



Auditor of Public Accounts  
Mike Harmon

**FOR IMMEDIATE RELEASE**

Contact: **Michael Goins**  
[Michael.Goins@ky.gov](mailto:Michael.Goins@ky.gov)  
**502.564.5841**  
**502.209.2867**

**Harmon Releases Audit of Knox County Fiscal Court**

**FRANKFORT, Ky.** – State Auditor Mike Harmon has released the audit of the financial statement of the Knox County Fiscal Court for the fiscal year ended June 30, 2014. 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 Knox 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 non-compliance with laws, regulations, contracts and grants. The auditor must also comment on material weaknesses involving the internal control over financial operations and reporting.

The audit contains the following comments:

**The Knox County Fiscal Court lacks adequate segregation of duties over disbursements.** The Knox County Fiscal Court lacks adequate segregation of duties over disbursements. The county treasurer posts the disbursements to the ledgers, prepares and signs the checks, and reconciles the bank account monthly. In addition, the county treasurer prepares the financial report. The condition is a result of a limited budget, which restricts the number of employees the fiscal court can hire or delegate duties to. Lack of segregation of duties increases the fiscal court's risk of misappropriation of assets, errors and inaccurate financial reporting. Segregation of duties over disbursements or implementation of compensating controls, due to a limited number of staff, is essential for providing protection to employees in the normal course of performing their duties and can also prevent inaccurate financial reporting and misappropriation

of assets. We recommend the fiscal court strengthen internal controls by segregating these duties. If segregation is not possible due to a limited number of staff, strong oversight should be implemented. The employee providing this oversight should document his or her review by initialing all source documentation.

*County Judge/Executive J.M. Hall's response: In the future one employee will complete reconciliations monthly, another employee will review there reconciliations and initial that they have reviewed the reconciliations.*

**The Knox County Fiscal Court did not have strong internal controls over disbursements.** Internal controls over disbursements were not operating as intended during Fiscal Year 2014. Disbursements were not properly authorized, supporting documentation was not maintained and appropriate, and proper procedures were not followed. As a result of not monitoring controls, the deficiencies below occurred. These deficiencies could result in inaccurate reporting and misappropriation of assets. The following exceptions were noted:

- The fiscal court approved 13 claims which were over the line item in the budget, leaving a negative balance at the time of purchase.
- Twenty-one disbursements were made and not presented to the fiscal court prior to payment or included on the annual standing order to pre-approve certain recurring expenses. Subsequent to payment, they were presented to the fiscal court and approved.
- Eight disbursements were not presented to the fiscal court. This included payments of \$405,700 to a paving contractor, \$159,364 for hospital liability insurance, \$610,000 in contributions to the county hospital and sheriff, \$10,000 for a pass through grant to a local fire department, and a \$174 refund.
- Two disbursements were not paid within 30 days. A late fee of \$4 was incurred on one of the invoices.
- Seventeen instances of no documentation to support contributions made to the hospital and the sheriff's office. In addition, 16 of these disbursements were incorrectly posted as capital assets.
- Five credit card disbursements totaling \$541 did not have a receipt or invoice to support the transactions.
- Six credit card purchase orders were dated after the invoice date.
- Sales tax of \$2 was paid on a credit card purchase for windshield wipers.
- Hauling tickets were not signed by road department personnel for gravel documenting the delivery date and quantity.
- Thirty-three hauling tickets for gravel were missing.
- Twenty-seven gas receipts tested were not maintained to support the monthly statement.
- One disbursement did not have a purchase order attached to the invoice.
- Twenty out of 87 invoices tested had purchase orders dated after the date of the invoices or receipts. Therefore, items could have been ordered or services rendered without prior approval to ensure adequate funds were available in each account.
- Purchase orders attached to six gravel invoices tested totaling \$344,191 did not agree to the purchase order number on the haul tickets.

- One disbursement totaling \$36,498 was for gabion baskets purchased in advance and stored at the vendor with the equipment bid to be used on future jobs. The fiscal court does not have a system for tracking the inventory.

Proper internal controls over disbursements are important to ensure purchase orders are created when sufficient funds are available, are presented to the fiscal court, include proper supporting documentation and are paid within 30 days. 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, “Purchases 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.” It also specifies “no prepayment for goods or services” in accord with Section 3 of the Kentucky Constitution.

KRS 68.300 states, in part, “[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.” KRS 68.275 requires claims within budget line items and authorized by the fiscal court be paid by the county judge/executive and co-signed by the county treasurer. In addition, KRS 68.275 also requires the county judge/executive to present all claims to the fiscal court for review prior to payment unless the expenses are included on a standing order adopted by the fiscal court to preapprove the payment of certain claims such as monthly payroll and utility expenses. Furthermore, KRS 65.140 requires invoices to be paid within 30 days of being received. We recommend the fiscal court implement proper internal controls over disbursements and ensure they are operating effectively.

*County Judge/Executive J.M. Hall’s response: In the future we will try to have all disbursements pre-approved and the fiscal court has implemented more internal controls over disbursements in that the County Treasurer is reviewing the disbursements made by the Finance Officer to assure disbursements are with the approved amounts. To address the first three points specifically.*

- 1. We agree this happened with appropriations only due to items being more expensive than expected but were adjusted prior to payment and no actual accounts were ever in a negative situation.*
- 2. Most of these incidents were situations where the invoices were required to be paid prior to the next meeting where the items were reconciled.*
- 3. The disbursement to the paving contractor was pursuant to a contract that had been approved by the Court and the Transportation Department. The other disbursements were transfers to other entities owned by the County.*

**The Knox County Fiscal Court did not have adequate internal controls over gravel inventory.** The Knox County Fiscal Court does not have adequate internal controls over gravel purchased and stored at the county’s road department. The road materials are contained within a fenced area to deter unauthorized access, and the county maintains a log for gravel that lists the date and location of job sites. However, the log does not document the gravel hauled to the road department from the rock quarry, making it impossible to estimate how much gravel should be in the stockpile. The fiscal court’s lack of controls has created an opportunity for misappropriation

of the county's assets to occur. When controls are not in place to protect the county's resources, the risk of fraud increases. Good internal controls dictate the fiscal court have better recordkeeping over the gravel stockpile and log gravel activity. We recommend the county maintain a log to track the gravel hauled to the road department and also track the gravel hauled from the road department to jobsites. This would allow an estimate of gravel on hand and help determine if a shortage exists.

*County Judge/Executive J.M. Hall's response: The Fiscal Court has now assigned an employee to monitor and log all incoming and outgoing materials including gravel.*

**The Knox County Fiscal Court did not follow proper bid laws and regulations.** The Knox County Fiscal Court did not properly bid and made payments to three vendors for purchases over \$20,000 in Fiscal Year 2014. These disbursements were for a sheriff's vehicle purchased for \$22,891, a bridge constructed for \$59,638, and two Mack trucks purchased for the road department for \$261,780. In addition, one of the federal projects for the Emergency Watershed Protection (EWP) program totaling \$31,600 was not bid or declared an emergency in accordance with state procurement laws, which would have allowed the fiscal court to waive competitive bid requirements.

The fiscal court bid some purchases over \$20,000, but sufficient internal controls were not in place over the procurement process to ensure items were not purchased from vendors without first advertising or receiving bids when necessary. By limiting competition or not receiving bids at all, the fiscal court may not get the best price available. Competitive bidding ensures the fiscal court procures equipment and services at the best price available. The EWP program requires projects be completed within 10 days. This requirement does not allow enough time for the bid process as outlined in the county's administrative code. The emergency management director contacts the Natural Resources Conservation Service (NCRS) to determine if the county qualifies for assistance without management's approval. Therefore, this was probably an oversight.

KRS 424.260(1) states, "Except 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 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) without first making newspaper advertisement for bids." According to KRS 424.260(4), the requirement to advertise for bids does not apply in an emergency if the county judge/executive has properly certified that an emergency exists and filed a copy of the certificate of emergency.

We recommend the fiscal court follow proper bid laws and regulations by ensuring all purchases of \$20,000 or more be made in compliance with KRS 424.260. We also recommend the fiscal court implement adequate internal controls to ensure all federal projects over \$20,000 are properly bid or a local emergency is declared and filed if necessary.

*County Judge/Executive J.M. Hall's response: If an emergency has not been declared, the Fiscal Court will bid all purchases required by KRS 424.260.*

**The Knox County Fiscal Court did not ensure the same level of health insurance benefits are provided to all county employees as stated in Kentucky Attorney General Opinion (OAG) 94-15.** County employees are not receiving the same level of health insurance benefits. Elected officials are receiving county-paid family coverage while others are paying for the extra cost for family coverage. During fiscal year ended June 30, 2014, the county paid as much as \$931 per month per employee for additional costs for the family plan over the single plan. The fiscal court believes they can separate elected officials and county employees. According to the County Administrative Code, "The County pays the premium for all individual health insurance policies offered by the county; except, however, the county will pay the premium for family health insurance plans for all elected county officials." As a result of different levels of health insurance benefits among the employees, it appears to be discrimination among the employees. In addition, county funds are being spent for the personal benefit of some employees which could have been expended on other necessary items for the benefit of the county. OAG 94-15 states, "The 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 the fiscal court follow the advice as expressed in OAG 94-15 and ensure the same level of health insurance coverage for all employees. The fiscal court should update the County Administrative Code to comply with KRS 79.080 and OAG 94-15.

*County Judge/Executive J.M. Hall's response: All county employees are equal and all county elected officials are equal.*

**The Knox County Jail commissary lacks adequate segregation of duties over receipts and disbursements.** Due to the limited number of employees, the jail has a lack of segregation of duties over receipts and disbursements. The bookkeeper prepares deposits and posts these deposits to the receipts ledger. The bookkeeper also prepares and signs checks and posts these disbursements to the disbursements ledger. This condition is a result of a limited budget, which restricts the number of employees the county can hire or delegate duties to. Lack of segregation of duties increases the risk of misappropriation of assets, errors, and inaccurate financial reporting. Adequate segregation of duties would prevent the same person from having a significant role in these incompatible functions. In addition, proper segregation of duties protects employees in the normal course of performing their daily responsibilities. Segregation of duties, or the implementation of compensating controls, is essential for providing protection to employees in the normal course of business. We recommend the jailer implement strong oversight in these areas, either by having an employee independent of those functions or by the jailer review transactions and initial the documentation.

*County Judge/Executive J.M. Hall's response: See Jailer's response.*

*County Jailer Mary Hammons' Response: We will work on trying to segregate the duties. We have already made some changes.*

**The Knox County Fiscal Court failed to implement adequate internal controls over federal funds.**

*Federal Program: CFDA 10.923 Emergency Watershed Protection Program*

*Name of Federal Agency: U.S. Department of Agriculture*

*Compliance Requirements: Activities Allowed or Unallowed; Allowable Costs/Cost Principles; Cash Management; Matching; Period of Availability; Procurement, Suspension, and Debarment; Special Test and Provisions*

*Type of Finding: Material Weakness*

*Amount of Questioned Costs: \$0*

The Knox County Fiscal Court failed to implement adequate internal controls over federal funds. The fiscal court appointed the emergency management director to act as grant administrator over the Emergency Watershed Protection (EWP) project awards totaling \$602,835. The fiscal court approved federal disbursements without knowing if the costs were allowable. Additionally, the fiscal court did not maintain documentation of all costs for each federal project. One vendor performed the construction for all the projects. However, there were additional costs for materials such as rock, gabion baskets, and grout excluded from the total project costs.

The fiscal court relied solely on the designated employee to monitor all applicable federal compliance requirements and had no controls in place to ensure they were met. The grant administrator was not properly trained and was not familiar with all the compliance requirements. He relied on the Natural Resource Conservation Service (NRCS) to ensure compliance with project agreements. The lack of monitoring resulted in material noncompliance with three federal compliance requirements: procurement, suspension and debarment; matching; and special tests and provisions. The Single Audit opinion over compliance has been modified due to the direct and material impact of these noncompliances. These noncompliances could result in the fiscal court being responsible for reimbursing these funds to the federal government and jeopardize the fiscal court's future federal funding.

Per grant project agreement Section B.16., "the sponsor will pay any contractor, subcontractor for any services secured by the sponsor, and as provided in the contract(s). Submit copies of billings for reimbursement to NRCS on Form SF-270, Request for Advance or Reimbursement. All billings shall include supporting documentation to substantiate associated project costs."

OMB Circular No. A-133, §.300(b) states the auditee shall maintain internal control over federal programs that provides reasonable assurance that the auditee is managing federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its federal programs. We recommend the fiscal court implement adequate internal controls to ensure federal compliance requirements are met.

*County Judge/Executive J.M. Hall's response: The grant administrator will attend the next available training. The Fiscal Court will maintain better logs and records of the expenses associated with each federally funded project and any project overruns will result in requests for grant amendments. The Fiscal Court will on all future federally funded projects maintain records of all county resources used, including manpower, materials and equipment.*

**The Knox County Fiscal Court failed to implement adequate internal controls over procurement.**

*Federal Program: CFDA 10.923 Emergency Watershed Protection Program*

*Name of Federal Agency: U.S. Department of Agriculture*

*Compliance Requirements: Procurement*

*Type of Finding: Material Weakness*

*Amount of Questioned Costs: \$0*

*Opinion: The Knox County Fiscal Court did not comply with federal requirements regarding this compliance requirement resulting in a Qualified Opinion.*

The Knox County Fiscal Court failed to implement internal controls to ensure compliance with procurement requirements. The fiscal court was unaware of all the compliance requirements and responsibilities.

As a result, the following deficiencies were noted:

- There was no evidence that the fiscal court reviewed invoices for allowable activities and costs and compared to final cost estimates prepared by the Natural Resources Conservation Service (NRCS).
- The fiscal court did not track all federal project costs and did not include all project costs on the requests for reimbursement. The federal government only reimburses for costs up to the amount included in the grant agreement. If the overall cost of a project exceeds the original estimates, the sponsor must absorb those additional costs. Due to the lack of policy and procedures over program procurement, the fiscal court can not readily determine the entire cost of each project including in-kind contributions. In addition, if the project exceeded federal funding provided, the fiscal court could have submitted a request for additional funds in an attempt to reduce the amount of costs the fiscal court paid for the project.
- The fiscal court did not request itemized statements of charges from the vendor. The vendor invoice included charges for equipment hours that were not verified or properly supported.
- Contracts were not required with the vendor to ensure compliance with special provisions, convey expectations, and aid in controlling budget cost estimates. The budget in the initial project description is recognized to be an estimate, so some variation from estimated costs are expected and not unusual. However, if significant cost changes occur, formal amendments to the project should be required.

Per the instructions for Form 270 Request for Advance or Reimbursement for Line 11a, “[e]nter program outlays to date (net of refunds, rebates, and discounts), in the appropriate columns. For requests prepared on a cash basis, outlays are the sum of actual cash disbursements for good and services, the amount of indirect expenses charged, the value of in-kind contributions applied, and the amount of cash advances and payments made to subcontractors and subrecipients.”

OMB Circular No. A-133 §.300(b) states the auditee shall maintain internal controls over federal programs that provide reasonable assurance that the auditee is managing federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its federal programs.

The fiscal court should establish policies and procedures to help ensure compliance with procurement requirements. Specifically, we recommend the fiscal court establish sufficient procedures to identify how to accumulate data for federal reports, and supervisors should perform a review over reimbursement requests to ensure accurate amounts are reported and supporting documentation is maintained. The fiscal court should keep an on-going file of expenses associated with each project to track all costs incurred and should maintain documentation of any in-kind contributions. We also recommend the fiscal court monitor project costs for any project overruns and request amendments if necessary.

*County Judge/Executive J.M. Hall's Response: The grant administrator will attend the next available training. The Fiscal Court will maintain better logs and records of the expenses associated with each federally funded project and any project overruns will result in requests for grant amendments. The Fiscal Court will on all future federally funded projects maintain records of all county resources used, including manpower, materials and equipment.*

**The Knox County Fiscal Court did not have sufficient internal controls to ensure federal requirements for matching were met.**

*Federal Program: CFDA 10.923 Emergency Watershed Protection Program*

*Name of Federal Agency: U.S. Department of Agriculture*

*Compliance Requirements: Matching*

*Type of Finding: Material Weakness*

*Amount of Questioned Costs: \$33,621*

*Opinion: The Knox County Fiscal Court did not comply with federal requirements regarding this compliance requirement resulting in a Qualified Opinion.*

The Knox County Fiscal Court did not have sufficient internal controls to ensure federal requirements for matching were met. The fiscal court is required to provide a ten percent match of the total federal funds expended for the Emergency Watershed Protection Program. This match can be met through cash and/or in-kind contributions. The fiscal court met the matching requirement with cash and in-kind contributions, but they did not provide supporting documentation for \$33,621 of in-kind contributions such as payroll records and detailed equipment logs. In addition, cash contributions including rock provided by the county and materials purchased from other vendors were not tracked and included in the matching totals. We are questioning these costs as unallowable charges due to the lack of supporting documentation.

The designated employee responsible for determining matching contributions was not aware he needed to maintain support for in-kind contributions. In addition, there was no supervisory review of matching activities performed to assess the accuracy and allowability of transactions. By not properly tracking, documenting, or reporting that the matching requirements are being met, the fiscal court is at risk of having to return federal funds. This also could jeopardize the fiscal court's future federal funding.



According to OMB Circular A-110 2 CFR §215.23(a), matching funds must be verifiable from the fiscal court's records, not used as a match for any other federal program, necessary and reasonable to achieve program objectives, and allowable under the applicable cost principles.

We recommend the fiscal court develop and follow internal controls over disbursements used to meet the matching requirement to ensure it complies with the federal grant agreement. In addition, we recommend the fiscal court maintain supporting documentation for in-kind contributions such as basis for labor rates, support of salaries and wages or confirmation from other organizations for services provided by their employees, basis for equipment rates, and documentation of equipment used to perform eligible work.

*County Judge/Executive J.M. Hall's Response: The grant administrator will attend the next available training. The Fiscal Court will maintain better logs and records of the expenses associated with each federally funded project and any project overruns will result in requests for grant amendments. The Fiscal Court will on all future federally funded projects maintain records of all county resources used, including manpower, materials and equipment.*

**The Knox County Fiscal Court did not implement adequate internal controls over suspension and debarment and special tests and provisions.**

*Federal Program: CFDA 10.923 Emergency Watershed Protection Program*

*Name of Federal Agency: U.S. Department of Agriculture*

*Compliance Requirements: Suspension and Debarment; Special Tests and Provisions*

*Type of Finding: Material Weakness*

*Amount of Questioned Costs: \$0*

*Opinion: The Knox County Fiscal Court did not comply with federal requirements regarding this compliance requirement resulting in a Qualified Opinion.*

The Knox County Fiscal Court did not implement adequate internal controls over federal compliance requirements for suspension and debarment and the special tests and provisions outlined in the attachments to the grant agreements. The fiscal court appointed the emergency management director to act as grant administrator and placed complete reliance upon this employee for ensuring compliance with federal requirements and the grant agreements. The fiscal court did not provide certification regarding lobbying to ensure federal funds were not paid to any person for influencing or attempting to influence anyone in connection with the awarding of any contract. Also, no documentation existed to show the fiscal court verified whether vendors were suspended or debarred from receiving federal funds. The fiscal court paid one vendor \$602,835 for construction services for five different projects under the Emergency Watershed Protection (EWP) program. The project files did not include all vendor invoices for materials, supporting documentation to substantiate in-kind contributions, and the final cost estimates prepared by the local federal agency.

There was no contract or written documentation with the contractor to ensure compliance with the special provisions included in attachment B of the project agreements. Per this attachment, the fiscal court should have notified the contractor to comply with the standard federal equal employment opportunity construction contract specifications and provide certification of non-segregated facilities. According to the project agreement section B.13, "the sponsor will ensure

that all contracts for design and construction services will be procured in accordance with procedures prescribed in the Code of Kentucky and Federal regulations application to the Sponsor, including the provisions contained in Attachment B to the agreement.”

OMB Circular No. A-133 §\_300(b) states the auditee shall maintain internal controls over the federal programs that provide reasonable assurance that the auditee is managing federal awards in compliance with laws, regulation, and the provisions of contracts or grant agreements that could have a material effect on each of its federal programs. Noncompliances with these special provisions could result in the fiscal court being responsible for repaying federal funds. This also could jeopardize the fiscal court’s future federal funding. We recommend the fiscal court implement adequate internal controls to ensure federal compliance requirements are met.

*County Judge/Executive J.M. Hall’s response: Prior to using any contractors on federally funded projects, the grant administrator will search readily available databases to insure that the contractor has not been previously disbarred for non-compliance with federal regulations. The grant administrator will also insure compliance with federal laws and regulations.*

**The Knox County Fiscal Court did not follow proper bid laws and regulations.**

*Federal Program: CFDA 10.923 Emergency Watershed Protection Program*

*Name of Federal Agency: U.S. Department of Agriculture*

*Compliance Requirements: Procurement*

*Type of Finding: Noncompliance*

*Amount of Questioned Costs: \$0*

*Opinion: The Knox County Fiscal Court did not comply with federal requirements regarding this compliance requirement resulting in a Qualified Opinion.*

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

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