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Harmon Releases Audit of Letcher County Fiscal Court

FRANKFORT, Ky. – State Auditor Mike Harmon has released the audit of the financial statement of the Letcher 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 Letcher 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 Letcher County Fiscal Court did not pay state income tax withholdings timely resulting in penalties and interest payments of \$7,078: The Letcher County Fiscal Court is withholding state income taxes on employees; however, they did not pay the withholdings timely to the Kentucky Department of Revenue, and have accrued penalties and interest for late payments totaling \$7,078 for Fiscal Year 2017. The following late payments were noted for state income tax:

- September 2016 state income tax withholdings paid on December 8, 2016, incurring penalties and interest of \$309

- October 2016 state income tax withholdings paid during December 2016, incurring penalties and interest of \$293
- February 2017 state income tax withholdings paid on July 31, 2017, incurring penalties and interest of \$716
- March 2017 state income tax withholdings paid on September 21, 2017, incurring penalties and interest of \$1,838
- April 2017 state income tax withholdings paid on September 21, 2017 and September 25, 2017, incurring penalties and interest of \$1,561
- May 2017 state income tax withholdings paid on September 25, 2017, incurring penalties and interest of \$1,138
- June 2017 state income tax withholdings paid on September 25, 2017, incurring penalties and interest of \$1,123
- Charge for late submission of 2017 W-2s on February 7, 2018, totaling \$100

It was also noted, based upon confirmation received from the Kentucky Department of Revenue that the fiscal court had subsequently paid \$4,067 for late payments of state income tax withholdings for Fiscal Year 2018.

The fiscal court finance officer had not completed state tax returns for February 2017 through June 2017. The county judge/executive said that the money was available in the payroll account to make these payments.

The payroll clerk had generated liability checks totaling \$32,144 for state income tax withholdings for this period, but the checks were never received by the Kentucky Department of Revenue, resulting in penalties and interest of \$7,078.

103 KAR 18:010 provides that “[e]very employer incorporated in Kentucky, qualified to do business in Kentucky, doing business in Kentucky, or subject to the jurisdiction of Kentucky in any manner, and making payment of wages subject to withholding shall deduct, withhold, and pay to the department the tax required to be withheld.” And the Kentucky Department of Revenue’s Withholding Kentucky Income Tax Instructions for Employers (May 2015) states “[e]mployers withholding \$2,000-\$49,999 Kentucky income tax a year must file and pay on a monthly basis.”

KRS 141.330(4) states, “[i]f the employer withholds but fails to pay the amounts withheld to the department, the lien shall accrue as of the date the amounts withheld were required to be paid to the department. If the employer fails to withhold, the lien shall accrue at the time the liability of the employer becomes fixed.”

We recommend the Letcher County Fiscal Court contact the Kentucky Department of Revenue to determine the actual amount due, with penalties and interest assessed, for the February 2017 state income tax payment of \$3,771. We also recommend controls be established to ensure withholdings are paid timely. This control could be as simple as comparing the payroll summary to actual payments made to the entity on the bank reconciliation and documenting the review by signatures or initials on the summary or bank statement.

County Judge/Executive's Response: The county has requested that these penalties be evaluated and consideration given for a refund. The county has a new payroll clerk. Controls have been changed to timely file tax payments.

The Letcher County Fiscal Court did not include all county funds on the fourth quarter financial report: The Letcher County Fiscal Court's fourth quarter financial report did not include all of the county's accounts. Two checking accounts were not included in the county's year-end financial report. These accounts are used to accumulate funds for future debt payments and also to process receipts from the Commonwealth of Kentucky for debt payments. Material adjustments were made to the beginning balances for the current year financial statement for the general fund, appropriations for the general fund, and receipts for the general fund:

- \$244,686 increase in beginning cash balance for balance in the general fund.
- \$260,720 decrease in debt service appropriations in the general fund.
- \$152,259 decrease in receipts for the general fund.

The fourth quarter financial report did not include the activity in the debt service account and the depreciation account because the Letcher County Treasurer failed to include them on financial reports. In addition, the fiscal court failed to realize these accounts were not included on the fourth quarter report. Failure to record the activity in these accounts on the fourth quarter financial report resulted in a materially inaccurate financial statements.

KRS 68.020(4) requires the county treasurer to "keep an accurate detailed account of all money received and disbursed by him for the county, and shall keep books of accounts of the financial transactions of the county in the manner required by the uniform system of accounting prescribed by the state local finance officer." Additionally, the Department for Local Government's *County Budget Preparation and State Local Finance Officer Policy Manual* states, "[a]ll county money is to be reported on the financial statement whether it is included in the budget or not."

We recommend the Letcher County Treasurer include all financial activity of the Letcher County Fiscal Court on the fourth quarter financial report.

County Judge/Executive's Response: The Letcher County Courthouse was remodeled in 1998. Financing was secured through USDA. USDA required that enough money be kept in an account to make one payment and also that the general fund make a monthly payment to a depreciation reserve account in the amount of \$2,560 to aid in making those semi-annual payments to USDA. The county has continued to hold these funds in accounts separate from the general fund to meet those requirements. The county will add those funds to the general fund for reporting purposes on our quarterly report.

The Letcher County Fiscal Court did not have sufficient controls over the payroll process: The Letcher County Fiscal Court did not establish sufficient controls over the processing of payroll and payroll liabilities. The lack of internal controls over payroll resulted in the following deficiencies:

- Two employees' compensatory time earned over 40 hours worked for the week was calculated incorrectly per the county's personnel policy by including holiday time in the calculation, resulting in the employee being given credit for more compensatory time than he had actually earned for the work week.
- Of 16 employees tested, one timecard was not complete for the pay period, two timecards did not have an employee and supervisor signature, and three timecards did not have a supervisor signature.
- Employee state income tax withholdings were not paid timely resulting in penalties and interest paid totaling \$7,078 for Fiscal Year 2017. See Finding 2017-001.
- The payroll account had a deficit of \$6,711 as of June 30, 2017, as a result of penalties and interest paid to the Kentucky Department of Revenue for late payments of employee state income tax withholdings.
- Occupational tax had not been withheld from one employee's wages

Weak internal controls failed to prevent or detect these issues with the payroll process.

The lack of sufficient controls over payroll allowed employees accumulated compensatory time to be incorrect by including days off for holidays with hours worked in the calculation of compensatory time. Without oversight, supervisors may not be aware of the time charged by the employees. Additionally, the county was not in compliance with certain Kentucky Revised Statutes (KRS).

Good internal controls are essential to ensure that all timecards are complete with time worked and signed by employee and supervisor, compensatory time is calculated correctly, and state income tax liabilities are paid timely.

Letcher County's Personnel Policy states, "(5) [o]ther employees, such as clerical and manual workers, who are not exempt for the overtime provisions of the federal Fair Labor Standards Act, 29 U.S.C., section 207, may be granted compensatory leave at a rate of one and one half hours for each hour worked in excess of forty hours in a work week."

KRS 337.285(1) states, "[n]o employer shall employ any of his employees for a work week longer than forty (40) hours, unless such employee receives compensation for his employment in excess of forty (40) hours in a work week at a rate of not less than one and one-half (1-1/2) times the hourly wage rate at which he is employed."

KRS 141.330(4) states, "[i]f the employer withholds but fails to pay the amounts withheld to the department, the lien shall accrue as of the date the amounts withheld were required to be paid to the department. If the employer fails to withhold, the lien shall accrue at the time the liability of the employer becomes fixed."

103 KAR 18:010 states, "[e]very employer incorporated in Kentucky, qualified to do business in Kentucky, doing business in Kentucky, or subject to the jurisdiction of Kentucky in any manner, and making payment of wages subject to withholding shall deduct, withhold, and pay to the department the tax required to be withheld." And the Kentucky Department of Revenue's

Withholding Kentucky Income Tax Instructions for Employers (May 2015) states, “[e]mployers withholding \$2,000-\$49,999 Kentucky income tax a year must file and pay on a monthly basis.”

The City of Whitesburg Occupational Payroll Tax Ordinance Section 3(1) states, “[t]he occupational payroll tax shall be measured by 1.5% of all wages and compensation paid or payable in the City for work done or services performed or rendered in the City by every resident and nonresident who is an employee[.]” Section 5(3) states, “[e]very employer who fails to withhold or pay to the City any sums required by this Ordinance to be withheld and paid shall be personally and individually liable to the city for any sum or sums withheld or required to be withheld in accordance with the provisions of this section.”

We recommend the fiscal court implement procedures to ensure that timesheets are maintained and properly documented with approval by the supervisor. We also recommend compensatory time is calculated in accordance with the personnel policy and occupational tax is withheld in accordance to the City of Whitesburg Occupation Payroll Tax Ordinance. Furthermore, the fiscal court should establish procedures to ensure all payroll liabilities for state income tax withholdings are submitted timely in accordance with 103 KAR 18:010 and KRS 141.330(4).

County Judge/Executive’s Response: The county has a new payroll clerk. Controls have been corrected and improved.

The Letcher County Jail commissary lacks segregation of duties over receipts, disbursements, and bank reconciliations: The Letcher County Jailer’s duties include posting receipts, preparing and posting disbursements, and completing the bank reconciliation. When one employee is responsible for the receipt, disbursement, and reconciliation process, the risk of misappropriation of assets, errors, and inaccurate financial reporting increases.

According to the jailer, the limited number of jail employees prevents a proper segregation of duties. This could result in undetected misappropriation of assets and incorrect reporting.

Effective internal controls require proper segregation of duties over accounting functions, such as making deposits, preparing disbursements, and reconciling the bank account. Segregation of duties, or the implementation of compensating controls, is essential for providing protection to employees in the normal course of performing their daily responsibilities.

We recommend the jailer segregate duties over receipts, disbursements, and the bank reconciliation process. If segregation of duties is not possible, then the jailer should implement compensating controls and maintain evidence of compensating controls.

County Judge/Executive’s Response: Please refer to Jailer’s response given to auditors.

County Jailer’s Response: Due to lack of additional funding to hire more staff to enable duty segregation, we must continue to segregate as we are now.

The Letcher County Fiscal Court exceeded the line item budget: In September 2016, the Letcher County Fiscal Court refinanced a portion of their 2011 lease agreement with the Kentucky

Association of Counties Leasing Trust (KACoLT) for the Letcher County Recreation Center to reduce total debt payments over the life of the lease. The amount refinanced was \$6,030,000, and was not included in the Letcher County Fiscal Court budget for the Local Government Economic Assistance Fund (LGEA) as lease proceeds and debt payment. As a result, the Letcher County Fiscal Court Fourth Quarter Financial Report, for the LGEA fund exceeded the debt service line item budget by \$5,999,649.

The county was unaware that the refinanced portion of the 2011 lease agreement had to be treated as a debt payment; therefore, they did not include the debt payment or lease proceeds of \$6,030,000, which caused the line item to exceed the amount budgeted for debt payments by \$5,999,649.

Failing to properly budget or amend line items as necessary resulted in non-compliance with applicable statutes and the quarterly report was materially misstated by \$6,030,000.

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.”

We recommend the Letcher County Fiscal Court ensure all line items are properly budgeted or prepare budget amendments if necessary.

County Judge/Executive’s Response: The county was not aware that we should have amended into the budget the portion of the recreation center debt that was refinanced by Kentucky Association of Counties. We will amend that amount so it will be reflected on our quarterly reports.

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

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