that all receipts for use are returned to my office in order to pair with the statement and properly issue payment.

The Fiscal Court should pay invoices timely in order to prevent unnecessary payments of penalties and interest payments. During review of disbursements, debt and payroll the following penalties and interest payments were noted:

- Eight (8) finance charges on credit card invoices totaling \$109.
- One (1) late payment fee on credit card invoice totaling \$39.
- Eight (8) penalties on debt payment invoices totaling \$706.
- Seventeen (17) penalties payable to the IRS and Kentucky State Treasurer on payroll totaling \$2,435.
- Sixteen (16) interest payments for late payments IRS and Kentucky State Treasurer on payroll totaling \$243.
- Four (4) out of the five (5) insurance bills tested were paid late.
- Two (2) penalty payments due for November and December 2013 to the Kentucky State Retirement System for \$1,000 each totaling \$2,000.

Of the items tested the total payments in penalties and interest were \$5,532. The payment of penalties and interest are due to invoices and payroll withholding not being remitted in a timely manner.

KRS 65.140 states “ (1) 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. (2) An interest penalty of one percent (1) of any amount approved and unpaid shall be added to the amount approved for each month or fraction thereof after the thirty (30) working days which followed receipt of vendor's invoice by the purchaser.”

KRS 61.675 states “Any agency participating in the Kentucky Employees Retirement System (b) 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 paying all invoices timely and forwarding all withholdings to the proper agency in a timely manner to avoid unnecessary penalties and interest.

County Judge/Executive's response: In recent months, I have implemented a better process for payment of outstanding invoices that should alleviate many of the issues discussed here. The county treasurer is working to ensure cash is on hand prior to the time the finance officer issues a purchase order. Sometimes, however, cash flow remains an issue and payments are made late. Again, I believe the process I have discussed with my staff, and internal changes I have made, will alleviate many of these concerns as late payment penalties are often avoidable.

The County should comply with the United States Department 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 funds in the Revolving Loan Fund contain repayments of loans from previous RBEG. By using funds from the Revolving Loan Fund the county 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."

We recommend the Fiscal Court reimburse the Revolving Loan Fund for the matching funds previously expended and comply with the USDA grant agreement.

County Judge/Executive's response: The statements made within this audit contradict what we were told by USDA officials regarding management of the old revolving loan fund and use of those funds. I understood this action as stated to be appropriate as the matching funds used were thought to have been county revolving loan funds, not federal funds. I will request a meeting with the USDA to review this action and take the steps necessary to correct it.

The County Treasurer should maintain accurate financial records. During the course of the audit, we had to make numerous adjustments and reclassifications to county's financial records in order to ensure their accuracy.

The county treasurer's ledgers did not agree with amounts reflected on the 4th quarter financial report and the county treasurer did not prepare and submit an annual settlement to the fiscal court as required by Kentucky Revised Statutes. Also, the county treasurer is allowing cash transfers between funds without first seeking fiscal court approval.

Kentucky Revised Statute (KRS) 68.210 gives the State Local Finance Officer the authority to prescribe a uniform system of accounts. The Instructional Guide for County Budget Preparation and State Local Finance Officer Policy Manual list the duties of the County Treasurer based on KRSs 68.020, 68.300, 68.360(1), and 441.235. This manual requires the County Treasurer to maintain the financial records, to receive and disburse money, to invest funds, to prepare financial reports monthly, and to settle accounts within thirty (30) days after the close of each fiscal year. In addition, the manual requires the County Treasurer to countersign all checks for payment of funds from the county treasury only if the payment is approved by the fiscal court, sufficient funds are available, and an adequate free balance is available in the properly budgeted appropriation account.

We recommend the county treasurer maintain accurate ledgers and from those ledgers, prepare the quarterly financial reports. Bank reconciliations should be accurately prepared, reconciled to the ledgers, and any variances promptly researched and resolved. The county treasurer should also prepare and submit an annual settlement to the fiscal court for approval.

County Judge/Executive's response: A change in personnel was made with the office of county treasurer following the audit period for which this report reflects. The new treasurer has worked closely with the Department of Local Government since taking office to correct many of these issues. The treasurer is also utilizing fiscal management software as recommended by the state and audit team and will alleviate the possibility of these inaccuracies reoccurring.

The Fiscal Court should maintain accurate capital asset records. During the review of capital assets, the auditors noted the fiscal court is not maintaining accurate asset schedule.

Because the fiscal court is not providing adequate oversight in this area, numerous audit adjustments were made to the asset schedules. These adjustments resulted in total increases of the beginning balances to land by \$1,049,409 and equipment by \$149,193. The adjustments also resulted in total decreases of the beginning balances to buildings by \$407,863, vehicles by \$261,278 and infrastructure by \$348,406.

By not maintaining an accurate schedule, there is a risk that capital assets may not be insured or that the County pays insurance for assets they no longer own.

Kentucky Revised Statute (KRS) 68.210 gives the State Local Finance Officer the authority to prescribe a uniform system of accounts. Per the Instructional Guide for County Budget Preparation and State Local Finance Officer Policy Manual, capital asset records are necessary for proper valuation, adequate and accurate insurance coverage, internal control, and long range planning for property replacement. The manual states that capital asset records should include a description of the asset, historical cost, date of acquisition, date of disposal, useful life of the asset, salvage value, depreciation expense, accumulated depreciation, and proceeds from sale or disposal of assets. In addition, the manual states that a capital asset record should be prepared for each acquisition.

We recommend the fiscal court appoint an employee in charge of maintaining fixed assets. The employee should maintain records throughout the year of any purchases and retirements of assets and provide periodic updates to the fiscal court. Purchases should include the date the asset was acquired, a description of the asset, the vendor name, the amount, salvage value and useful life. Invoices 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. We further recommend that as an asset is retired or disposed of, it be removed from the listing. If possible, an inventory count at June 30 of each fiscal year should be conducted. The fiscal court should provide the necessary oversight needed to perform this important function.

County Judge/Executive's response: Throughout the course of my administration, each auditing team has recommended a different way to report the assets in holding of county government. While the final report may not reflect the information exactly as requested by auditors, I do feel I have strong control over county inventory, including insurance for this inventory. Each year, every department updates an inventory schedule. That schedule is reviewed by my office and then referenced against the insurance database to make sure every item in county control is properly managed and insured. In the future, I will direct my staff to make the appropriate adjustments to the final asset record report recommended by this audit team.

The Fiscal Court should improve internal control procedures over receipts by maintaining accurate records and by segregating duties over all accounting functions. A lack of segregation of duties exists over the following accounting functions: receipts, collection and processing, recording-keeping, report preparation and reconciliations. No documented review or compensating controls exist over these areas. We noted the following during our review of internal controls:

- The County Treasurer prepares and deposits the receipts, posts to the ledger, and prepares reports from these ledgers for submission to the Department for Local Government (DLG), and performs the bank reconciliations.
- Items returned from the bank are returned to the County Treasurer.
- Deposits were not made in a timely manner.
- Items outstanding for a sufficient period of time were not followed upon.
- The Finance Officer prepares a listing of bills for Fiscal Court's approval and prints the checks.
- The County Judge and County Treasurer sign the checks without evidence of a comparison to the invoices.
- Ledgers are not being reconciled between the County Treasurer and the Finance Officer.

The lack of segregation of duties occurs because of the fiscal court has failed to segregate incompatible duties or implement oversight when duties cannot be segregated. Lack of segregation of duties increases the risk of misappropriation of assets, errors, and inaccurate financial reporting. Adequate segregation of duties would prevent the same person from having a significant role in these incompatible functions.

We recommend the fiscal court separate the duties in preparing and depositing receipts, recording transactions, preparing reports, and reconciling bank accounts. If any of these duties cannot be segregated due to limited staff or budget, strong oversight should be provided over the

employee responsible. The employee providing the oversight should document this oversight. We also recommend the County Treasurer and County Judge/Executive, prior to signing the checks; compare them against the original invoices. Additionally, we recommend ledgers maintained by the County Treasurer and Finance Officer be reconciled monthly and this reconciliation be documented.

County Judge/Executive's response: Many of the items discussed here are continuing occurrences from audit to audit. The limitations of my staff do not appropriately allow for segregation of duties as the auditors would like. However, I ensure that each of my staff will do their jobs in the best way possible to ensure compliance with state laws and auditing standards. I also work to review the actions my staff has taken but appropriate segregation of duties is very difficult with our staff limitations.

The former County Treasurer and Finance Officer did not reconcile their financial records. The former County Treasurer and the Finance Officer maintained two separate sets of financial records using two different computer programs. However no reconciliations of the two were performed. As a result, we noted the following:

- The Finance Officer voided numerous checks from various funds without notifying the former County Treasurer. These disbursements were approved by the fiscal court and the checks had been prepared, signed, and posted to the former County Treasurer's appropriation's ledger. Since the former County Treasurer was not informed that these checks had been subsequently voided, she continued to show them as outstanding on her June 30, 2014 bank reconciliations and did not take them off of her appropriations ledgers. The Finance Officer did not document the reasons for voiding these checks and we were unable to determine if these checks were for legitimate claims or if replacement checks should have been issued.
- The former County Treasurer voided prior year outstanding checks and posted them to her appropriations ledger as negative disbursements instead of restating the beginning surplus balances.
- The former County Treasurer posted various immaterial adjustments to her receipts and/or appropriations ledgers in order to agree them to her reconciled bank balances. These adjustments did not reflect any actual receipts or disbursements but were made based on inaccurate postings to these ledgers as well as inaccurate bank reconciliation. Had the former County Treasurer and the Finance Officer reconciled their financial records these adjustments would not have been necessary.
- Cash transfers were not accurately accounted for. Cash transfers totaling \$15,000 were made from the General fund to the Jail fund and the Ambulance Equipment Fund but were re-deposited to the General Fund. The former County Treasurer included these as transfers out of the General fund and then made a \$15,000 adjustment to increase the miscellaneous receipts account within the General fund in order to agree her financial

records to her June 30, 2014 reconciled bank balance. These transfers were not included as transfers in to the Jail and Ambulance Equipment Funds.

- On June 6, 2014 a check was issued to transfer \$5,000 from the General Fund to the Ambulance Equipment Fund. However this check was not deposited until July 11, 2014 and was not counted as a transfer in of the Ambulance Equipment fund for the fiscal year ended June 30, 2014. Additionally a transfer totaling \$115 was made from the General

Fund to the Grant Fund. This transfer was posted as a transfer out of the General Fund but not as a transfer in to the Grant Fund. Therefore the totals for transfers out and transfers in did not agree. Checks written to transfer cash to the Ambulance Equipment fund were regularly held for several days before being deposited.

- Six (6) checks totaling \$18,390 were issued for amounts due to the Road Fund from the General, Jail, Park and Solid Waste Funds but were not deposited. These checks were issued to reimburse the Road Fund for fuel purchased from Road Fund monies but used by other county offices. These checks were included as outstanding on the former County Treasurer's June 30, 2014 bank reconciliation and were posted to the respective appropriations ledgers. They were subsequently voided by the incoming County Treasurer and no replacement checks were issued. Since Road Fund monies can be used for road purposes only, these amounts are still due to the Road Fund.
- One check in the amount of \$33 from the county's Solid Waste Fund did not clear the bank but was counted as a disbursement of grant funds. This check was included on the documentation sent to the state to document the disbursement of a tire recycling grant. It was also included as outstanding on the former County Treasurer's June 30, 2014 bank reconciliation and was posted to her appropriations ledger for the Solid Waste Fund. The check was subsequently voided by the incoming County Treasurer and no replacement check was issued.
- Payments to vendors were regularly held for up to several weeks after the claims were approved and checks were issued. Auditors discussed this with the Deputy Judge/Executive and the Finance Officer and were told that the fiscal court regularly approved claims without having the funds available to cover the checks. Checks were then held until funds became available. Although the checks were dated as of approval date and indicate that vendors were paid with thirty days as required by KRS 65.140(2), the fiscal court was not in compliance with this statute since these payments were held.

This failure to reconcile the two sets of financial records increases the risk that fraud could occur and go undetected and financial records maintained are inaccurate. In addition, since the quarterly financial statements are prepared from the receipts and appropriation ledgers, an inaccurate fourth quarter financial statement was prepared. If the two sets of financial records had been reconciled, the former County Treasurer could have provided the fiscal court members with accurate fund balances prior to them approving claims.

Kentucky Revised Statute (KRS) 68.210 gives the State Local Finance Officer the authority to prescribe a uniform system of accounts. The County Budget Preparation and State Local Finance Officer Policy Manual lists the duties of the County Treasurer and finance officer. Duties of the finance officer include the requirement that the finance officer reconcile the appropriation ledger with the treasurer's appropriation ledger at least once a month. This Policy Manual also states that the County Treasurer may countersign checks only if there is a sufficient fund balance and adequate cash in the bank to cover the check. 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. No member of the fiscal court shall vote for any such illegal appropriation or claim. The county treasurer shall be liable on his official bond for the amount of any county warrant willfully or negligently signed or countersigned by him in excess of the budget fund out of which the warrant is payable." KRS

68.275(1) and (2) states “Claims against the county that are within the amount of line items of the county budget and arise pursuant to contracts duly authorized by the fiscal court shall be paid by the county judge/executive by a warrant drawn on the county and co-signed by the county treasurer. The county judge/executive shall present all claims to the fiscal court for review prior to payment and the court, for good cause shown, may order that a claim not be paid” If the fiscal court had known that funds were not available to pay claims they could have ordered that the claims not be paid.

KRS 43.070(1)(a) states “To determine whether any unauthorized, illegal, irregular, or unsafe handling or expenditure of revenue or other improper practice of financial administration has occurred and to assure that all proper items have been duly charged, taxes, and reported, the Auditor shall audit annually the funds contained in each county’s budget.”

We have determined that a fiscal court approving a claim, then cutting a check to pay that claim, but then holding the check for weeks until there is enough money in the bank before signing and mailing the payment to the claimant, not only violates KRS 65.140(2) which requires payment within 30 days, but is an irregular and improper practice of financial administration per KRS 43.070; and that, this irregular and improper practice should cease, especially considering the language of KRS 68.275(1) and (2), and of KRS 68.300, and of the DLG’s Budget Manual.

We recommend the Fiscal Court ensure that accurate financial records are maintained by requiring the County Treasurer and Finance Officer to reconcile their financial records on a monthly basis. All outstanding checks should be followed up on in a timely manner before they are voided. Reasons for voiding outstanding checks should be documented and replacement checks issued if required. Additionally both sets of the financial records should be adjusted accordingly. We also recommend that claims be approved only if funds are available at the time of approval.

County Judge/Executive’s response: A change in personnel was made with the office of county treasurer following the audit period for which this report reflects. The new treasurer has worked closely with the Department of Local Government since taking office to correct many of these issues. The treasurer is also utilizing fiscal management software as recommended by the state and audit team and will alleviate the possibility of these inaccuracies reoccurring. Since issuance of this audit, other changes have been made within my office that will allow for proper reconciliation of records to prevent reoccurrence.

The Fiscal Court should not have deficit balances in the Jail and Grant Funds. As of June 30 2014, the Jail Fund and the Grant fund had deficit balances of \$6,476 and \$10,048 respectively. The deficit in the Jail Fund resulted from the failure to properly follow up on outstanding checks in a timely manner and properly monitor cash balances. The deficit in the Grant Fund was due to Fiscal Court’s practice of approving and issuing a check prior to having funds available to cover the check. On June 6, 2014 a check was issued from the Grant Fund. This check was held until the grant funds were deposited on July 22, 2014 and the check cleared on July 23, 2014.

KRS 68.110(1) states, “The fiscal court shall not in any year expend any money in excess of the amount annually levied and collected for that year or levied, collected or appropriated for any special purpose.”

We recommend the Fiscal Court not allow county fund to operate with deficit balances by ensuring that cash funds are available before checks are issued.

County Judge/Executive's response: Use of fiscal management software and proper accounting procedures by both the treasurer and the finance officer will allow for proper review of finances prior to issuance of a purchase order. This action alone will prevent the occurrence of deficit balances in any account. This issue will be monitored closely and further corrections implemented.

The McCreary County Fiscal Court should strengthen 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 county 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 32 loans made since June 2000,

- The total loans documented were \$1,530,029.

- Five (5) loans have been paid in full. Total loan repayments for these five loans were \$277,980.
- Eight (8) loans totaling \$363,015 have filed bankruptcy, of which \$318,509 was uncollected.
- One (1) loan for \$50,000 is in litigation with a loan balance of \$15,842.
- Seven (7) loans made 39 payments in fiscal year 2014 totaling \$20,746.
- Twelve (12) loans totaling \$454,247 had no repayment activity in FY 2014. The uncollected balances were \$388,243.
- Documentation obtained from the finance officer and the Economic Development officers regarding the amounts owed and the balances due does not agree. The Finance Officer had a total loan balance outstanding of \$782,291 and the Economic Development officer had a total loan balance outstanding of \$950,443. Variances are due to the finance officer including interest in the initial loan amount recorded in the program and the Economic Development director only records the principal. One list also includes bankruptcies and the other does not causing a discrepancy between totals.
- Estimated uncollectable loans are \$706,752 or 74% of the outstanding loan balance per the report submitted to the USDA for FY 2014.
- Loans totaling \$199,952 went to a board member, county employees or relatives of board members or county employees.
- Loans and payments are not reported to the credit bureau which could allow the borrower to obtain additional loans.
- Payments, late payments, and non payments are not being reported to the credit bureau.
- The county has submitted fourteen (14) loans representing \$563,379 in outstanding principal and interest was submitted to the County Attorney for legal action as of January 2015.

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.”

The application requires “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 loan application and that all loans are properly made, documented, collected and reported. It is further recommended that the McCreary County 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. The McCreary County Fiscal Court should also ensure they meet the reporting requirement established by the USDA.

County Judge/Executive's response: The loan program has plagued my administration since the beginning. Prior to my administration, the program was not managed by the Fiscal Court and therefore not properly audited, so many of these instances were not revealed until audited of recent. 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 and all proper paperwork is being completed, loan documentation secured and loans properly managed. Many of the problems go beyond my control and tenure in office. However, I, along with the Fiscal Court, have worked to push this issue forward so corrective action can be taken. I, and those that have oversight of this program, are satisfied that the program is being properly managed. All loans that are in delinquency are being pursued. Either the economic development director has made contact with those individuals to take corrective action, or those individuals have been turned over to the county attorney's office for legal action and collections.

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

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