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

FRANKFORT, Ky. – State Auditor Mike Harmon has released the audit of the financial statements of the Anderson County Fiscal Court for the fiscal year ended June 30, 2015. State law requires annual audits of county fiscal courts.

Auditing standards require the auditor's letter to communicate whether the financial statement presents fairly the receipts, disbursements and changes in cash and cash equivalents of the Anderson County Fiscal Court in accordance with accounting principles generally accepted in the United States of America. The fiscal court's financial statement did not follow this format. However, the fiscal court's financial statement is fairly presented in conformity with the regulatory basis of accounting, which is an acceptable reporting methodology. This reporting methodology is followed for 115 of 120 fiscal court audits in Kentucky.

As part of the audit process, the auditor must comment on non-compliance with laws, regulations, contracts and grants. The auditor must also comment on material weaknesses involving the internal control over financial operations and reporting.

The audit contains the following comments:

The fiscal court does not have adequate segregation of duties over payroll. There is not sufficient segregation of duties over payroll. Although the finance officer receives the timecards, the treasurer inputs the payroll information into the payroll software, prepares the reports, prepares payroll checks and direct deposit information, signs checks, and prepares and disburses all required payroll deductions, taxes, and retirement payments. The checks are given to the judge/executive or designee to sign, but no comparison is being done to the payroll reports.

The lack of segregation of duties is due to insufficient cross-training and knowledge of the payroll system. Without proper segregation of duties over the payroll process, the risk of fraud or error increases. Segregation of duties over these tasks, or the implementation of compensating controls, is essential for providing protection against the misappropriation of assets and/or inaccurate financial reporting. Additionally, proper segregation of duties protects employees in the normal course of performing their daily responsibilities.

We recommend the fiscal court strengthen internal controls by segregating these duties. If segregation of duties is not possible, strong oversight should be implemented. The employee providing this oversight should document his or her review by initialing source documents. The following compensating controls should be implemented:

- The judge/executive or designee should review the payroll report before checks are signed or information is sent to the bank and document the review by initialing the report.
- The judge/executive or designee should compare the disbursement checks for deductions, payroll taxes, and retirement to the reports before signing checks and document the review by initialing the reports.

County judge/executive's response: Compensating controls do exist in regards to segregation of duties over payroll. However, ACFC has a unique arrangement that utilizes payroll professionals that are employees of the County Treasurer, rather than direct employees of ACFC. ACFC only has one Treasurer and one Finance Officer, necessitating some creative solutions to accomplish the age old problem of segregating duties with minimal accounting personnel.

Auditor's reply: As stated in the comment, the recommended compensating controls could be implemented to increase review by Anderson County Fiscal Court personnel in order to verify work done by treasurer.

The fiscal court does not have adequate segregation of duties over disbursements. The treasurer prepares a master claims list, prepares and signs checks, posts to the appropriation ledger, and reconciles the bank statements.

During fiscal year 2015, the county judge/executive did not keep certain records and make certain reports or designate the finance officer to perform these duties as outlined by the Department for Local Government in the *County Budget Preparation and State Local Finance Officer Policy Manual*, as noted below:

1. Receive all county claims, and then prepare a master claims list to present to the fiscal court.
2. Prepare all checks on claims reviewed by the fiscal court.
3. Maintain an appropriation ledger.
4. Be responsible for the county's quarterly financial statement, pursuant to KRS 68.360.
5. Reconcile the appropriation ledger with the treasurer's appropriation ledger at least once a month.

These duties were all performed in the treasurer's office rather than by the finance officer as required by DLG. When one person has complete control over financial activity in the county, the risk of fraud or error increases.

We recommend the judge/executive follow the requirements of the Department for Local Government or designate the finance officer to maintain the appropriate records and perform the duties listed above. Duties should be adequately segregated to ensure that no one person has complete control over financial activity in the county.

County judge/executive's response: *Action has already been taken to strengthen and improve controls and segregation of duties over disbursements. Personnel changes have been made that should mitigate the situations found (missing invoices, presentation on bill list, and lack of a purchase order). The Treasurer and the Finance Officer work together to perform the duties outlined in the Budget Manual; so much so that the lines are sometimes blurred on paper when auditors are documenting the internal controls. However, we believe the objective of segregation of duties is satisfied to the degree that ACFC is able with such a small staff. We think all will agree that segregation of duties is difficult to achieve in a small organization. ACFC is also concerned about budget restrictions and takes its stewardship very seriously. ACFC does not want to hire personnel just to achieve segregation of duties; the cost to benefit simply does not justify this action*.

The county does not have sufficient controls over credit card purchases. Several weaknesses were noted with the controls over credit card purchases. Based on this review, the following were noted:

- Desktop Computer, Laptop and Printer totaling $980 for the AEMS, coded to "Computer Maintenance and Repair."
- Printer for AEMS for $400, coded to "Computer Maintenance and Repair."
- GPS for AEMS for $270, coded to "EM Program."
- Radio and Modem for AEMS totaling $385, coded to "Computer Maintenance and Repair."
- Projector Screen for AEMs for $143, coded to "Office Supplies."
- Interest of $25 was paid due to a purchase being left off of the check.
- Sales tax was paid on numerous occasions.
- Most purchase orders are filled out after the purchases have been made. They were used more as a method of documenting the coding for purchases, not as a purchase request system as required by the Department for Local Government.

Because purchases on credit cards do not follow the ordinary purchase order process and are not sufficiently documented and clearly coded, it is likely the members of the fiscal court are unaware of the nature and volume of items purchased with these cards.

Due to a lack of detailed review of receipts supporting credit card charges, the reasonableness and/or allowability of the disbursements cannot be determined. The fiscal court therefore cannot ensure purchases are valid and credit cards are not being abused. Sufficient review should be performed in order to ensure disbursements are necessary, adequately documented, reasonable, and beneficial to the business of the county.

Based on the weaknesses noted, we are recommending the following:

- Credit card purchases should follow the normal purchase order request system used for all other disbursements, which would allow for approval/denial of a purchase before it takes place.
- Purchases should be coded accurately to reflect the item purchased. General categories, such as “DES Program” should not be used for computers or other large purchases.
- The county should require all receipts be submitted to support the charges on the credit card bill. Any charges without supporting receipts will be the responsibility of the user to pay.
- The county should perform detailed reviews of credit card receipts and bill statements to ensure all purchases are necessary, reasonable, were properly requested and approved, sufficiently documented, and recorded.

In order to fully inform the fiscal court of the individual transactions making up the bill list total for each credit card, we are recommending the following:

- All receipts for credit card transactions should be attached to the statement and filed for preparation of the claims list.
- Once the statement is received and all receipts related to that statement are attached to the credit card statement, a detailed list of transactions should be included on the claims list presented to the fiscal court for approval.

County judge/executive’s response: Credit cards are only issued to Department Heads for use within the normal purchase order system. Extra effort has been devoted to improving ACFC control over credit card expenditures. Potential purchases must receive authorization to ensure there is sufficient line-item budget availability. All charge slip documentation and explanation of unusual transactions should be attached to the purchase ticket and the individual charges must be reconciled to the monthly credit card statement.

The fiscal court did not maintain a complete and accurate capital asset listing. The county’s capital asset listing did not include all purchases required to be capitalized per the county’s capitalization policy. Due to oversight by the treasurer, several purchases were left off of the additions list provided to the auditor; therefore, the capital assets schedule was not accurate. No review is being done to ensure the additions list is accurate and all-inclusive.

Not maintaining an accurate list of capital assets could cause capital assets to be uninsured or result in paying for insurance for an asset the county no longer owns. The Department for Local Government (DLG) requires counties to maintain capital asset records (see DLG County Budget Preparation and State Local Finance Officer Policy Manual pages 55-60), including, among other things, a description of the asset, historical cost, date of acquisition, and useful life of the asset.

We recommend a schedule of additions should be maintained as assets are purchased to simplify the process of updating the capital asset schedule. The schedule should include the date the asset is acquired, a description of the asset, the vendor name, and the amount. Furthermore, the capital asset listing should be monitored and maintained on a regular basis. As new assets are acquired they should be added to the listing. As equipment is retired or disposed of it should be removed from the listing.

We also recommend that the county implement policies that will identify and track additions, retirements, and disposed assets for the purpose of the capital asset schedule.

County judge/executive's response: The capital asset listing for the fiscal year did not include the items financed and paid directly to vendors. This oversight was caught when the auditors added the new financing for the fiscal year. Auditors suggested that ACFC keep a folder with invoices of significant acquisitions. We agree that the separate folder idea is a good solution.

County funds were not deposited daily. Deposits were not prepared or deposited daily. During fiscal year 2015, there was one month with two deposits, five months with three deposits, three months with four deposits, two months with five deposits and one month with six deposits. Deposits were not made daily due to time constraints of the treasurer.

When funds are not properly deposited, this could result in loss of receipts or misplaced monies. KRS 68.210 gives the State Local Finance Officer the authority to prescribe a uniform system of accounts. The minimum requirements for handling public funds as stated in the *County Budget Preparation and State Local Finance Officer Policy Manual* require that deposits be made daily and intact. Additionally, the practice of making daily deposits reduces the risk of misappropriation of cash, which is the asset most subject to possible theft.

We recommend fiscal court deposit receipts daily as required by the State Local Finance Officer.

County judge/executive's response: Significant amounts of cash are deposited into the bank checking accounts pronto; checks are restrictively endorsed and deposited less frequently. Even though DLG suggests daily deposits, the idea of safeguarding County assets is being accomplished without such a rigorous control. Since interest rates on bank checking accounts do not provide much incentive, our fiduciary responsibility is also being met.

Auditor's reply: Daily deposits are not a "suggestion" from the Department for Local Government, but rather a requirement. Page 61 of the *County Budget Preparation and State Local Finance Officer Policy Manual* outlines the "Handling Public Funds Minimum Requirements Pursuant to KRS 68.210 for All Local Government Officials (and Employees)." The third bullet states, "Daily deposits intact into a federally insured banking institution. (KRS 68.210)"

Duties are not adequately segregated over receipts and reconciliations. During fiscal year 2015, the county treasurer prepared and deposited receipts, posted receipts and disbursements to the accounting system, maintained the purchase order listing, prepared checks for disbursement, prepared monthly reports for fiscal court and quarterly reports for the Department for Local Government, made cash transfers between funds and bank accounts, and performed bank reconciliations for all bank accounts. While some compensating controls are in place, including the preparation of a receipts log by the finance officer and the review of prepared checks by the county judge/executive or his designee, they are not sufficient.

Because duties were not adequately segregated, posting errors were made in both receipts and disbursements. We have prepared a schedule of proposed audit adjustments for review. Lack of adequate segregation of duties and too much control by one individual could result in the undetected misappropriation of assets and/or inaccurate financial reporting. A sufficient internal control structure requires adequate segregation of duties. Without proper segregation, the county cannot ensure all receipts are deposited and all bank activity is appropriately documented in the accounting system.

We recommend the county segregate incompatible duties or implement strong compensating controls to mitigate the risk identified above. In conjunction with the lack of adequate segregation of duties in the disbursement process, as documented in finding 2015-002, the county should determine which duties should be performed by the judge/executive or the finance officer that will address these weaknesses.

County judge/executive's response: Adequate segregation of duties over reconciliations requires a higher level of skills, knowledge, and experience than ACFC has available except for the Treasurer. A portion of ACFC's self-error trapping procedures is accomplished through reconciliations. ACFC will reassign reconciliations as sufficiently trained personnel become available.

Receipts and disbursements were not posted correctly. The following posting errors and misclassifications were noted during our review:

- Receipt of $47,450 from KACO was posted to a debt service account as a negative receipt, offsetting disbursements.
- Disbursements of $72,920 for the county clerk's building were posted to the debt service line item for this building. Because there was not an appropriate line item to reclassify disbursements on the fourth quarter report, the auditor could not make an adjustment for this misclassification.
- Receipt of $6,325 from the state was posted as a negative receipt, offsetting salaries.

Audits as far back as 2011 have addressed posting errors, including posting negative receipts to offset disbursements, but this practice has continued.

Posting errors as noted above were due to deficiencies in the internal control structure. Good internal controls over the processing and review of financial reporting could eliminate such errors. Amounts reported in the county's quarterly report submitted to the Department for Local Government were inaccurate due to misclassifications and posting errors. When receipts are posted as negative disbursements, both receipts and disbursements are understated.

We recommend the fiscal court ensure receipts and disbursements are posted to the correct account and negative receipts are not posted to offset disbursements. If someone other than the treasurer posts the information into the accounting records, the treasurer should check the posting for accuracy.

County judge/executive's response: ACFC will utilize the all inclusive method of accounting rather than netting the borrowed funds against disbursements.

The audit report can be found on the auditor's website.

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