



Auditor of Public Accounts
Mike Harmon

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Harmon Releases Audit of Laurel County Fiscal Court

FRANKFORT, Ky. – State Auditor Mike Harmon has released the audit of the financial statement of the Laurel 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 Laurel 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 Laurel County Fiscal Court lacks segregation of duties over the accounting process: The Laurel County Fiscal Court lacks adequate segregation of duties over receipts, disbursements, and the reconciliation process. The county treasurer prepares deposits, creates the claims list, prints and signs disbursements, posts to the receipts and disbursements ledgers, and also prepares the monthly bank reconciliation. The fiscal court has implemented some compensating controls, such as having the front desk receptionist open the mail and prepare a receipts listing of all monies received through the mail. Also, the county judge/executive's executive assistant receives the claims list from the county treasurer and compares the listing to the invoices. She initials the claims list evidencing her review. The claims list is then presented to fiscal court, who approves. Once approved, the disbursements are printed by the county treasurer and signed by the county

judge/executive and the county treasurer. Monthly bank reconciliations are prepared by the county treasurer and a Certified Public Accounting (CPA) firm. However, the county treasurer is the only one reviewing the monthly bank reconciliation prepared by the CPA firm. Although the fiscal court has some compensating controls in place, they are not enough to override the lack of segregation of duties. However, the condition is reduced to a significant deficiency. The fiscal court has some compensating controls in place but has areas where improvement is needed.

A 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.

We recommend the fiscal court strengthen internal controls by segregating duties over the accounting process. If segregation is not possible, strong oversight should be implemented. We recommend the receipts listing be compared to the daily deposit, the claims listing be compared to the disbursements prior to signing the disbursements, and the monthly bank reconciliation be reviewed by another employee. The employee providing this oversight should document his or her review by initialing all source documentation.

County Judge/Executive's Response: The County Judge Executive administrative assistant not only compares the claims list to the invoices, but also reviews the check register to the claims list and invoices. The check register is printed from the computer system after the checks are printed and reflects the same information as the check.

We will implement the recommendations immediately. Either the County Judge Executive administrative assistant, the finance officer or the assistant payroll clerk will review the daily deposits and the bank reconciliation. We will review the check along with the check register.

Auditor's Reply: Reviewing and comparing the check register to the claims list is a good compensating control, but is still not sufficient to mitigate the lack of segregation of duties noted in the finding.

The Laurel County Fiscal Court did not have sufficient controls over capital asset listing preparation: This is a repeat finding and was included in the prior year report as Finding 2016-001. The Laurel County Fiscal Court did not accurately maintain a capital assets listing. Upon review of the receipts and disbursements ledgers, a total of \$86,643 in equipment, \$1,755,638 construction in progress (new detention center), and \$2,217,218 in infrastructure additions were not included on the capital asset schedule that should have been. In addition, no evidence was found that a physical inventory of the fiscal court's capital assets had been completed. Also, items sold during a surplus auction could not be matched to the capital asset listing for the item. The fiscal court lacks adequate controls over reporting of capital assets. Physical inventory controls have not been established to maintain accurate listing of equipment.

By not maintaining an accurate list of capital assets, assets could be improperly stated, increasing the risk of material misstatement to the capital asset schedule. The fiscal court cannot properly determine insurance needs without proper documentation being maintained.

KRS 68.210 gives the State Local Finance Officer the authority to prescribe a uniform system of accounts. The Department for Local Government's *County Budget Preparation and State Local Finance Officer Policy Manual* states that capital asset records are necessary for proper asset valuation, adequate and accurate insurance coverage, internal control, and long range planning for property replacement. It further states fixed asset records should include a description of the asset, historical cost, date of acquisition, date of disposal, and proceeds from sale or disposal of assets.

We recommend fiscal court maintain a complete and accurate capital asset schedule to comply with the Department for Local Government requirements. Policies should be implemented that will identify and track additions and deletions for the purpose of the capital asset schedule and required insurance coverage. In addition, the fiscal court should complete a physical inventory at least yearly to ensure all assets meeting the fiscal court's capitalization policy threshold are included.

County Judge/Executive's Response: The CPA firm that prepares the listing did not make adequate changes to reflect what was sent to them. Also, the codes on the asset listing shows the assets that were disposed of by surplus but did not include all information as needed.

The insurance agent reviews the asset listing and updates the information yearly. If he doesn't locate an asset or finds an asset not on his list, he contacts us to verify that the asset should or should not be listed. We feel confident that all the assets are covered under an insurance policy.

Administration will do an annual physical inventory of all assets to verify that the list is complete. Also, administration will review documentation to assure schedule complies with dlG requirements.

The Laurel County Fiscal Court has not adopted a written data breach policy: The Laurel County Fiscal Court has not adopted a personal information security and data breach investigation policy as required by KRS 61.932 and Department for Local Government (DLG) policy DLG-PPI 100. During the course of the audit, the fiscal court experienced a data breach. The prior CPA firm mailed to the APA the Fiscal Year 2016 audit documentation and the flash drive was lost during mailing. Included on the flash drive in the prior year work papers were social security numbers of the county judge/executive and the jailer. The data breach was not reported by the fiscal court, as required by KRS 61.932. Due to lack of management's knowledge of requirements per statute, the fiscal court has not yet approved a data breach policy.

The Laurel County Fiscal Court is not in compliance with KRS 61.932 or DLG-PPI 100. In addition, the fiscal court did not have a proper level of protection for sensitive personal information. Due to the fiscal court not having a policy, the fiscal court did not handle the data breach in accordance with DLG's policy.

KRS 61.932(1)(a) states, “[a]n agency. . .that maintains or otherwise possesses personal information, regardless of the form in which the personal information is maintained shall implement, maintain, and update security procedures and practices, including taking any appropriate corrective action, to protect and safeguard against security breaches.”

KRS 61.932(1)(b) states, “[r]easonable security and breach investigation procedures and practices established and implemented by units of government listed under KRS 61.931(1)(b) and (c) that are not organizational units of the executive branch of state government shall be in accordance with policies established by the Department for Local Government.”

In accordance with KRS 61.932 the Department for Local Government (DLG) has issued Policy Number: DLG-PPI 100 which states, “[t]he purpose of this policy is to provide guidance to Local Governmental Units (“LGUs”) to minimize the risk of disclosing personal information and setting practical guidelines for effectively responding to security incidents. LGUs are encouraged to tailor this policy to meet their own specific security and operational requirements. Having a policy is important because it promotes consistent response procedures to make sure appropriate actions are taken. This policy sets forth the procedures and practices pursuant to KRS 61.932 for LGUs to follow in order to:

- 1) Identify vulnerabilities;
- 2) Eliminate or mitigate those vulnerabilities;
- 3) Recognize when an incident has occurred;
- 4) Notify appropriate personnel in the event of an incident;
- 5) Respond to information security threats; and
- 6) Recognize events that require special handling due to their potential impact or special reporting due to legal or other concerns.”

In addition, this policy requires LGUs to enact appropriate measures to protect information stored on media, both digital and non-digital, during the entire term of its use, until its destruction.

We recommend the Laurel County Fiscal Court develop and implement a data breach policy and procedure to ensure compliance with KRS 61.932 and DLG-PPI 100.

County Judge/Executive’s Response: We have introduced and have had a first reading of such a policy in our March 2018 regular fiscal court meeting. We expect second reading and approval to happen in the April 2018 regular fiscal court meeting.

The Laurel County Fiscal Court did not properly disclose debt information on the quarterly financial report: Required debt information was not properly disclosed in the liabilities section of the quarterly financial report that is required to be submitted to the state local finance officer upon submission of the fiscal court’s proposed budget and quarterly financial report.

The Public Properties Corporations (PPC) First Mortgage Revenue Bonds, Series 2008 and First Mortgage Revenue Bonds, Series 2015 were not disclosed in the liabilities section of the quarterly financial report. The outstanding principal balances as of June 30, 2017, were \$6,060,000 and \$9,295,000 respectively.

Laurel Housing, Inc. General Obligation Improvement Bonds, Series 2006, General Obligation Refunding Improvement Bonds, Series 2010, General Obligation Refunding Bonds, Series 2012A and General Obligation Refunding Bonds, Series 2013A were not disclosed in the liabilities section of the quarterly financial report. The outstanding principal balances as of June 30, 2017, were as follows: Series 2010 \$3,615,000, Series 2012A \$5,610,000, and Series 2013A \$4,835,000. The Series 2006 bond was paid in full during fiscal year 2017.

The liabilities section of the quarterly financial report is not accurate since it is prepared based on the information maintained in the accounting system. The PPC bond obligations and Laurel Housing, Inc. bond obligations are not reported in the accounting system therefore, they are not reported on the quarterly financial report.

By omitting liabilities of the fiscal court, the state local finance officer did not see the accurate financial position of the fiscal court. The principal balance reported for the general obligations and revenue bonds was understated on the quarterly financial report by \$29,415,000 and the interest balance was understated by \$7,331,349.

Since the Department for Local Government (DLG) and the fiscal court rely on the quarterly financial report to make decisions regarding new debt and other financial decisions, it is important the quarterly financial report be accurate and complete. The quarterly financial report is a cumulative report and is prepared on a regulatory basis by the county judge/executive and county treasurer pursuant to KRS 68.210. KRS 68.210 states, “[t]he administration of the county uniform budget system shall be under the supervision of the state local finance officer who may inspect and shall supervise the administration of accounts and financial operations and shall prescribe. . . a uniform system of accounts[.]” This uniform system of accounts, as outlined in the *County Budget Preparation and State Local Finance Officer Policy Manual*, requires the budget section of the fourth quarter financial report to be utilized for reporting all current long-term debt, including public corporation, general obligation bonds, Government Leasing Act issues, and Bond Anticipation notes.

We recommend the fiscal court ensure all debt information is disclosed and reported accurately in the liabilities section of the quarterly financial report.

County Judge/Executive’s Response: This action wasn’t reported and was a repeat violation because it hasn’t been required to be listed in the past and the prior year audit wasn’t completed in time for us to correct the issue. The state local finance officer was aware of this debt even though it wasn’t listed on our report. Though we do not agree that these should be listed, we will list the debt on a quarterly financial report begin [sic] with the 4th quarter of fy 2018.

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

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