Auditor of Public Accounts
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FOR IMMEDIATE RELEASE

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Harmon Releases Audit of Hickman County Fiscal Court

FRANKFORT, Ky. – State Auditor Mike Harmon has released the audit of the financial statement of the Hickman County Fiscal Court for the fiscal year ended June 30, 2017. 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 Hickman 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 Hickman County Fiscal Court did not require monthly bank reconciliations of the payroll revolving accounts: The former Hickman County Treasurer did not perform monthly bank reconciliations on the payroll revolving accounts during the 2017 fiscal year. She made additional transfers to these accounts directly from the general fund of $59,500 with no supporting documentation in order to cover shortages in the retirement account.

The retirement account had a negative book balance of $10,180 as of June 30, 2017, (See Finding 2017-002). Also, by not reconciling the payroll accounts it could cause potential overdraft fees to be charged, increases the risk of misappropriation of assets, and increases the risk of potential

fraud. The fiscal court did not require the county treasurer to perform monthly bank reconciliations on the payroll accounts.

Good internal controls dictate that all accounts be reconciled on a monthly basis. 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* requires officials to reconcile all accounts monthly.

We recommend that the fiscal court require monthly bank reconciliations be prepared on the payroll revolving accounts. These reconciliations should also be submitted to the fiscal court for approval along with all other reconciliations.

County Judge/Executive's Response: The Hickman County Fiscal Court is currently requiring monthly bank reconciliations be prepared on all accounts, including the payroll revolving accounts. These reconciliations will be submitted to the fiscal court monthly for approval along with all other reconciliations.

The Hickman County Fiscal Court did not report proper amount of employer's share of retirement: The former county treasurer transferred an additional $59,500 from the general fund to the retirement account in order to cover total retirement expenses. These disbursements were not supported or recorded as retirement expenses.

The former county treasurer failed to inform the service organization processing the county's payroll the correct rate for the employer's share of retirement. The employer's share of retirement was calculated at the Fiscal Year 2015 rate. Also, due a lack of internal controls over payroll, this error was allowed to continue for over two years. The former treasurer would transfer lump sums directly from the general fund to the retirement account every couple of months to cover retirement payments being paid to the state from the retirement account.

By not having sufficient controls over payroll, total payroll expenses were not calculated or recorded properly. This situation also increases the risk of misappropriation and fraud. Good internal controls dictate that procedures be in place to ensure the accuracy of payroll expenses.

We recommend the fiscal court develop internal control procedures to ensure payroll reports accurately support payroll expenses.

County Judge/Executive's Response: The Hickman County Fiscal Court has already developed internal control procedures to ensure payroll reports accurately support payroll expenses.

The Hickman County Fiscal Court did not utilize a purchase order system: The Hickman County Fiscal Court did not utilize a purchase order system. No purchase orders were issued for approval on any of the expenditures tested.

The fiscal court does not require purchase orders to be issued for goods and services received. Failure to properly issue purchase orders could result in unauthorized items being purchased. Also,

the fiscal court could expend more funds than available in the budget which would result in negative fund balances.

KRS 68.210 gives the state local finance officer the authority to prescribe a uniform system of accounts. This uniform system of accounts, as outlined in the *County Budget Preparation and State Local Finance Officer Policy Manual* requires the fiscal court implement a purchase order system. The required purchasing procedures are: (1) Purchases shall not be made prior to approval by the County Judge/Executive (or designee) or department head. (2) Purchase requests shall indicate proper appropriation account number to which the claim will be posted. (3) Purchase requests shall not be approved in an amount that exceeds the available line item appropriation unless the necessary and appropriate transfers have been made. (4) A purchase order journal (listing) should be maintained and contain a daily, chronological listing of all purchase orders issued. The listing is the book of original entry for all county purchases. The journal should indicate the PO number, appropriation account code to where the payment will be posted, vendor name, date invoice received, amount of invoice, date claim reviewed by fiscal court, date and amount paid.

KRS 68.300 states, "[a]ny 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."

The Hickman County Fiscal Court Administrative Code also requires a copy of the purchase order be attached to claims approved by the fiscal court.

We recommended the fiscal court require purchase orders be issued for all purchases of goods and services prior to items being ordered or services being rendered to determine if adequate funds and budget appropriation are available for the purchase. All purchase orders should be prepared, signed, and dated by the employee requesting the purchase. All purchase orders should contain an indication of approval by the appropriate personnel prior to the purchase. A purchase order journal should also be maintained.

County Judge/Executive's Response: The Hickman County Fiscal Court currently requires purchase orders be issued for all purchases of goods and services prior to items being ordered or services being rendered to determine if adequate funds and budget appropriations are available for the purchase. All purchase orders are prepared, signed and dated by the County Treasurer and Deputy Judge approving the expenditure prior to purchase. A purchase order journal will be maintained.

The Hickman County Fiscal Court's outstanding liability section was understated by $1,675,000: This is a repeat comment and was reported in the prior year audit report as Finding 2016-001. The county's outstanding liability section of the fourth quarter report did not accurately reflect total debt obligations. The schedule did not report outstanding debt of $595,000 for the First Mortgage Refunding Revenue Bonds, Series 2008 - Courthouse Annex and the amount reported

as outstanding for the General Obligation Refunding Bonds, Series 2010 - Detention Center was understated by $1,080,000.

This was due to errors made in the preparation of the schedule by the former treasurer, and a misunderstanding of whether the debt on the courthouse annex should be included on the county's schedule. By making these errors, the county's outstanding liabilities reported to the Department for Local Government (DLG) was materially misstated.

Strong internal controls over financial reporting are necessary to ensure financial information reported is accurate and complete. Material errors occurred that were not detected and corrected.

KRS 68.210 gives the state local finance officer the authority to prescribe a uniform system of accounts. This uniform system of accounts, as outlined in the *County Budget Preparation and State Local Finance Officer Policy Manual*, requires counties to budget and report information pertaining to all the county's outstanding debt.

We recommend the fiscal court implement internal controls to ensure the county's outstanding liabilities section is accurately reported.

County Judge/Executive's Response: The Hickman County Fiscal Court has implemented controls to ensure the county's outstanding liabilities section is accurately reported. A detail journal of all outstanding debt at year end will be reconciled to the county's outstanding liabilities section at year end.

The Hickman County Fiscal Court's schedule of capital assets did not include $225,748 in construction costs for the Rotary Park project: The fiscal court's schedule of capital assets for the period ending June, 30, 2017, was materially misstated because the fiscal court did not recognize $225,748 of construction costs on the Rotary Park that was expended throughout the year. There were also several instances that the county treasurer had to make corrections for additions and retirements of capital assets that should have been made in prior years.

The fiscal court was unaware that they should have capitalized construction in progress, and due to poor controls over capital asset reporting in prior years, adjustments were necessary to bring the capital assets list up to date. By having weak internal controls over capital assets, they were left vulnerable to misappropriation or misstatement. In this case, misstatements were able to occur without detection.

Strong internal controls over capital assets are necessary to ensure accurate financial reporting and to protect assets from misappropriation.

KRS 68.210 gives the state local finance officer the authority to prescribe a uniform system of accounts. This uniform system of accounts, as outlined in the *County Budget Preparation and State Local Finance Officer Policy Manual*, requires counties to maintain records for general fixed assets which fall into any of the following three categories (1) Real Estate, (2 Motor vehicles (including road equipment), (3) Any other fixed assets that meet the useful life criteria. Adequate fixed asset records provide the information necessary to: (1) Report the cost or other basis of

valuation, (2) Determine the accuracy of insurance coverage (3) Maintain control of county property, (4) Long range planning for property replacement. An annual physical inventory of property and equipment shall be conducted on or before June 30. Physical counts must be compared to the master asset inventory listing. Resulting differences must be reconciled, explained, and documented.

We recommend the fiscal court establish a detailed inventory system. The inventory of county assets should be updated throughout the year as new assets are acquired or old assets are retired. This system should be applied consistently in accordance with the county's capitalization policy. We also recommend the county conduct a physical inspection of the county's assets at the end of each year to make comparisons to the county's inventoried assets.

County Judge/Executive's Response: All Rotary Park construction cost have since been capitalized and all future construction cost will be capitalized as "construction in progress" until the project is complete, at which time the cost will be moved to the correct property asset account and depreciated. The fiscal court will establish a detailed inventory system, which will be updated throughout the year as new assets are acquired and old assets are retired. This system will be applied consistently in accordance with the county's capitalization policy. We will inspect the county's assets at the end of each year and make comparisons to the county's inventoried assets.

The Hickman County Jailer did not maintain proper accounting records or submit an annual financial report for the commissary fund: These issues are repeat issues and were reported in the prior year audit report as Findings 2016-002 and 2016-005. The Hickman County Jailer failed to submit an annual commissary report to the county treasurer for Fiscal Year 2017. Also, bank reconciliations and ledgers for the commissary account were not maintained for Fiscal Year 2017. Although the jail closed in October 2015, the bank account was still open and subject to minimum accounting requirements prescribed by state regulations.

The jailer did not realize an annual report or financial records should have been maintained since the jail was closed. Since accurate reports and records were not maintained, the county treasurer and the fiscal court were not made aware of the financial activity of the jail commissary fund. This also increases the risk of misappropriation of the commissary funds.

KRS 441.135(2) states, "[t]he jailer shall keep books of accounts of all receipts and disbursements from the canteen and shall annually report to the county treasurer on the canteen account."

KRS 68.210 gives the state local finance officer the authority to prescribe a uniform system of accounts. This uniform system of accounts, as outlined in the *County Budget Preparation and State Local Finance Officer Policy Manual*, requires books of original entry be maintained for receipts and expenditures of all transactions of the fiscal court.

We recommend the jailer maintain required accounting records for the commissary account until the account is closed. We also recommend that this account be closed with the balance being transferred to the jail fund.

County Judge/Executive's Response: The Hickman County Fiscal Court will ensure the commissary account is closed with the balance being transferred to the Jail Fund.

The Hickman County Fiscal Court did not report encumbrances on quarterly financial reports: The Hickman County Fiscal Court did not report encumbrances (unpaid purchase orders) on the quarterly financial reports. Auditors noted $174,083 in outstanding expenses as of the quarter ending June 30, 2017, which should have been reported. Since the fiscal court does not require purchase orders to be issued, they are unaware of the amount of encumbrances existing at the end of each quarter.

The fiscal court could exceed cash balances available in any one quarter which would lead to negative unencumbered fund balances. This would also limit the amount of funds available to spend during the next quarter.

KRS 68.210 gives the state local finance officer the authority to prescribe a uniform system of accounts. This uniform system of accounts, as outlined in the *County Budget Preparation and State Local Finance Officer Policy Manual*, requires encumbrances be reported in Section I of the quarterly financial report.

We recommend the fiscal court report all unpaid purchase orders as encumbrances at the end of each quarter. The fiscal should maintain a list of these encumbrances and should not encumber more than the available cash balance in each fund.

County Judge/Executive's Response: The Hickman County Fiscal Court currently reports all unpaid purchase orders as encumbrances at the end of each quarter. We maintain a list of these encumbrances and do not encumber more than the available cash balance in each fund.

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

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