



Auditor of Public Accounts
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FOR IMMEDIATE RELEASE

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Harmon Releases Audit of Breathitt County Fiscal Court

FRANKFORT, Ky. – State Auditor Mike Harmon has released the audit of the financial statement of the Breathitt 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 Breathitt 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 fiscal court did not follow proper procedures for year-end budget amendments: The fiscal court used an emergency budget amendment in June 2017 to amend the budget for unanticipated revenues and expenditures at year-end to ensure the budget was not overspent. In order to approve an emergency amendment, an order must be in place naming and describing the emergency. We could not find documentation of this action.

The fiscal court was aware that emergency budget amendments must follow the guidelines set forth in KRS 67.078, but failed to follow and document the proper procedures. The county’s budget was not amended properly and the county is in violation of KRS 67.078 and KRS 68.280.

KRS 68.210 gives the state local finance officer the authority to prescribe a uniform system of accounts. The uniform system of accounts is set forth in the *County Budget and State Local Finance Officer Policy Manual* and requires any amendments to a county budget submitted to the state local finance officer on an emergency basis must strictly adhere to the provision of KRS 67.078 and a photocopy of the fiscal court order naming and describing the emergency must accompany the budget amendment submitted for approval pursuant to KRS 68.280.

KRS 67.078(2) states, “[a] majority of the fiscal court may declare an emergency to exist by naming and describing the emergency, and thereafter may adopt a county ordinance to address that emergency[.]” KRS 68.280 states, “[t]he fiscal court may make provision for the expenditure of receipts unanticipated in the original budget by preparing an amendment to the budget, showing the source and amount of the unanticipated receipts and specifying the budget funds that are to be increased thereby. The amendment shall be submitted to the state local finance officer subject to the same provisions as the original budget.”

We recommend the fiscal court adhere to the provisions of KRS 67.078 and KRS 68.280 and use emergency budget amendments only in the appropriate circumstances and maintain proper supporting documentation of this action.

County Judge/Executive’s Response: Effective 9-6-18 any emergency amendment there will be a detailed summary in the court minutes why it is an emergency.

The fiscal court lacks adequate segregation of duties for occupational tax collections: During our review of internal control procedures, we noted the fiscal court lacks adequate segregation of duties for occupational tax collections. Occupational tax receipts account for 39.5 percent of general fund receipts (the single biggest source of revenues for the general fund).

The fiscal court has failed to adequately assess risk associated with occupational tax collections and has not adequately segregated the duties of occupational tax collections. One individual is responsible for receiving, depositing, and recording all occupational tax receipts, net profits tax receipts, and license fee receipts. The occupational tax administrator has a separate post office box to which all occupational taxes are mailed. This individual processes and records all transactions in the occupational tax ledger, prepares all deposit tickets, and makes the deposit at the bank. The treasurer is given a copy of the deposit ticket to post to the general ledger.

By delegating all of these functions to one individual, there is an increased risk that undetected material misstatements and fraud will occur, especially considering occupational taxes comprise such a large portion of general fund revenues.

In order for internal controls to be effective in preventing and detecting errors, misstatements, and fraud, the functions of any significant area should be separated. If segregation is not possible or practical, the fiscal court could implement and document compensating controls to reduce the risk associated with inadequate segregation of duties. Strong compensating control could include review of deposit tickets, tax returns, and occupational tax ledger by someone independent of occupational tax collections. This could be documented by initialing all supporting documentation after the review is complete.

We recommend the fiscal court separate the functions of receiving, depositing, and recording occupational tax revenues or implement and document compensating controls to offset the risk noted.

County Judge/Executive's Response: Judge's Secretary will start getting checks out of mailbox and she will receipt all checks then occupational tax admin. will record checks for deposit and then county treasurer will take deposit to the bank. Effective today this procedure will begin.

State payments were not deposited timely: The fiscal court did not deposit four state payments totaling \$196,470 timely. These checks were dated mid-to-late June 2016 but were not recorded and deposited until July 13 and 14, which resulted in a delay of three to four weeks. Due to an oversight, these payments were not deposited timely. The fiscal court has not established adequate internal control procedures over timely deposits of state payments. Inadequate controls over deposits increase the risk that undetected fraud, errors, and misstatements will occur. A delay in deposits also increases the risk that the funds will be lost, stolen, or otherwise misappropriated. Good internal controls require all payments be deposited timely. We recommend the treasurer ensure all payments are deposited timely. The fiscal court and county judge/executive should strengthen internal controls to ensure deposits are made timely and sufficient oversight and effective supervisory review should be implemented.

County Judge/Executive's Response: All checks are received in front office by Secretary and recorded when mail is received. At the exit conference I was told about this. I am not sure which checks totaled this amount. I will try to get all checks deposited in as soon as they get to me.

The fiscal court did not establish adequate controls over the general obligation bond fund and the justice center corporation fund: The fiscal court did not maintain adequate controls over the general obligation bond fund or the justice center corporation fund. No financial statements were prepared for these funds and no information regarding the activity in these funds was submitted to the fiscal court for review. The treasurer was unaware she had to prepare a financial statement for the general obligation bond fund and the justice center corporation fund. These funds are for reporting of debt financing for the fiscal court and are not included on the quarterly report, per Department for Local Government guidelines.

By not preparing an annual financial statement, the fiscal court is not aware of the transactions that are occurring relating to the receipts and disbursements of the unbudgeted funds. This could result in undetected fraud, errors, or misstatements. The fiscal court is financially accountable and legally obligated for the debt of the general obligation bond fund and the justice center corporation fund. The fiscal court should establish adequate controls over these funds so that proper records are maintained and complete and accurate information is available for review. We recommend the county treasurer reconcile these accounts and prepare a financial statement for the general obligation bond fund and the justice center corporation fund.

County Judge/Executive's Response: I will call the Administrator of AOC to verify the balance on the funds.

The Breathitt County Fiscal Court did not maintain an adequate list for purchase orders:

The fiscal court's listing of purchase orders does not include the amount (or estimated amount) of each purchase. The date, vendor, and fund are listed. The finance officer was not aware that the amounts should be listed. Also, management oversight failed to indicate this to be a problem. The purpose of a purchase order system is to ensure the county is aware of cash balances and budget capacity at any given time. Without amounts or estimated amounts for purchase orders, it is impossible for the county to determine if there are adequate cash balances and adequate budget capacity to cover the purchases, which could lead to overspending. The amount (or estimated amount) is the single most important piece of information to include on the purchase order listing. This also prevents the county from disclosing complete and accurate encumbrance information, which impacts their ability to report complete and accurate financial information at year end.

The Department for Local Government outlines the necessary requirements of a purchase order system in the *County Budget Preparation and State Local Finance Officer Policy Manual*. These requirements include listing the amount of the claim and the appropriation code to which the claim will be posted. We recommend the county add the amounts of the purchases to the purchase order list to reduce the risk of encumbering more than the available cash balance in each fund. In addition, the account code to which the claim will be posted should be listed.

County Judge/Executive's Response: Purchase Orders will now have an approx amount once assigned to the vendor.

Occupational tax receipts were not deposited timely: The occupational tax administrator did not deposit occupational taxes timely. There were 17 instances in which the check date was more than 10 days before the deposit date, suggesting these checks had been held for a week or so before they were processed and deposited. The fiscal court has failed to establish adequate internal control procedures over timely deposits of occupational taxes. This is related to the inadequate segregation of duties issue discussed in Finding 2017-002.

Inadequate controls over deposits increase the risk that fraud, errors, and misstatements will occur and go undetected. A delay in deposits also increases the risk that the funds will be lost, stolen, or otherwise misappropriated.

Good internal controls require all payments be processed, recorded, and deposited timely, preferable the date received.

We recommend the occupational tax administrator ensure all payments are deposited timely. The fiscal court and County Judge/Executive should strengthen internal controls to ensure deposits are made timely and an effective supervisory review/oversight process needs to be implemented.

County Judge/Executive's Response: Due to segregation of duties these are now being deposited in a timely manner.

The fiscal court lacks internal controls over capital asset inventory items: The fiscal court purchased two iPads totaling \$1,523 for the former clerk to use in her office. These items cannot be located.

The fiscal court has not placed sufficient emphasis on the importance of conducting regular physical inventory counts on all assets purchased, tagging inventory items as “Property of Breathitt County Fiscal Court,” and stressing the importance that county owned property should not be used for personal use and should not be removed from the premises unless expressly permitted by management.

Not performing periodic physical inventory counts leaves inventory susceptible to loss and misappropriation. Without regular physical inventory accounts, the county’s inventory may contain undetected errors. In addition, the removal of county property from county premises increases the risk of personal use and that the item will not be properly returned.

Inventory should be documented by each department supervisor and reviewed by the county judge/executive or other senior management and clearly document each item for all assets even those under the capitalization threshold.

We recommend the county judge/executive consult with the county attorney on what actions to take in collecting the amount paid for the tablets or locating them. The county should implement an inventory list for all assets, even those under the capitalization threshold and ensure a complete inventory count is conducted for all outgoing officials.

County Judge/Executive’s Response: The 2 iPads were bought with Coal Severance funds approved for the clerk’s office. When the previous clerk left the office and an inventory of the office was done, the 2 iPads were not to be found. I reported these to the judge and I asked the current clerk to please check the clerk’s office for these two missing items.

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

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