



Auditor of Public Accounts
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FOR IMMEDIATE RELEASE

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Harmon Releases Audit of Magoffin County Fiscal Court

FRANKFORT, Ky. – State Auditor Mike Harmon has released the audit of the financial statement of the Magoffin County Fiscal Court for the fiscal year ended June 30, 2016. 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 fund balances of the Magoffin 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 noncompliance with laws, regulations, contracts, and grants. The auditor must also comment on material weaknesses involving internal control over financial operations and reporting.

The audit contains the following comments:

The county did not maintain capital asset schedules in accordance with regulatory requirements. The fiscal court did not maintain a complete and accurate capital asset schedule for fiscal year ending June 30, 2016. This is a repeat finding and was included in the prior year audit report as Finding 2015-001. The fiscal court has historically not maintained a fixed asset register and has relied upon the auditor to update fixed asset information within the financial statements based upon information related to additions, retirements, and disposals provided by the fiscal court. The fiscal court is not in compliance with the requirements of the DLG and fixed asset information in the financial statements may be misstated.

The Department for Local Government (DLG) requires fiscal courts to track capital assets (i.e. land, buildings, equipment, vehicles, infrastructure, etc.) and maintain a listing of capital assets to be provided to auditors for inclusion in the audit report. This list should include all current year additions/purchases, retirements, disposals/sale of assets, etc. Any related documentation for capital asset additions, retirements, and disposals in the form of invoices, deeds, purchase orders, sales records, titles, liens, etc. should be maintained in a manner that facilitates easy access, retrieval, and verification of capital asset amounts recorded.

We recommend the fiscal court implement procedures to identify and track capital asset additions, retirements, and disposals in order for capital asset schedules to be complete and accurate. Additionally, we recommend the fiscal court perform physical inventories periodically to further ensure the accuracy and completeness of capital asset schedules.

County Judge/Executive's response: Recommendation accepted.

The county's administrative code does not address commuting mileage or the personal use of a county vehicle. Fiscal court employees' personal use (e.g. commuting mileage) of a vehicle, or other asset owned by the fiscal court is not being reported as compensation to the employees. The fiscal court's administrative code does not address the use of a vehicles and other asset owned by the fiscal court, therefore, it is unclear as to whether personal use of the vehicles and other assets is authorized by the fiscal court. This is a repeat finding and was included in the prior year audit report as Finding 2015-002. The fiscal court understands the recommendation, but as of June 30, 2016 has not been able to implement the recommendation. Personal use of public resources is permitted if the fiscal court has approved such use and should be reported as compensation to employees. Historically, the fiscal court has not maintained the appropriate documentation or complied with Internal Revenue Code Section 61(a). Internal Revenue Code Section 61(a) states that the commuting value of a vehicle owned or leased by a public entity represents taxable income to the employee. The fiscal court's administrative code should address the use of vehicles and other assets owned by the fiscal court.

We recommend the fiscal court establish internal controls over vehicles by implementing the following:

- Report personal use and commuting mileage for vehicles as compensation/employee benefit on W-2 wage and tax statements in accordance with IRS regulations. Several methods can be used to determine the vehicle use that is taxable income to the employees, including the cents-per-mile rule, the lease value rule, and the commuting rule.
- Every employee and every department that has vehicles should maintain vehicle logs. The logs should include, at a minimum, the date, destination, purpose, and mileage for all use of the vehicle.
- The fiscal court should amend the current administrative code to include a policy on the authorization and use of vehicles (and other assets) owned by the fiscal court. In addition, it should address the tax implications of using a vehicle for personal use or commuting travel.

County Judge/Executive's response: Will address with fiscal court.

The fiscal court did not prepare a schedule of expenditures of federal awards. The fiscal court did not timely prepare a SEFA for the fiscal year ended June 30, 2016. Historically, the fiscal court has not timely prepared the SEFA. This is a repeat finding and was included in the prior year audit report as Finding 2015-003.

The fiscal court's small accounting department makes it difficult for all requirements of the accounting department to be performed timely. By not timely preparing a SEFA, the fiscal court creates the risk of a single audit not being performed, if needed, which could affect the fiscal court's ability to receive federal funding.

The fiscal court is required to prepare a Schedule of Expenditures of Federal Awards (SEFA) for each fiscal year in order to determine whether an audit in accordance with the provisions of the Single Audit Act, Subpart F of Title 2 U.S. CFR Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, and the U.S. Office of Management and Budget's (OMB) Compliance Supplement is required.

The fiscal court should timely prepare a SEFA. At a minimum, the SEFA should include the following, if applicable:

- A listing of individual federal programs by federal agency.
- For federal awards received as a subrecipient, the name of the pass-through entity and identifying number assigned by the pass-through entity.
- Total federal awards expended for each individual federal program and the Catalogue of Federal Domestic Assistance (CFDA) number or other identifying number when the CFDA information is not available.
- Total amount provided to subrecipients from each federal program.
- The value of the federal awards expended in the form of non-cash assistance, the amount of insurance in effect during the year, and loans or loan guarantees outstanding at year-end.
- Notes that describe the significant accounting policies used in preparing the SEFA.

County Judge/Executive's response: Will abide by recommendation and improve timeliness.

The fiscal court lacks adequate segregation of duties over payroll. This is a repeat finding and was included in the prior year audit report as Finding 2015-005. We noted inadequate segregation of duties for payroll. The treasurer is responsible for maintaining timesheets, entering payroll information into the computer system for processing, posting to the payroll ledgers, transferring funds to the revolving payroll account, administering health reimbursement and flex spending programs, preparing pay checks, preparing state and local withholding reports, and reconciling the payroll account. By delegating all these duties to the same individual, the risk of undetected fraud and errors will occur increases. The fiscal court has a small accounting/payroll department and segregation of duties has been challenging to achieve.

Segregation of duties is an essential element of sustainable risk management and internal controls. The principle of segregation of duties is based on shared responsibilities of a key process that disperses the critical functions of that process to more than one person or

department. A strong internal control system does not allow one person to perform processing, documentation, and reporting functions.

We recommend the fiscal court find ways to segregate key duties related to payroll or implement other controls to compensate for these weaknesses (for example, designating an individual to review the payroll ledgers, reconciliations, and reports, and requiring the individual to document their review by initialing the documents that were reviewed).

County Judge/Executive's response: Changes were made after the FY2015 audit. The Deputy Judge reviews and signs time sheets, Finance Officer post[s] to ledger and secretary reviews checks.

The fiscal court does not have adequate internal controls over gravel inventory. This is a repeat finding and was included in the prior year audit report as Finding 2015-006. The fiscal court does not have adequate internal controls over gravel purchased and stored at the Road Department. Review of the controls over gravel revealed the fiscal court maintains a log for gravel transported out to county roads, however, the log is not updated consistently. In addition, the log does not track the gravel hauled to the Road Department from the rock quarry. During our procedures relating to expenditures, we noted gravel purchases for fiscal year 2016 were \$72,841.

The fiscal court understands the recommendation, but as of June 30, 2016, has not been able to implement the recommendation. The fiscal court's lack of internal controls has created an opportunity for misappropriation of the assets to occur or for errors in the value of the gravel inventory to remain undetected in the financial statements.

The fiscal court should have appropriate controls over gravel inventory in order to prevent errors within the financial statements, and also protect the fiscal court against theft of gravel inventory.

We recommend the fiscal court maintain a log that tracks the gravel being hauled to the Road Department and also tracks the gravel hauled from the Road Department. This would allow an estimate of the gravel on hand to be calculated and costed. The gravel inventory should be periodically counted to determine if a shortage exists.

County Judge/Executive's response: Recommendation accepted.

The fiscal court does not have adequate controls over health reimbursement accounts and flexible spending accounts. This is a repeat finding and was included in the prior year audit report as Finding 2015-007. The fiscal court does not adequately track health reimbursement account and flexible spending account contributions. The amounts contributed to these accounts are not maintained separately from regular fiscal court funds and payroll funds, and cannot be easily identified in the accounting records. These monies do not belong to the fiscal court and good internal controls require that these monies be maintained and tracked separately in the accounting system.

The fiscal court understands the recommendation, but as of June 30, 2016, has not been able to implement the recommendation. During Fiscal Year 2017, the fiscal court opened a separate bank account in order to track and identify health reimbursement and flexible spending accounts for all employees who participate in the program. Failure to track these accounts separately increases the risk that the monies could be misappropriated.

The fiscal court should properly track all expenditures and should not comingle assets of the fiscal court with assets owned by third parties. We recommend the fiscal court opened a separate bank account in order to track and identify health reimbursement and flexible spending accounts for all employees who participate in the program.

County Judge/Executive's response: A new bank account was opened for the flex spending account as we said would be after the June 30, 2013 audit.

The fiscal court does not have adequate controls over notes receivable. This is a repeat finding and was included in the prior year financial statements as Finding 2015-008. The fiscal court does not have proper oversight and controls over notes receivable. In August 2008, the fiscal court loaned the Magoffin County Water District \$20,000 for a water project. The water district has not made any payments to date, and the entire amount is still outstanding. In September 2011, the fiscal court loaned \$50,000 to the Magoffin County Water District, who then loaned the money to the Salyersville Water District for water projects. The fiscal court minutes indicate this was a loan, but it has not been repaid.

The fiscal court understands the recommendation, but as of June 30, 2016, has not been able to implement the recommendation. Failure to follow up on notes receivable, a lack of payment plans, and having notes receivable outstanding for significant time periods deprives the fiscal court of needed funds.

To ensure that the fiscal court's assets are properly safeguarded and the fiscal court has the appropriate remedies available for lack of payment of receivables, the fiscal court should ensure that internal controls and agreements related to receivables are properly maintained. We recommend the fiscal court review the terms of all notes receivable to determine if the fiscal court will pursue collection or alternate disposition (i.e. loan forgiveness) and document those decisions in the fiscal court minutes.

County Judge/Executive's response: With respect to the \$50,000 given to the City of Salyersville, the Fiscal Court will review the terms of the loan. The loan to Magoffin County Water District was forgiven.

The fiscal court does not have adequate oversight of monthly reconciliation processes. This finding was included in the prior year financial statements as Finding 2015-009. The Finance Officer's appropriation ledger is not reconciled on a monthly basis. Historically, this reconciliation has not been performed. The fiscal court has a small accounting department and performing all required reconciliations on a timely basis has been challenging to achieve. Errors that would be identified by performing this reconciliation may remain undetected in the financial statements. The DLG manual requires that the Finance Officer's appropriation ledger is

reconciled on a monthly basis with the Treasurer’s information. We recommend that the Treasurer and Finance Officer’s appropriation ledgers are reconciled on a monthly basis.

County Judge/Executive’s response: Recommendation accepted.

The fiscal court did not consistently utilize the purchase order system. The fiscal court is not consistently utilizing the purchase order system in accordance with the DLG guidelines. Purchases for certain services, such as election expenses, pest control, landscaping and routine maintenance did not have purchase orders. The fiscal court has a small accounting department and preparing purchase orders for all purchases is challenging to achieve. Failure to maintain appropriate records for purchase orders could result in incorrect amounts being paid or not having adequate funds or sufficient budget appropriation available.

The DLG Budget Manual states “purchases shall not be made prior to approval by the county judge/executive (or designee) or department head.” The DLG guidelines require that the fiscal court issue purchase orders for all purchases.

We recommend that the fiscal court require purchase orders be obtained prior to items being ordered or services received to determine adequate funds and budget appropriations are available for the purchase. Purchase orders should be completely filled out at the time of issuance. Additionally, we recommend that the fiscal court properly utilize the purchase order system in order to comply with the DLG Budget Manual requirements.

County Judge/Executive’s response: Recommendation accepted.

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

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