



Auditor of Public Accounts
Mike Harmon

FOR IMMEDIATE RELEASE

Contact: **Michael Goins**
Michael.Goins@ky.gov
502.564.5841
502.209.2867

Harmon Releases Audit of Henry County Fiscal Court

FRANKFORT, Ky. – State Auditor Mike Harmon has released the audit of the financial statement of the Henry 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 Henry 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 Henry County Fiscal Court lacks segregation of duties over receipts and bank reconciliations: This is a repeat finding and was included in the prior year audit report as Finding 2016-001. The county lacks segregation of duties over receipts and bank reconciliations. The same person collects receipts, prepares the deposit ticket, takes the deposit to the bank, records the receipts in the ledger, and reconciles the bank account. There is no independent review over these procedures. As a result of limited staff, the county does not have any other employees separate from the treasurer involved in checking deposits and the bank reconciliations. When duties are performed by the same employee and no compensating controls are in place, the risk for material misstatement significantly increases due to undetected errors and fraud.

A proper segregation of duties over the accounting and reporting functions such as preparation of bank reconciliation reports or implementing compensating controls, when necessary because of a limited number of staff, is essential for providing protection from undetected errors. Additionally, a proper segregation of duties protects employees in the normal course of performing their daily responsibilities.

We recommend the county separate the control functions related to receipts and bank reconciliations or implement procedures to begin having these steps reviewed for accuracy. The review should be done by someone not involved in the process and be documented by initials of the reviewer on all documents reviewed.

County Judge/Executive's Response: Prior to this audit, the County had instituted several additional controls over Receipts and Reconciliation. All deposit slips prepared and initialed by that person, then they are checked and then initialed by that individual. The deposits are taken to the bank by someone other than the person preparing the deposit.

The initial Bank Reconciliation is prepared by the Treasurer along with supporting documentation. It is then reviewed by the Fiscal Officer for discrepancies, and then signed by the Treasurer before it is presented to Fiscal Court at their monthly meeting.

Auditor's Reply: Controls implemented after the end of the audit period will be evaluated in the next audit.

The Henry County Fiscal Court lacks adequate segregation of duties over payroll: This is a repeat finding and was included in the prior year audit as Finding 2016-002. The Henry County Fiscal Court lacks adequate segregation of duties over payroll. The same employee who enters payroll data into the payroll system, also reviews it and compares it against timesheets, prints checks, requests funds for payroll from the operating account, signs the payroll checks, and reconciles the revolving payroll account. All of these procedures are done without independent review.

The county had one person handling incompatible duties over payroll due to a limited budget and limited staff. No supervisory review procedures were performed. When controls procedures are performed by the same employee and no compensating controls are in place, the risk for material misstatement significantly increases due to undetected errors and fraud.

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.

We recommend the fiscal court implement adequate controls over payroll by segregating the duties over the handling of payroll. If this is not feasible, the county should implement compensating controls. For example, an independent county employee should compare payroll data to payroll reports for accuracy. The independent employee should then sign off on the payroll reports that this compensating control was completed.

County Judge/Executive's Response: The Court has instituted several additional controls over payroll. The Treasurer receives the timesheets and inputs the data into a spreadsheet, then inputs the data into the payroll software and prints a report that previews the payroll. The Treasurer presents the packet, along with a tracking document, to the Finance Officer who then reviews the timesheets ensuring that they reconcile to the spreadsheet. After the spreadsheet is validated, the Finance Officer reviews the report to ensure that it reconciles back to the spreadsheet. If there are errors, the entire packet is sent back to the Treasurer for correction, and the errors are noted on the tracking document. Once the errors are corrected and reviewed (if needed), the Treasurer then prints checks. After the checks are printed, they are presented to the Finance Officer along with a tracking document for review. The Finance Officer reviews the checks and then submits them back to the Treasurer along with the tracking document noting any errors, omissions, or duplication that might appear. The Treasurer then prepares the documentation and reports necessary to request funds from the Finance Officer. The Finance Officer reviews the documentation and reports, and if no errors are found, issues a check(s) to the payroll account. The Treasurer then signs the payroll checks.

Auditor's Reply: Controls implemented after the end of the audit period will be evaluated in the next audit.

The Henry County Fiscal Court reported negative fund balances: The Henry County Fiscal Court uses one bank account for all of the county's funds. The county reported negative fund balances in the jail fund (\$29,733) and fair fund (\$2,641).

The county uses a clearing bank account for payroll processing. Deposits are made into the account from the county's operating fund to pay for salaries, taxes, the county's matching portion of taxes, retirement, and health insurance. The account should reconcile to zero every month because the total deposited into the account should be completely paid out that same month. The county's payroll account also had a negative cash balance in the amount of (\$5,916) as of June 30, 2017.

During Fiscal Year 2016 and Fiscal Year 2017, the county experienced numerous changes in county treasurer, the employee responsible for monitoring accounting and financial reporting functions. During this time, errors occurred and had to be identified and corrected, making it difficult to determine the amount of transfers needed to prevent the negative fund balances. In addition, the county had a lack of adequate segregation of duties over bank reconciliations and payroll. (See Finding 2017-001 and 2017-002) The county lacked an effective review process to mitigate risks associated with the lack of segregation of duties.

Fund balance is a critical indicator of financial health and negative fund balances are indicative of cash flow problems. Furthermore, a negative fund balance represents noncompliance with applicable laws and regulations.

Good internal controls dictate that an effective review process be implemented when segregation of duties issues exist. This review should be designed to ensure amounts reported agree to supporting documentation. The controls should be designed to address any errors noted in a timely fashion.

Furthermore, maintaining positive fund balances is required by statutes. KRS 68.210 requires the state local finance officer to create a system of uniform accounts for all counties and county officials. The *County Budget Preparation and State Local Finance Officer Policy Manual* states that the county treasurer is only to sign checks if there is sufficient fund balance and adequate cash in the bank to cover the check.

We recommend the fiscal court maintain positive balances in all funds by monitoring fund balances. The county should implement procedures to ensure that transfers within the operating account and deposits to the revolving account are adequate to cover claims and liabilities. The county should request cash transfers as necessary from the fiscal court to avoid negative fund balances.

County Judge/Executive's Response: The reporting of negative fund balances was caused by the failure to submit necessary transfers to Fiscal Court on a regular basis. These transfers are being reviewed by the Treasurer and Finance Officer on a monthly basis, and are being submitted to Fiscal Court with the claims, for approval. After Fiscal Court approval, the Treasurer is inputting the approved transfers before the monthly closeout and reconciliation.

The Henry County Fiscal Court did not prepare purchase orders: During testing of disbursements, auditors noted that the fiscal court did not utilize a purchase order system. Testing was conducted on 41 invoices and no purchase orders were noted for any of the tested items.

The county's established policy was to allow department heads to order items they need. The department heads brought the reviewed and initialed invoice to the finance officer for entry into the county's computer system and for presentation to fiscal court for approval.

As a result, the county is not in compliance with the requirements of KRS 68.210.

KRS 68.210 requires the state local finance officer to create a system of uniform accounts for all counties and county officials. The *County Budget Preparation and State Local Finance Officer Policy Manual* outlines requirements for handling of public funds, including required purchasing procedures for counties. These requirements prescribe that (1) purchases shall not be made without approval by the judge/executive (or designee) and/or department head and (2) 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.

Furthermore, according to the manual, purchase order systems are required for fiscal courts and should be issued for all goods and services utilized by the fiscal court. The Department for Local Government issued a memorandum on August 4, 2016, in which it highly recommends implementation of issuing purchase orders for payroll and utilities. This allows for fiscal court to ensure that sufficient budget allocation is available for all expenses and provides a better representation of financial status by reflecting more accurate encumbrances.

We recommend the Henry County Fiscal Court ensure that purchase orders are obtained prior to all purchases.

County Judge/Executive's Response: Currently, we do not have the staff available to prepare and distribute purchase orders. We are considering how we might establish this system in the future. All supervisors have spending limits. Any purchase over the authorized limit must be preapproved by the Judge/Executive.

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

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