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Harmon Releases Audit of LaRue County Fiscal Court

FRANKFORT, Ky. – State Auditor Mike Harmon has released the audit of the financial statement of the LaRue 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 LaRue 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 LaRue County Fiscal Court lacks adequate segregation of duties over receipts: This is a repeat finding and was included in the prior year audit report as Finding 2016-001. The LaRue County Treasurer prepared and deposited receipts, posted receipts to the accounting system, prepared monthly reports for the fiscal court and quarterly reports for the Department for Local Government (DLG), made cash transfers between funds and bank accounts, and performed bank reconciliations for all bank accounts. A new county treasurer was appointed on September 1, 2016. New compensating controls have been implemented to offset the lack of segregation of duties. All bank reconciliations are now reviewed and initialed by the county judge/executive. In addition, all monthly and quarterly reports and cash transfers between banks are reviewed by the

county judge/executive before approval by the fiscal court. However, there was no documentation of this review by the county judge/executive.

The LaRue County Treasurer's Office has limited staff. However, the county has implemented policies to ensure adequate segregated duties by implementing compensating controls. By implementing strong compensating controls, the county reduces the potential for undetected misappropriation of assets, errors, and inaccurate financial reporting. The lack of adequate segregation of duties and too much control by one individual could result in undetected misappropriation of assets, errors, and inaccurate financial reporting.

Good internal controls dictate adequate segregation of duties to prevent the same person from having complete control in the receiving, recording, and reporting of funds. A strong internal control structure includes adequate segregation of duties or strong compensating controls to offset the risk caused by the lack of segregation of duties. Without proper segregation or strong compensating controls, the county cannot ensure all receipts are deposited and all bank activity is appropriately documented in the accounting system.

We recommend the LaRue County Fiscal Court strengthen internal controls by segregating the duties involved in receiving, recording, reconciling, and reporting receipts. If segregation is not possible, we recommend further compensating controls, such as a receipt listing prepared by another person should be compared to the deposit ticket by the county judge/executive or other designee and the deposit ticket from the bank should be initialed to evidence this review. In addition, all monthly and quarterly reports and cash transfers between funds should be initialed by the county judge/executive after review and prior to approval by the fiscal court.

County Judge/Executive's Response: This is a comment found in many if not most audits of local government agencies. It involves having different employees handle funds and duties regarding finances. Small local government agencies, such as LaRue County, have limited staff and as a result employees often have to wear multiple "hats". This doesn't allow duties to be spread among a large group of employees resulting in the audit comment. However, beginning this Fiscal Year we have employees cross checking each other's work and responsibilities. Hopefully this will suffice in eliminating this comment in the future.

Auditor's Reply: As stated above, we recommend all compensating controls be documented.

The LaRue County Fiscal Court did not follow the Department for Local Government's guidance for reporting general obligation bond proceeds: This is a repeat finding and was included in the prior year audit report as Finding 2016-003. The county did not include all funds on the fourth quarter report, resulting in unreported general obligation bond expenditures of \$212,565 and a transfer out to the general fund of \$51,694 as of June 30, 2017. The fiscal court did not budget or include these items on the county's financial statement. Invoices were submitted to the Kentucky Association of Counties (KACo), and payments were made from this account and not included on the financial statements.

When the fiscal court does not include all county money on the financial statement, taxpayers may not be aware of all funds available for expenditure. Furthermore, if the fiscal court does not budget

the funds before expending them, they are in danger of overspending the budget and violating KRS 68.220.

KRS 68.210 gives the state local finance officer the authority to prescribe a uniform system of accounts. Guidance in the *County Budget Preparation and State Local Finance Officer Policy Manual* indicates that “[a]ll county money is to be reported on the financial statement whether it is included in the budget or not.”

KRS 68.220 requires all funds to be budgeted and states, “[t]he fiscal affairs of each county, except those pertaining to education, shall be administered by the fiscal court under a uniform budget system. The county budget shall provide for all the funds to be expended by the county from current revenue for each fiscal year. The state local finance officer shall classify the counties for budget purposes upon the basis of their populations and expenditures, or upon some other proper basis, and may classify them in the same manner for the purpose of prescribing accounts.”

The LaRue County Fiscal Court had funds totaling \$264,259 in U.S. Bank from a financing lease obligation for improvements to the courthouse. According to the Department for Local Government (DLG), these funds should be budgeted in the county’s annual budget before they are expended and included in the financial statement. By not including this information, the financial statement and notes are not providing a complete overview of the county’s available funds. We recommend the fiscal court include all funds in the county’s annual financial statement and budget.

County Judge/Executive’s Response: As I did in a prior year, I challenge and dispute this finding. All funds WERE included on the county financial statement. The funds mentioned were included in the carryforward line item. We may disagree on whether they should have been included in the carryforward line item or in another fund account. However, they did appear in the financial statement and budget. The funds mentioned were part of the original bond issue refinancing the jail and lowering the interest rate on the jail construction and for jail security improvements. However, timing became an issue and General Fund dollars were used to finish the jail security improvements and these funds lay dormant until they were then used to replenish the General Fund account. Each year the funds appeared in the carryforward line item of the budget as they were carried forward until utilized.

Auditor’s Reply: As stated, the General Obligation Bond was not budgeted in the county’s fiscal year 2017 budget or included on the fourth quarter report. The receipts and expenditures are included as an unbudgeted fund on the county’s financial statement. The county is required by the Department for Local Government to budget the activity of this fund as a separate budgeted fund of the county or budget it in an existing fund.

The LaRue County Fiscal Court lacks adequate internal controls over disbursements: This is a repeat finding and was included in the prior year audit report as Finding 2016-004. The LaRue County Fiscal Court had a deficiency in internal controls over disbursements which caused the county to not be in compliance with state budget law and KRS 68.275. The LaRue County Fiscal Court approved claims and made appropriations in excess of budgeted appropriations nine times during the fiscal year without approval of budget transfers prior to overspending. These claims were approved and paid even though the budget line item did not have sufficient budgeted free

balance. In addition, wire transfers were made for purchases even though the expenditures were not listed on the approved standing order.

The county determined that when claims were posted in the payables system by the finance officer and then uploaded to the treasurer's ledgers, adequate funds were not available for many line items causing overpayments. The county treasurer would transfer within the fund to eliminate all line items that were over budget by year-end. The county now has steps in place to make sure adequate funds are available before claims are posted. For Fiscal Year 2015 there were 283, Fiscal Year 2016 there were 31, and for Fiscal Year 2017 there were only nine instances of line items expenditures being over budget. Strong internal controls over disbursements are important to ensure the budget is not overspent. In addition, wire transfers for payments of equipment purchased online was the only means of payment acceptable. The purchases were on the claims list approved by the fiscal court. The lack of internal controls increases the risk of material misstatement due to fraud and errors.

KRS 68.275(1), states, "[c]laims 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." Strong internal controls dictate that the fiscal court approve budget transfers prior to disbursing funds to prevent overspending budget line items. In addition, KRS 68.275(3), states, "[n]otwithstanding KRS 68.020(1), payment of preapproved expenses may be made by means of electronic fund transfers. . .if approved by the fiscal court in a standing order, and if the fiscal court has received the payee's prior written consent for the payment of funds by electronic funds transfer due to payee."

We recommend the fiscal court implement strong internal controls over disbursements to ensure that budget transfers be obtained prior to disbursing funds to prevent overspending budget line items and electronic fund transfers be approved in a standing order by the fiscal court.

County Judge/Executive's Response: Information has been provided by the county treasurer and finance officer. A problem was found in the way the program places a disbursement to the ledger causing an appearance of a negative balance in an account. Transfers were always done to fill the account needs. We have reduced this problem over time with the number of account balance issues dropping from nearly 300 to 31 to 9 during the current audit period. We feel the issue has now been eliminated.

The LaRue County Fiscal Court did not follow proper procedures for disbursements: Auditors selected 93 disbursements that were determined to be individually significant items and/or large and unusual, and the following were noted:

- 70 disbursements did not include a purchase order.
- Two invoices were not paid within 30 days of the receipt.

The invoice is after the work is done. The purchase order is what authorizes the county to make the purchase. Purchase orders should be the first step in the expenditure process. It ensures they have budget and funds available to complete the project. Invoices should be paid within 30 days

from stamped date received. The county indicated that purchase orders were not required for road bid contracts and service contracts and the two invoices that were not paid within 30 days were for road repairs that the state had not reimbursed the county for. A written purchase policy stating when purchase orders are required or not required was not available. Work should not be completed unless funds are available to complete the project. Insufficient records and management oversight resulted in noncompliance with state regulations over disbursements. The Department for Local Government (DLG) required purchase procedures were not followed which increases the risk of material misstatement due to fraud and errors. Noncompliance with KRS 65.140 could result in penalties and interest being assessed to the county.

DLG's *County Budget Preparation and State Local Finance Officer Policy Manual* includes purchase procedures and guidelines for counties as prescribed by the state local finance officer. The guidelines include:

1. Purchases shall not be made without approval by the judge/executive (or designee), and/or a department head.
2. Purchase requests shall indicate the 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. Each department head issuing purchase requests shall keep an updated appropriation ledger and/or create a system of communication between the department head and the judge/executive or designee who is responsible for maintaining an updated, comprehensive appropriation ledger for the county.

Any county may opt to retain their current purchase order system provided that the guidelines above are met.

KRS 65.140(2) states, “[u]nless 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.” KRS 65.140(3) states, “[a]n 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.”

We recommend the county follow required purchase order procedures and that invoices be paid timely within 30 days per KRS 65.140.

County Judge/Executive's Response: Information has been provided by the county treasurer and finance officer. The disbursements noted by the auditor involved contracted services or work performed by the county. Every contract must be approved by the fiscal court prior to any work being performed. The contract details the work or service to be done and the amount to be paid for that work or service. LaRue Fiscal Court has never, in its history, issued a Purchase Order for contracted services. As required by statute, a contract would not be presented to Fiscal Court for

approval without sufficient funds available to fulfill the contract. A Purchase Order being issued for a contracted service is redundant as the purpose of the PO is to validate sufficient funds available. The comment comes from the Dept. for Local Government and it stating that Purchase Orders should be issued to authorize any purchase, which is exactly what the approval of a contract does. Its double work required for a short staffed office trying to work as efficiently as possible. As stated earlier, LaRue Fiscal Court has never issued a Purchase Order for work done under a contract for work or services.

Regarding the two invoices not being paid within 30 days, we dispute this comment as the auditor ONLY uses a portion of KRS 65.140(2) for justification of the comment. The auditor fails to utilize 65.140(2) which states: "Unless the purchaser and vendor otherwise contract, all bills for goods or services shall be paid within 30 working days....". The two invoices noted were for bid and contracted paving done on county roads. The nature of the work being done under a contract eliminates the need for the 30 working day limit. Payment for the contracted work exceeded 30 days due to the Transportation Cabinet changing it payment and reimbursement policy, not because of actions on the part of LaRue County.

Auditor's Reply: Approval of contracts by the fiscal court does not remove the requirement to utilize a purchase order system for the approval of the related expenditures. Additionally, the finding cited the relevant portion of KRS 65.140, as no evidence was identified or communicated indicating the contract between the county and the vendor permitted payments to exceed 30 days.

The LaRue County jail commissary fund lacks adequate segregation of duties: This is a repeat finding and was included in the prior year audit report as Finding 2016-006. A lack of segregation of duties exists over all jail commissary fund accounting functions with no management supervision or oversight. The bookkeeper receives the mail, prepares and deposits receipts, posts to computer accounting software, receives invoices, and writes checks without management review. The jailer and jail personnel lack understanding of the financial information provided through the accounting system from an external source. If one employee is solely responsible for the receipt, disbursement, reconciling process, and reporting, the risk of misappropriation of assets and inaccurate financial reporting increases. Adequate segregation of duties would prevent the same person from having a significant role in the receiving process, recording, and reporting of receipts and disbursements.

The jailer should strengthen internal controls by either segregating duties or by implementing and documenting compensating controls. Good internal controls dictate adequate segregation of duties to prevent the same person from having complete control in the receiving, recording, and reporting of funds. A strong internal control structure includes adequate segregation of duties or strong compensating controls to offset the risk caused by the lack of segregation of duties. Without proper segregation or strong compensating controls, the jailer cannot ensure all receipts and disbursements are properly recorded and accounted for.

We recommend the jailer separate the duties in preparing and depositing receipts, recording transactions, preparing checks, and reconciling bank accounts. If these duties cannot be segregated due to limited number of staff or budget, strong oversight should be provided over the employee responsible for these duties. Any compensating controls performed should be documented.

Jailer's Response: The official did not provide a response.

The LaRue County Jailer did not properly oversee the jail commissary fund: Deposits are not made intact daily as required. There were less than three deposits made for most months. Computer reports for checkouts were not detailed by source. Money is on hand for long periods of time without being deposited. Disbursements were not paid timely. Invoices submitted for payments to the county were over 30 days past due. Accounting records were not up to date. Jail personnel were not knowledgeable about accounting software reports. Bank statements were not reconciled on a monthly basis. The lack of management oversight, supervision, and review caused deficiencies in the jail commissary fund for accounting and reporting. There are no compensating controls in place. Failure to maintain accurate records can result in inaccurate information as to funds available for use or benefit of the inmates. Good internal controls dictate that adequate reporting be maintained for all receipts and disbursements.

KRS 441.135 requires the jailer to maintain records of receipts and disbursements of the jail commissary fund. In addition, 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* provides guidelines for the jail commissary fund.

In accordance with these guidelines, the jailer should maintain the following records:

- Daily checkout sheets should include a category for all funds collected to be posted to the jail commissary receipts journal.
- Jail commissary receipts journal should agree to the daily checkout sheets and include a category for all funds collected.
- Jail commissary disbursements journal should include every check written. Each check written should be posted to the proper category.

We recommend the jailer oversee the jail commissary fund and comply with the applicable statutes by maintaining required records. Furthermore, we recommend the jailer implement internal controls to ensure deposits are made timely, invoices are paid within 30 days, and bank accounts are properly reconciled to ensure accurate financial reporting.

Jailer's Response: The official did not provide a response.

The LaRue County Jailer did not present the jail commissary fund's annual financial statement to the county treasurer as required: The annual report of the jail commissary fund was not provided to the county treasurer at fiscal year-end. The lack of management oversight, supervision, and review caused deficiencies in the jail commissary fund for accounting and reporting. The jailer prepared a cash flow summary report, however the report did not accurately reflect the sources of receipts as required. It reflects only the deposits made as an account line item "cash on hand."

Failing to maintain accurate records can result in inaccurate information as to funds available for use for benefit of the inmates. Good internal controls dictate that adequate reporting be maintained for all receipts and disbursements.

KRS 441.135 requires the jailer to maintain records of receipts and disbursements of the jail commissary fund and to prepare a report annually for the county treasurer.

We recommend the jailer comply with the applicable statute by preparing and submitting an accurate annual commissary report to the county treasurer at year-end that includes all receipts and disbursements and reconciles to the receipts ledger and disbursements ledger.

Jailer's Response: The official did not provide a response.

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

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