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Harmon Releases Audit of Estill County Fiscal Court

FRANKFORT, Ky. – State Auditor Mike Harmon has released the audit of the financial statement of the Estill County Fiscal Court for the fiscal year ended June 30, 2020. 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 Estill 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 Estill County Fiscal Court does not have adequate controls over financial accounting software program: This is a repeat finding and was included in the prior year audit report as Finding 2019-002. The fiscal court utilizes a financial accounting software program to post financial transactions. This system is shared among several employees on a computer network. The employees that have access to this system do not have unique usernames and passwords. One username and password is shared among several employees. Management failed to identify the risk associated with financial accounting data and failed to implement adequate policies and procedures to protect such data and ensure that it is complete, accurate, and free of material misstatement.

Shared usernames and passwords increase the risk that undetected fraud, errors, and misstatements will occur. Without proper controls over financial data, it is harder to determine which employees are responsible for problems that may arise. Employees are also in violation of the county's administrative code as it pertains to passwords.

The Estill County Administrative Code page 77 under "Security" states, "[p]asswords and sign on access codes shall not be shared with anyone including co-workers, family members, or other unauthorized personnel." Furthermore, strong internal controls require each employee to have a unique user name and password that is changed at regular intervals. Computer programs should have a log that lists changes to data and the person performing such changes so that an appropriate level of management can periodically review to ensure all changes are necessary and approved. Passwords should never be shared among employees and employees should be restricted to certain parts of the program they can access based on their job duties.

We recommend the fiscal court review the policies and procedures regarding computer information and implement adequate controls to ensure data is complete, accurate, and free of material misstatement.

County Judge/Executive's Response: Software program is restricted as far as can be done at this time. All passwords have been changed and each individual has their own username to access network. Currently working with IT Specialist to complete additional safeguards.

The Estill County Fiscal Court failed to implement adequate internal controls and oversight for disbursements: This is a repeat finding and was reported in the prior year audit report as Finding 2019-003. Our tests of disbursements included an examination from the county's operating funds. We noted numerous noncompliance issues:

- Four disbursements totaling \$224,080 were not paid timely (within 30 working days of receiving the invoice or bill).
- Fifteen disbursements totaling \$547,168, did not have a properly executed purchase order because the description of items being purchased was vague or incomplete, the account code listed was absent or incorrect, and the estimated amount for the purchase was not filled out until after the purchase order had been issued.

The fiscal court did not implement adequate procedures and oversight regarding the documentation, preparation, and authorization of disbursements. The county's administrative code outlines proper procedures for disbursements. The absence of significant review procedures or oversight also allowed numerous invoices to not be processed timely and this occurred without detection or knowledge of the fiscal court. Another contributing factor to untimely payments was the absence of an effective purchase order system, which allows management to track outstanding obligations to ensure commitments are not made in excess of available resources/fund balances. Some invoices were not paid timely simply because the funds were not available when the invoice was received.

The fiscal court's failure to establish effective internal controls over disbursements resulted in numerous instances of noncompliance, violations of statutes, and violations of the county's

administrative code as reflected above. The lack of proper accounting practices, internal controls, and oversight increases the risk that undetected misstatements and fraud will occur. Failure to pay obligations timely is indicative of poor financial management practices and can result in late fees and finance charges, which are a wasteful use of taxpayer resources. We noted \$2,717 of late fees and finance charges that were incurred. It is also a violation of statute for failure to pay invoices within 30 working days of receipt of the invoice or bill. The risk of overspending the budget or spending in excess of funds available increases significantly without an effective purchase order system in place. It is also a violation of Department for Local Government (DLG) requirements for disbursements to be processed without a purchase order. Without proper procedures in place to mitigate the risks discussed above, the fiscal court is exposing public resources to potential 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 laws, regulations, and grant agreements.

The most basic requirement of strong internal controls is to maintain adequate supporting documentation to substantiate disbursements. Additionally, KRS 68.020(1) states, “[t]he county treasurer shall receive and receipt for all money due the county from its collecting officers or from any other person whose duty it is to pay money into the county treasury, and shall disburse such money in such manner and for such purpose as may be authorized by appropriate authority of the fiscal court. He shall not disburse any money received by him for any purpose other than that for which it was collected and paid over to him, and when he pays out money he shall take a receipt therefor.”

KRS 65.140(2) stipulates timely payments to vendors by stating, “[u]nless the purchaser and vendor otherwise contract, all bills for goods and 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.”

Purchase order requirements are by outlined the Department for Local Government (DLG). 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*, page 57, requires purchasing procedures include the following:

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.

We recommend the fiscal court implement adequate, effective internal control procedures for disbursements, including segregation of duties, to address each of the areas previously discussed. Additionally, strong management oversight and review procedures should be implemented to prevent and detect errors or fraud. Effective review procedures could be achieved if performed by an employee independent of the person or department initially performing those functions. All oversight and review procedures must be properly documented by initialing source documents, ledgers, reports, or other supporting documentation.

County Judge/Executive's Response: We have implemented stronger controls to resolve this issue. All purchases require purchase orders. Invoices are processed in timely manner.

Internal controls over occupational tax collections are not adequate: This is a repeat finding and was reported in the prior year audit report as Finding 2019-005. Occupational tax collections comprise about 52% of the county's general fund operating revenue - by far the single biggest source of revenue for this fund. Internal controls over occupational taxes are not adequate to ensure amounts reported are complete, accurate, and free of material misstatement due to the following issues:

- Occupational taxes were sometimes batched and posted to the ledgers in a lump sum rather than listing each individual taxpayer.
- Occupational taxes were not reconciled to the ledgers by someone independent of receiving and posting occupational tax receipts.
- Delinquent occupational tax notices are not sent out with any regularity or consistency.
- Records could not be located to support occupational tax payments handled in person (i.e. three part receipt books).
- There are no effective review or oversight procedures for occupational tax collections.

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. Failure to implement adequate controls over occupational tax collections increases the risk that undetected material misstatements and fraud will occur, especially considering occupational taxes comprise such a large portion of general fund revenues.

Strong internal controls over occupational taxes require each transaction be recorded separately so that finding errors, discrepancies, etc. is possible. Additionally, a log or receipt books should be maintained that lists each transactions so that a comparison can be made to deposit slips and to the ledgers by someone independent of the receiving and posting functions. Delinquent notices should be sent out regularly and consistently in order to collect amounts owed to the county and to detect any misstatements, errors, or misappropriation of funds. The delinquent notices should direct any questions or concerns to someone independent of occupational tax collections so that discrepancies can be investigated and resolved without risk of alteration of records by staff involved in the collection process.

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. A 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 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: Occupational tax is processed daily as received and deposits are made. Notices are sent for late payments and records are maintained.

Internal controls, review procedures, and oversight for payroll processing are not adequate:

This is a repeat finding and was included in the prior year audit report as Finding 2019-009. The following issues were noted for payroll processing:

- The fiscal court did not provide the same level of health insurance coverage to all employees (see Finding 2020-005 for additional details).
- Health insurance premiums in two pay periods, were not paid timely.
- Pay rates were not properly implemented and documented. The fiscal court approved a salary schedule for all employees on August 20, 2018, but the pay rates and ranges approved were not implemented and applied to all employees and these wage rate changes were not documented in personnel files.
- Payroll was not properly supported. Employees did not have a supervisor signature or approval on timesheets.

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 nor adequate oversight for the majority of the audit period to ensure the completeness and accuracy of payroll information. Failure to implement adequate controls over payroll increases the risk that undetected material misstatements and fraud will occur, especially considering payroll accounts for a large portion of the county's budget. Numerous undetected errors were noted 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 area should be separated. If segregation is not possible or practical, the fiscal court should implement and document compensating controls to reduce the risks associated with inadequate segregation of duties. A strong compensating control could include review of payroll reports, review of payroll payments, comparison of payroll documentation to amounts recorded, and 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: Timesheets are reviewed and approved by department head and Judge. Finance Officer and Treasurer proof timesheets. Review procedures have been implemented. Salary schedule has been implemented as approved.

The Estill County Fiscal Court did not provide the same level of health insurance coverage to all county employees: This is a repeat finding and was included in the prior year audit report as Finding 2019-012. Three county employees received health insurance coverage that was not made available to all other county employees. County employees are provided individual health insurance coverage. If the employee chooses to elect additional coverage for a spouse, children, or family coverage they may do so but are responsible for the cost of the health insurance premium that exceeds the individual coverage premium. For Fiscal Year 2020, the cost of an individual health insurance premium was \$500. Three employees elected to add coverage for dependents, which was an additional \$399 per month per employee. This additional cost was not paid by the employees via payroll deduction. The fiscal court did not have adequate internal controls in place to ensure health insurance benefits were applied equally among all classes of employees and that proper wage deductions were applied to employees that requested coverage in excess of standard county employee coverage. As a result, the fiscal court has applied employee benefits in an unequitable manner. Additionally, county funds are being spent for the personal benefit of select employees that could have been expended on other items to benefit the entire county.

OAG 94-15 states, “[t]he basic statute providing for governmentally funded health coverage (KRS 79.080) for public employees does not provide for one level of coverage for officers, and another level for employees. Accordingly, we believe such differing coverage would not be lawful as not authorized by statute.”

We recommend management ensure that employee benefits are applied equally among all employees and that proper amounts are withheld from employees' wages for elective/optional employee benefits.

County Judge/Executive's Response: This was corrected July 1, 2021.

The remaining balance of the line of credit was not paid by the end of the fiscal year: On July 23, 2019, the fiscal court was approved for an operating line of credit in the amount of \$500,000 to provide the fiscal court a mechanism to pay for the Chemical Stockpile Emergency Preparedness Program (CSEPP) funded projects and subsequently seek financial reimbursement from the Kentucky Division of Emergency Management (KyEM). The line of credit was for one year and renewable on an annual basis. As of fiscal year ended June 30, 2020, the fiscal court owed \$131,866. The treasurer was waiting on reimbursement from CSEPP and was unaware that the loan had to be paid off at the end of the fiscal year. As a result, the fiscal court is not in compliance with requirements set by the Department for Local Government (DLG) when entering into financial obligations. The DLG's *County Budget Preparation and State Local Finance Officer*

Policy Manual allows bank notes, however, they must be paid off before the end of the fiscal year in which they are borrowed.

We recommend the fiscal court seek guidance from DLG before entering into any financial obligation of any nature, to ensure they are in compliance with the state local debt officer.

County Judge/Executive's Response: This is due to Federal reimbursements not being received in time to pay by end of fiscal year.

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

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