



Auditor of Public Accounts
Mike Harmon

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, 2022. 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.

We were engaged to audit the financial activity contained in the fourth quarter financial statement, which comprises the financial statement of the Breathitt County Fiscal Court, for the year ended June 30, 2022.

We do not express an opinion on the accompanying financial activity of the Breathitt County Fiscal Court. Because of the significance of the matters described in the Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial activity.

During the audit, significant risks were identified, including failure to maintain sufficient supporting documentation and account records, not having segregation of duties, and management override of controls. Due to the county’s failure to maintain adequate accounting records, and other failures noted, we were unable to perform sufficient audit procedures to overcome the significant risks. Therefore, we cannot issue an opinion on the Breathitt County Fiscal Court’s financial statement or give reasonable assurance the financial statement is free from material error or fraud.

Finding 1 of the audit report will be referred to the Department for Local Government (DLG) for further review.

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 findings:

The Breathitt County Fiscal Court failed to implement and maintain an effective internal control environment: This is a repeat finding and was included in the prior year audit report as Finding 2021-001. During our engagement to audit, significant risks were identified, including failure to maintain sufficient supporting documentation and accounting records, lack of segregation of duties, and management override of controls. Due to the county's failure to maintain adequate accounting records, and other failures noted below, we were unable to perform sufficient audit procedures to overcome the significant risks. Therefore, we cannot issue an opinion on the Breathitt County Fiscal Court's financial statement and on compliance for each major federal program or give reasonable assurance the financial statement and the schedule of expenditures of federal awards are free from material error or fraud. A disclaimer of opinion will be issued.

In the audit procedures we were able to perform, we noted the following issues:

- Failure to maintain supporting documentation for \$938,698 of occupational tax receipts (See Finding 2022-002).
- The jail fund had a reconciled deficit balance of (\$31,874).
- Failure to maintain accounting records, including records for the justice center corporation fund and an accurate capital asset schedule.
- Failure to obtain proper approval for one of the budget amendments.
- Failure to prepare an annual settlement in accordance with KRS 68.020.
- Failure to implement proper internal controls over disbursements (See Finding 2022-003).
- Failure to implement proper internal controls over payroll disbursements (see Finding 2022-004).
- Failure to establish and maintain effective internal controls over compliance with FEMA requirements (See Finding 2022-005).

The Breathitt County Fiscal Court did not provide sufficient oversight for management's day-to-day financial activities. Without sufficient oversight, management did not follow established internal control procedures or ensure compliance with laws and regulations.

The Breathitt County Fiscal Court's current practices could create an environment for potential undetected material misstatements in the financial statements caused either by error or fraud. The noted weaknesses could affect the fiscal court's ability to ensure that financial data is recorded, processed, and reported in an accurate and reliable manner and ensure that assets are sufficiently safeguarded. If the Breathitt County Fiscal Court continues these poor financial practices and does not improve the internal control structure, taxpayer monies will continue to be at risk. In addition,

various local and state agencies that rely on and monitor the financial and program activity of the Breathitt County Fiscal Court cannot rely on, or have any confidence in, the reports submitted by the Breathitt County Fiscal Court.

Proper accounting procedures and internal controls require that financial statements be supported with accurate underlying accounting records. Strong internal controls over financial reporting are vital in ensuring the fiscal court's financial statement accurately reflects the financial activity of the fiscal court and ensures compliance with applicable state and federal laws and regulations. Additionally, complete, and accurate financial records can ensure expenditures are made only when sufficient funds are available, and receipts are properly recorded.

In addition, 2 CFR 200.303 states in part, "[t]he non-Federal entity must: (a) Establish and maintain effective internal control over the Federal award that provides reasonable assurance that the non-Federal entity is managing the Federal award in compliance with Federal statutes, regulations, and the terms and conditions of the Federal award."

We recommend the Breathitt County Fiscal Court provide sufficient management oversight of the day-to-day financial activities of the county. We further recommend the fiscal court improve its overall control environment in order to ensure sufficient accounting records are maintained to support transactions, accounts are reconciled, and bills are paid timely, and duties are adequately segregated to safeguard public assets. Only with a strong internal controls system can the fiscal court prepare and ensure that complete and accurate financial reports are produced and that the county is in compliance with each major federal program's guidelines. This finding will be referred to the Department for Local Government (DLG).

County Judge/Executive's Response: The Breathitt County Fiscal Court has hired a new County Treasurer since the completion of the 2022 audit who will ensure stronger internal controls are maintained in her official capacity and will be working with additional staff members, such as the Finance Officer and Occupational Tax Administrator, to segregate duties in a more controlled method. The newly hired County Treasurer will work to resolve the following issues by the end of the calendar year in the following manner.

- *Maintaining supporting documentation.*
- *Maintaining accurate accounting records.*
- *Obtaining proper approval for budget amendments.*
- *Failure to prepare financial statements timely -the new Treasurer will complete the annual statement in accordance with KRS 68.020 in a timely manner.*

The Breathitt County Fiscal Court did not maintain supporting documentation in the amount of \$938,698 of occupational tax receipts: Per the county's ordinance, the taxpayers are required to send in a tax return to the fiscal court which includes the amount of wages and the percentage that is due the fiscal court. However, the fiscal court did not maintain these returns. Without this supporting documentation, the amount of taxes due the fiscal court per the ordinance could not be determined.

The fiscal court failed to adequately assess risk associated with occupational tax collections and has not implemented effective internal controls, review procedures, or oversight for occupational tax collections. The Breathitt County Fiscal Court's current practices over the collections of occupational tax receipts could create an environment for undetected material misstatements in the financial statements caused either by error or fraud. The noted weaknesses could affect the fiscal court's ability to ensure that financial data is recorded, processed, and reported in an accurate and reliable manner.

Proper accounting procedures and internal controls require that financial statements be supported with accurate underlying accounting records. Strong internal controls over financial reporting are vital in ensuring the fiscal court's financial statement accurately reflects the financial activity of the fiscal court and ensures compliance with applicable laws and regulations.

We recommend the fiscal court implement effective internal controls, review procedures, and oversight for occupational tax collections and document the procedures performed that ensure recorded amounts are complete, accurate, and free of material misstatement.

County Judge/Executive's Response: The Breathitt County Fiscal Court has hired a new County Treasurer since the completion of the 2022 audit who will ensure stronger internal controls are maintained in her official capacity and will be working with additional staff members, including the Occupational Tax Administrator. Effective immediately all occupational tax receipts and tax returns will be maintained by the Fiscal Court.

The Breathitt County Fiscal Court did not implement proper internal controls over disbursements: The fiscal court did not implement adequate procedures and oversight regarding the documentation, preparation, and authorization of disbursements. The fiscal court did not follow proper procedures and requirements for disbursements of county funds. The follow deficiencies were noted during the testing of disbursements:

- A transaction paid with management's credit card did not follow normal procurement processes. During the fiscal year, a vendor that did not win the bid for the year was paid with the county judge/executive's credit card after this vendor was not awarded the bid for an invoice that was not presented to the fiscal court.
- Twenty-one transactions totaling \$776,243 did not have supporting documentation.
- Thirty-nine transactions did not have detailed support for the credit card transaction.
- Purchase orders were not issued for the 75 disbursements tested and 17 invoices tested were not paid within 30 days.
- Proper bid documentation was not properly maintained for transactions that exceeded the county's administrative code bid threshold of \$20,000.
- An encumbrance list was not maintained.

The fiscal court's failure to establish effective internal controls over disbursements resulted in numerous instances of noncompliance, negative unencumbered cash balances, and violations of the county's administrative code as reflected above. The lack of proper accounting practices, internal controls, and management oversight increases the risk of undetected misstatements and fraud.

Effective internal controls provide for adequate segregation of duties and prevent the same person from having a significant role in incompatible functions. Segregation of duties and proper oversight helps prevent fraud or misappropriation of assets and protects employees in the normal course of performing their daily responsibilities. Effective internal controls and proper oversight also help ensure compliance with state and federal laws, regulations, and grant agreements. Without these effective internal controls the procurement process could be circumvented, and disbursements could be processed outside the normal procurement process.

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 Department for Local Government's (DLG) *County Budget Preparation And State Local Finance Officer Policy Manual* which states, "[p]urchases shall not be made without approval by the judge/executive (or designee), and/or a department head...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." DLG requests that purchase orders be issued for all disbursements. In addition, good internal controls dictate that disbursements should be properly supported as evidenced by invoices and/or at a minimum evidenced by supporting documentation that supports the amount.

The version of KRS 424.260(1) in effect during the fiscal year ending June 30, 2022 stated, "[e]xcept where a statute specifically fixes a larger sum as the minimum for a requirement of advertisement for bids, no city, county, or district, or board or commission of a city or county, or sheriff or county clerk, may make a contract, lease, or other agreement for: (a) Materials; (b) Supplies, except perishable foods such as meat, poultry, fish, egg products, fresh vegetables, and fresh fruits; (c) Equipment; or (d) Contractual services other than professional; involving an expenditure of more than thirty thousand dollars (\$30,000) without first making newspaper advertisement for bids." However, according to the administrative code adopted by the county, "any expenditure or contract for materials, supplies (except perishable meat, fish, and vegetables, equipment or for contractual services other than professional, involving an expenditure of more than twenty thousand dollars (\$20,000) shall be subject to competitive bidding."

We recommend the fiscal court implement policies and procedures to ensure disbursements are in compliance with applicable statutes and regulations. Additionally, we recommend the fiscal court put into place internal controls to monitor that these policies and procedures are operating effectively.

County Judge/Executive's Response: With the hiring of the new County Treasurer the Fiscal Court is already maintaining stronger internal controls over keeping detailed support of expenditures and credit cards transactions. The Breathitt County Fiscal Court has adopted the KY Model Procurement Code and is already ensuring that proper procedures surrounding the procurement process be maintained at all times, including proper bid documentation. Encumbrance lists will be maintained moving forward. Additionally, the Fiscal Court has changed software systems & is currently in the process of setting up the new system with all records which will allow for better tracking of purchase orders moving forward.

The Breathitt County Fiscal Court did not implement proper internal controls over payroll disbursements: The fiscal court did not implement adequate procedures and oversight regarding the documentation, preparation, and authorization of payroll disbursements. The fiscal court did not follow proper procedures and requirements for payroll disbursements. The following deficiencies were noted during the testing of payroll disbursements:

- The payroll account had 21 instances of a negative daily balance with the highest negative balance during the period being \$73,468.
- Failure to perform accurate reconciliations: the payroll account was not properly reconciled and had a negative \$5,702 balance as of June 30, 2022.
- Federal and state tax obligations were not paid timely.
- The county did not approve a current year annual pay rate list.
- The county lacks controls over payroll checks. Blank payroll checks were observed in an unsecured environment.
- The treasurer received training incentive pay without supporting documentation.

The fiscal court failed to adequately assess the risk associated with payroll processing and failed to implement adequate internal controls regarding the documentation, preparation, and authorization of payroll. There were no significant review procedures in place or adequate oversight to ensure the completeness and accuracy of payroll information.

Failure to implement adequate controls over payroll increases the risk of undetected material misstatements and fraud, especially considering payroll constitutes a large portion of the county's budget. Numerous previously undetected errors were noted by the auditors for payroll processing and the fiscal court is in violation of various statutes.

In order for internal controls to be effective in preventing and detecting errors, misstatements, and fraud, the functions of any significant process 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 controls could include review of payroll reports, review of payroll payments, comparison of payroll documentation to amounts recorded, reconciliation of withholding and matching reports to supporting documentation. Further, review procedures and oversight should be exercised consistently to detect errors and to reconcile payroll to supporting documentation.

We recommend the fiscal court implement effective internal controls, review procedures, and oversight for payroll processing to ensure the completeness and accuracy of all payroll information.

County Judge/Executive's Response: With the hiring of the new County Treasurer the Fiscal Court is already maintaining stronger internal controls over payroll disbursements. Moving forward accounts will be properly reconciled and obligations met in a timely manner. Proper documentation will be maintained to support all disbursements. Annual pay rate lists will be established. Proper review procedures and oversight for payroll processing to ensure completeness and accuracy will be maintained.

The Breathitt County Fiscal Court did not establish and maintain effective internal controls over compliance with Federal Emergency Management Agency (FEMA) Requirements:

Federal Program: Assistance Listing # 97.036 Disaster Grants - Public Assistance (Presidentially Declared Disasters)

Award Number and Year: 4428 PW# 493 2019

Name of Federal Agency and Pass-Thru Agency (if applicable): U.S. Department of Homeland Security and Kentucky Emergency Management

Compliance Requirements: Activities Allowed or Unallowed; Allowable Costs/Cost Principles; Matching, Level of Effort, Earmarking; Period of Performance; Reporting; Special Tests & Provisions

Type of Finding: (Material Weakness, Noncompliance)

Amount of Questioned Costs: \$236,464

Opinion Modification (if applicable): Disclaimer

COVID Related: No

The Breathitt County fiscal court did not establish and maintain effective internal controls over compliance with Federal Emergency Management Agency (FEMA) requirements. Purchase orders were not consistently used for the approval and tracking of federal expenditures. Transactions requiring bids were not presented to the fiscal court for approval.

From the sample of 11 invoices tested there were nine instances of noncompliance and lack of controls over compliance regarding purchase orders and bid approvals.

The deficiencies listed occurred due to lack of monitoring of controls, which diminishes the effectiveness of the controls put in place over disbursements by fiscal court. These deficiencies could create errors in recording or allow for the possibility of misappropriation of assets.

Transactions were initiated without considering available line item balances and tracking with the use of a purchase order. Items requiring the bid process were not presented to the fiscal court for the approval of bids.

Proper internal controls over expenditures are important to ensure purchase orders are created with sufficient funds available, include proper supporting documentation, and are paid in a timely manner. KRS 68.210 gives the state local finance officer the authority to prescribe a uniform system of accounts. Per the *County Budget Preparation and State Local Finance Officer Policy Manual*, issued by the Department for Local Government (DLG), “[p]urchases shall not be made without approval by the judge/executive (or designee), or a department head.” In addition, according to the fiscal court’s administrative code, transactions exceeding \$20,000 are subject to the bidding process.

We recommend fiscal court design and implement proper internal controls over compliance with federal program requirements and ensure they are operating effectively.

County Judge/Executive’s Response: The Breathitt County Fiscal Court has adopted the KY Model Procurement Code, effective in August 2023. In addition the Fiscal Court hired a new Applicant

Agent in January 2023 and transitioned all FEMA related work to the in-house Applicant Agent in August of 2023 rather than contracting services through the Disaster Recovery firm the court had been working with prior to August 2023. With the hiring of the new Applicant Agent, proper bid documentation is being maintained & proper procedures are being followed for procurement of bids. The Breathitt County Fiscal Court has also changed the software used for tracking purchase orders which will allow for better tracking of both planned expenditures and already expended funds.

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

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