Auditor of Public Accounts
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FOR IMMEDIATE RELEASE

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Harmon Releases Audit of Madison County Fiscal Court

FRANKFORT, Ky. – State Auditor Mike Harmon has released the audit of the financial statements of the Madison 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 Madison 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:

2015-001 Madison County Fiscal Court's internal control procedures over expenditures failed resulting in questioned costs. During the period spanning 2006 through May 2015, law enforcement identified potential misappropriated assets totaling $368,725 in the Chemical Stockpile Emergency Preparedness Program (CSEPP). Auditors performed procedures to verify amounts incurred during fiscal year 2015 and expanded testing in the area of expenditures to determine if further amounts should be questioned. The auditor's expanded testing did not result in additional questioned costs beyond what law enforcement identified.

Auditors question costs associated with 60 transactions in the amount of $34,489 in federal funds for fiscal year 2015, including:

- Purchase of 59 iPads.
- Reimbursement of three out-of-state travel expenses when the employee was clocked in on county property.
- Repairs to a vehicle that was not owned by the county on three occasions.

CSEPP expenditure transactions did not receive the same scrutiny when processed for payment as the other departments within the county due to the nature of the program. Adequate supervisory review was not performed to ensure all payments made were for valid purchases. In addition, the county did not properly utilize the purchase order system (See Finding 2015-006). Thus, management's documented controls failed to work properly over CSEPP transactions.

The failure to have effective internal controls resulted in the county expending funds for purposes that were not associated with the federal program. Failure to expend federal funds for allowable purposes could result in the county having to reimburse the federal government for questioned costs. Management has a responsibility to design and implement internal controls to provide reasonable assurance of safeguarding resources against waste, fraud and abuse. Good internal controls provide reasonable assurance that the recording, processing and reporting of data is properly performed and that if errors or fraud occur, detective controls will bring these to management's attention. Management should be sufficiently involved with the day to day operations, by providing strong oversight and review, to mitigate the risks inherent in certain accounting areas. In addition to good internal controls, 2 CFR 200.403 requires that costs be necessary and reasonable in order to be allowable under federal awards. The costs must also be consistent with county policies and procedures.

We recommend the fiscal court strengthen established controls to ensure all expenditures are properly reviewed and approved to ensure federal expenditures are valid and allowable under 2 CFR 200.403. All county departments should be treated with equal scrutiny. During review of documentation, purchases should be questioned as to the necessity and reasonability for the performance of the program.

County Judge/Executive Reagan Taylor's response: The following finding is a result of the theft from our CSEPP program. We are currently in the process of litigating this situation. The new administration was already in the process of modifying the disbursement process prior to the identification of the theft and since that time has implemented new request and disbursement processes.

2015-002 Madison County Fiscal Court did not have controls in place to ensure the Schedule of Expenditures of Federal Awards accurately reported federal program expenditures. The Schedule of Expenditures of Federal Awards (SEFA) prepared by the fiscal court did not accurately represent amounts expended for federal programs. It appears that the amount reported on the SEFA was the amount received from the federal program instead of what was expended, resulting in a misstatement of $1,393,120. Management was made aware of this error during the audit and appropriately revised the SEFA.

2 CFR 200.510(b) requires a schedule of expenditures of federal awards be prepared to include total federal awards expended for the period covered by financial statements. Good internal controls would dictate that records be maintained to document expenditures of federal awards and those expended federal award amounts be reported on the SEFA.

It is recommended that the fiscal court improve controls over financial statement reporting to ensure that the SEFA is reported accurately.

County Judge/Executive Reagan Taylor's response: This finding has never been noted on previous audits. Upon receipt of the Audit Exit Conference, the Finance Department has modified its process to ensure the Federal Awards are properly reflected. It is important to note that while misstated, all funds have been accounted for within the CSEPP program.

2015-003 Madison County Fiscal court did not comply with bidding requirements. The Madison County Fiscal Court had the following exceptions with bidding requirements:

- Four purchases exceeding $20,000 were not bid:
  - The Madison County Fiscal Court purchased an excavator for $82,500. The expenditure was broken into two transactions of $32,500 and $50,000, paid to two separate vendors but with the same address. The only supporting documentation for the purchase was a handwritten note on the former county judge/executive's letterhead with the name, address and payment amount for each vendor.
  - The county purchased two yellow 2001 Chevrolet 7500 pick-up trucks, totaling $24,000. The purchases were made on the same day and to the same vendor, but on separate checks.
  - The county entered into a lease agreement for mowers for the golf course. The term of the lease agreement is May to October, from 2014 through 2019, with a total lease value of $292,435.
  - The county entered into a lease agreement for golf carts for the golf course. The term of the lease agreement is 63 months, with a total lease value of $198,400.

- Bid documentation was not properly maintained for nine bids:
  - No documentation available for review for two bids.
  - No documentation available for review for purchase made on state price contract.
  - No documentation maintained regarding the advertisement of six bids.

The Madison County Fiscal Court appeared to be aware of the bidding requirements per KRS 424.260; however, they did not bid due to various reasons. The purchase of the excavator was deemed to be a good deal and would save the county money. The Chevrolet pick-up trucks were not bid because it was a purchase of two separate vehicles. Finally, lease agreements were not viewed as requiring bidding. The lack of properly maintained bid documentation was due to a lack of policies and procedures over the handling of bid documentation.

Competitive bidding ensures that the county procures materials and services at the best price available. By limiting competition, the county may not get this benefit. In addition, the lack of proper documentation would make it difficult to prove adherence to the provision of KRS 424.260 and the county's administrative policy. Documentation should be complete and consistent to ensure adequate records management in terms of providing evidence to demonstrate adherence to applicable laws and regulations. KRS 424.260(1) states, "Except where a statute specifically fixes a larger sum as the minimum for a requirement of advertisement for bids, no city, county, or district, or board or commission of a city or county, or sheriff or county clerk, may make a contract, lease, or other agreement for materials, supplies except for perishable meat, fish, and vegetables, equipment, or for contractual services other than professional, involving an expenditure of more than twenty thousand dollars ($20,000) without first making newspaper advertisement for bids." In addition, the DLG manual states, "All contracts, invoices, purchase orders & authorizations, vendor bidding documentation, receipts, deeds, etc. must be maintained/filed with the asset documentation records."

We recommend that the Madison County Fiscal Court follow the requirements of KRS 424.260 and the county's administrative policy. Purchases of $20,000 or more should be competitively bid unless the requirements for negotiated procurement have been met. Every purchase should have adequate supporting documentation, including purchases made under the state price contract. A copy of the applicable state price contract should be kept on file and all bidding documentation should be maintained.

County Judge/Executive Reagan Taylor's response: The following findings were approved during the previous administration with the exception of the lease of the Golf Course Carts. While we recognize the finding in this audit will change how we handle leases in the future, we relied on past practices and renewed a lease that had not been identified as an issue in past audits. We will no longer lease without going through the bidding process.

2015-004 Madison County Fiscal Court had negative bank balances during the fiscal year. The fiscal court had negative bank balances in the jail fund and the payroll revolving account during fiscal year 2015. The jail fund account was overdrawn eight times, and the payroll revolving account was overdrawn a total of seven times. The negative bank balances in the payroll account are attributed to the delay in deposits to the revolving account on the day that payroll is processed. The negative bank balance in the jail fund appears to be the result of not monitoring fund balances when claims were paid to determine that a transfer was needed to cover the claims.

Negative bank balances are indicative of cash flow problems and are a poor business practice. Aside from being good business practice, maintaining positive bank balances is required by statutes. KRS 68.210 requires the State Local Finance officer to create a system of uniform accounts for all counties and county officials. The *County Budget Preparation and State Local Finance Officer Policy Manual* states that the County Treasurer is only to sign checks if there is sufficient fund balance and adequate cash in the bank to cover the check.

We recommend that the fiscal court maintain positive balances in all bank accounts by monitoring fund balances and ensuring that deposits to the revolving account are made immediately.

County Judge/Executive Reagan Taylor's response: The negative balances are based on the transfer of funds from the General Fund to the Jail Fund and the payroll fund. The Fiscal Court is in a no-win situation with the payroll fund because of the time constraint from the time payroll is processed to which the payroll is deducted from the account. The payroll is deducted the next morning from the account, but the deposits from each fund covering the payroll are in check form and must be signed by two parties and then deposited, causing a negative balance for a short period of time. The Fiscal Court has never been charged a fee because the bank understands the process, however we are looking at alternative pay dates to extend the payroll process turnaround time.

2015-005 The jail did not present an accurate financial statement. The financial statement presented to the treasurer for fiscal year 2015 was not an accurate representation of the commissary account. The document presented as a financial statement was a recapitulation of activity posted to the bank account. Financial information was maintained by the jail using software that does not produce a financial statement, but does produce the information that can be compiled into a financial statement. Since the jail software does not produce a financial statement, jail employees tried to compile information based upon banking records. This resulted in the presentation of an inaccurate financial summary to the treasurer at fiscal year-end.

KRS 68.210 requires the State Local Finance Officer to create a system of uniform accounts for all counties and county officials. The *County Budget Preparation and State Local Finance Officer Policy Manual*, under Jail Commissary Fund instructions provides minimum accounting and reporting standards. It requires a jail commissary year-to-date summary compiled with information obtained from receipts and disbursements journals. The ending balance reported on the summary is reconciled to the bank balance. This summary is sufficient to use as the year-end report that is submitted to the county treasurer.

It is recommended that an accurate financial statement be compiled using financial information from receipts and disbursement journals. The ending balance should be reconciled to the bank balance. It is further recommended that this report be submitted to the county treasurer as the year-end report instead of the bank activity recapitulation.

County Jailer's response: Since the conclusion of the audit, the facility has attained a new company for our commissary sales. Subsequently, that company has launched new accounting software. We are confident in our new system and feel like we will no longer have issues retrieving necessary reports and financial statements.

2015-006 Madison County Fiscal Court did not properly handle disbursement transactions. Testing was conducted of 109 expenditure transactions. Of those transactions, the following exceptions were noted:

- 15 transactions had no supporting documentation that would support the allowability of the disbursement. Of those 15, the support for 13 transactions was not the original PO and/or invoice. The support for the remaining two transactions was a copy of a hand-written note on the former county judge/executive's letterhead (See also Finding 2015-03).
- Three expenditures that did not appear to be valid obligations of the fiscal court. Payments included sales tax, penalties due to late payments, and reimbursement that included charges for excess baggage fees and charges for an infant car seat included in with car rental fees.
- 35 invoices were not paid within 30 days.
- Four purchase orders lacked the signature of the department head.

The county did not properly utilize the purchase order system. The majority of purchases were made prior to the purchase order being obtained, and no log was maintained of the outstanding purchase orders. In addition, the county did not have adequate policies and procedures in place to require original invoices be submitted for payment. Documented controls failed to work properly. The tested invoices did not have date stamps to signify when the invoice was received by the department or by the finance department. Lack of proper accounting practices and internal controls increase the risk that misstatements of financial activity or fraud will occur and go undetected. Without proper procedures in place or the proper execution of documented controls to mitigate this risk, the county is exposing public resources to potential misstatements and fraud.

Good internal controls dictate that adequate original supporting documentation should be maintained for all expenditures and approval be obtained before payment. All original invoices should be maintained, cancelled upon payment, and paid within 30 days. KRS 65.140 states, unless the purchaser and vendor otherwise contract, all bills for goods and services shall be paid within 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.

Without invoices with adequate information, there is not proper justification for the disbursement. We recommend that the county properly utilize the purchase order system, requiring purchase orders prior to purchase. All purchase orders should have the approval of the department head and/or county judge/executive, or their designee. Adequate, original documentation should be provided and reviewed to ensure all expenditures are valid obligations of the county. We further recommend that the county ensure that all invoices are paid within 30 days as required by KRS 65.140. All county department heads should be instructed to date stamp invoices when received to help ensure that payment is made timely.

County Judge/Executive Reagan Taylor's response: The following finding is a result of the theft from our CSEPP program. We are currently in the process of litigating this situation. The new administration was already in the process of modifying the disbursement process prior to the identification of the theft and since that time has implemented new request and disbursement processes.

2015-007 The Madison County Battlefield Golf Course Manager is receiving golf lesson fees and conducting outside employment during county work hours. The Battlefield Golf Course manager is receiving payment directly to provide golf lessons. Per the county's website, all payments are to be made directly to the golf course manager. The county does not have a job description or contract with the employee which documents an arrangement where the fees would go directly to the manager. Further, there is no account of the total fees paid to the golf course manager. In addition, the golf course manager teaches a course for a local university. The classes are held at the county's golf course during the week during normal business hours. The manager does not clock out to conduct these classes. Thus, the golf course manager is conducting outside employment responsibilities during county work hours.

The county is treating the arrangement with the golf course manager in a similar fashion to what is industry standard for private golf courses when providing golf lessons. Additionally, the county did not have written policies regarding acceptable practices for outside employment. By not having an approved agreement with the golf pro to receive direct payment for golf fees, it gives the appearance that the employee is receiving additional payment for duties that would be considered a part of his normal job duties. Furthermore, the lack of policies on outside employment led to the county employee engaging in activities related to outside employment during county work hours. In addition, by performing job duties related to outside employment, the employee is getting paid by the county for hours not attributed to county work duties.

While these arrangements may be industry standard, the rules applicable to county governments are different. Employees should not receive additional compensation to perform duties considered a part of their normal job duties. If a different arrangement is agreed upon, a written job description and/or contract should be on file for the employee. The county's *Personnel and Administrative Code* states, "All positions shall be identified with a written job description that outlines the duties and responsibilities of their positions. These descriptions will be updated periodically by the County Judge/Executive or their designee with the approval of Fiscal Court." Furthermore, employees should be effectively clocked out, with the proper use of leave time, or off duty when performing job duties related to outside employment.

Employees should not be paid by the county for hours used performing job responsibilities for outside employment. Section 7 of the county's administrative policy states, "All employees shall work according to a schedule of hours recommended by the Supervisor, County Judge/Executive and Fiscal Court. No employee will leave work at any time during regular working hours without supervisor's approval. No employee will leave work before he/she has personally clocked out or signed out. No employee will leave their working area for personal reasons without supervisor's approval." Ethical standards would dictate that employees not use official time to perform activities other than those required in the performance of their official duties.

We recommend the Madison County Fiscal Court review the arrangement with the golf course manager. If it is the intention of the county to allow the golf course manager to retain fees directly for the golf lessons, a job description should be prepared and/or a contract entered into with the employee and approved by fiscal court. Otherwise, the golf lesson fees should be turned over to the treasurer and deposited into the appropriate fund. We further recommend that that the fiscal court update the county's administrative policy and/or ethics policy to include acceptable practices in regards to outside employment. The county should refer this matter to their ethics board for review and determine whether this is not a violation of ethical standards.

County Judge/Executive Reagan Taylor's response: The Madison County Fiscal Court will enter into a contract with our Golf Pro for outside lessons and will run said lessons through the Point of Sale program. The Human Resources Department has implemented clocking in and out for salaried employees to ensure it is reflected that the employee is not on county time when working a second job during their personal time. While these findings will be corrected, the action of the Golf Pro was in line with how golf courses are managed in the private sector and all actions taken were with the approval of the Fiscal Court.

2015-008 Madison County Fiscal Court lacks adequate segregation of duties over payroll. Madison County Fiscal Court has a lack of adequate segregation of duties over the following payroll accounting functions: processing, record-keeping, report preparation, disbursements, and reconciliations. The county treasurer processes payroll, which includes calculating hours worked, checks and confirms leave balances, prepares payroll reports, and reconciles the payroll fund bank account. In addition, payroll is not subject to final approval prior to payment by someone independent of payroll preparation and timekeeping. There were no documented compensating controls to offset the lack of segregation of duties or reduce the control deficiency to an acceptable level. The finance department has a limited staff size, which requires that the treasurer handle the payroll function.

Due to these weaknesses in controls, we noted the following deficiencies:

- Three employees were paid incorrectly because hours worked per timesheets did not agree to hours paid.
    - During the pay period 2/11/15 through 2/24/15, the county closed the offices due to the inclement weather. Two employees had total hours for the pay period that exceeded 80 hours, yet were not paid straight time for those additional hours because the county closed. The auditors were told that they could not get additional time over 80 hours since they closed the offices.
    - One employee was paid for more than hours worked.
- One employee's salary exceeded the amount approved by fiscal court.
- Change orders for three employees receiving pay increases were not properly documented.
    - One change order included the signature of the employee's supervisor and treasurer, but not the county judge/executive.
    - One pay increase was documented by correspondence from employee's supervisor; no signatures noted.
    - One change order included only the signature of the treasurer, not the supervisor or county judge/executive.
- Negative bank balances noted in the payroll fund account (See Finding 2015-004).

The segregation of duties and responsibilities between different individuals for custody of assets, recordkeeping for those assets, and reconciliation of those asset accounts is an important control activity needed to adequately protect the county's assets and ensure accurate financial reporting.

Adequate segregation of duties would prevent the same person from having all the significant roles in the preparation of payroll. Lack of segregation of duties increases the fiscal court's risk of misappropriation of assets, errors, and inaccurate financial reporting. In addition, KRS 64.530(1) requires the fiscal court of each county to annually fix the compensation of every county officer and employee except the officers named in KRS 64.535 and the county attorney and jailer. This list as approved by the fiscal court should be documented in the Fiscal Court Order Book. The fiscal court should also approve any changes in compensation. The Fair Labor Standards Act requires that all covered, nonexempt employees be paid at least the minimum wage for all hours worked.

To adequately protect against misappropriation of assets and/or inaccurate financial reporting, we recommend the fiscal court separate the duties of the payroll functions to the extent possible. If these duties cannot be segregated due to limited staff or limited budget, then strong oversight should be provided to the employee responsible for these duties. An independent county person should compare payroll data to payroll reports for accuracy. The independent person should then sign off on the payroll reports that this compensating control was completed.

County Judge/Executive Reagan Taylor's response: The Finance Department has modified the payroll process to ensure there is an adequate number of employees involved in the checks and balance process from the point of timesheet entry to the payout of the check to the employee.

2015-009 The Madison County Fiscal Court did not have sufficient controls over program income. The fiscal court received program income associated with the Chemical Stockpile Emergency Preparedness Program (CSEPP) that was not used according to federal requirements (See Finding 2015-001). The fiscal court was collecting annual maintenance fees for radios that were purchased using federal CSEPP funds. This practice is permitted; however, the program income that was being received was not utilized to offset allowable expenses to the federal program. The funds were being used by the county to fund purchases prior to being reimbursed by the grantor. The funds were also being used by a former employee to misappropriate funds for unallowable purposes. The cause of this control weakness appears to have been a misunderstanding of the program income requirements by program managers. The county has been collecting these fees for years and did not realize they were not utilizing them appropriately. In addition to being noncompliant to federal regulation, the failure to utilize the funds as required by federal regulation left funds available for misappropriation. 2 CFR 200.307 requires program income to be deducted from program outlays unless otherwise specified by the federal grantor. It is recommended that the fiscal court implement controls over program income to ensure that it is handled in a manner that is compliant with federal regulations.

County Judge/Executive Reagan Taylor's response: The Madison County Fiscal Court had identified prior to the audit this issue in conjunction with the theft in the CSEPP program. We implemented a new control system in April 2015.

2015-010 Madison County Internal Control Procedures Over Expenditures Failed Resulting in questioned Costs (See Finding 2015-001).

Federal Program: CFDA 97.040
Name of Federal Agency: U.S. Department of Homeland Security
Compliance Requirements: Activities Allowed or Unallowed and Allowable Costs/Cost Principles
Type of Finding: Material Weakness
Amount of Questioned Costs: $34,489
Opinion: Madison County did not comply with federal requirements regarding this compliance requirement resulting in a Qualified Opinion.

2015-011 Madison County Fiscal Court did not have sufficient controls over program income (see finding 2015-009).

Federal Program: CFDA 97.040
Name of Federal Agency: U.S. Department of Homeland Security
Compliance Requirements: Program Income
Type of Finding: Significant Deficiency
Amount of Questioned Costs: $0

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

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