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Harmon Releases Audit of Marshall County Fiscal Court

FRANKFORT, Ky. – State Auditor Mike Harmon has released the audit of the financial statement of the Marshall County Fiscal Court for the fiscal year ended June 30, 2019. 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 Marshall 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 Marshall County Fiscal Court's Schedule of Expenditures of Federal Awards was materially misstated:

Federal Program: CFDA 66.458 Capitalization Grants For Clean Water State Revolving Funds
Award Number and Year: A18-014
Name of Federal Agency and Pass-Through Agency: U.S. Department of Environmental Protection Agency and Kentucky Infrastructure Authority
Compliance Requirements: Reporting
Type of Finding: Material Weakness and Material Non-Compliance
Amount of Questioned Costs: $0

The fiscal court's internal controls were not adequate to ensure the Schedule of Expenditures of Federal Awards (SEFA) accurately reported all federal awards expended. The county treasurer has overall responsibility for final preparation of the SEFA. The SEFA for Fiscal Year 2019 was materially misstated. The treasurer's original SEFA total was $349,699. The Kentucky Infrastructure Authority (KIA) federal loan in the amount of $964,226 was omitted from the Marshall County Fiscal Court's SEFA, and the Homeland Security Grant, which was expended on ambulance equipment in April 2019, was understated by $22,217. Additionally, the fiscal court failed to submit the SEFA to the Department for Local Government (DLG) and the Auditor of Public Accounts (APA). This is a material weakness in internal controls over the SEFA's preparation and reporting.

This misstatement is largely the result of turnover in the county treasurer's office near the end of the fiscal year, and the lack of familiarity with the reporting requirements. The county treasurer prepared the SEFA based on grant awards received rather than grant funds expended. The fiscal court failed to implement internal controls procedures to ensure the SEFA was accurate and complete. Based on the amount of federal funds omitted from the SEFA, the fiscal court was not aware that they met the requirements of CFR Part 200 of the Uniform Guidance which increases the risk of material noncompliance.

Title 2 U.S. Code of Federal Regulations (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles and Audit Requirements for Federal Awards* (Uniform Guidance) states:

§200.502 Basis for determining Federal awards expended.
(a) *Determining Federal awards expended.* The determination of when a Federal award is expended must be based on when the activity related to the Federal award occurs.
(b) *Loan and loan guarantees (loans).* Since the Federal Government is at risk for loans until the debt is repaid, the following guidelines must be used to calculate the value of Federal awards expended under loan programs, except as noted in paragraphs (c) and (d) of this section: (1) Value of new loans made or received during the audit period; plus (2) Beginning of the audit period balance of loans from previous years for which the Federal Government imposes continuing compliance requirements; plus (3) Any interest subsidy, cash, or administrative cost allowance received.

§200.510 Financial Statements
(b) *Schedule of expenditures of Federal awards.* The auditee must also prepare a schedule of expenditures of Federal awards for the period covered by the auditee's financial statements which must include the total Federal awards expended as determined in accordance with §200.502 Basis for determining Federal awards expended.

We recommend the fiscal court provide knowledgeable and independent oversight of SEFA preparation and ensure staff responsible for it do an effective job, perform a detailed reconciliation of the federal assistance reported by the treasurer, and establish reporting guidance and assistance to the treasurer to ensure timely, accurate and consistent information and periodically assess the effectiveness of the treasurer's records to ensure accurate reporting.

County Judge/Executive's Response: This finding relates to the comment that the Schedule of Expenditures of Federal Awards (SEFA) was materially misstated. The SEFA form requests a reporting of all federal awards expended. The county expended funds from a KIA loan program that ultimately resulted in this finding. The Treasurer's office was unaware that this loan would be required to be reported as an "award;" further, the Treasurer's office was unaware that this loan was funded through federal dollars. This misstatement is largely the result of turnover of the entire Treasurer's office in the last month of the 2019 fiscal year.

Planned corrective actions include verifying outstanding loan balances and sources at fiscal year-end prior to completing the SEFA. Further, collaborative researching efforts between the Treasurer's Office, the County Judge/Executive, Deputy Judge and any department director responsible for grants will occur prior to external reporting of federal funding.

Material weaknesses exist over the reporting of liabilities and debt: Material weaknesses existed over the reporting of liabilities and debt of Marshall County. The June 30, 2019 outstanding debt balances reported on the fourth quarter financial report were misstated when compared to the actual debt balances confirmed with lenders. In total, $2,366,493 of outstanding debt was not properly reported on the county's fourth quarter financial report.

This misstatement is largely the result of turnover in the county finance office near the end of the fiscal year and the lack of familiarity with the reporting requirements. However, the fourth quarter financial report was reviewed and approved by the fiscal court, therefore, the misstatement should have been detected. Because the county failed to report $2,366,493 in outstanding debt, the fourth quarter financial report was materially misstated. Strong internal controls over outstanding debt and liabilities are necessary to ensure accurate financial reporting.

We recommend the county strengthen internal controls over the reporting of debt service payments and outstanding debt balances. Internal controls, such as comparisons of payment amounts and outstanding balances to amortization and payment schedules, should be implemented. We also recommend the county consult with lenders to verify outstanding debt balances are in agreement with the county's schedule of leases and liabilities. Such practices will strengthen internal controls over liabilities and debt service and ensure that proper amounts are reported.

County Judge/Executive's Response: This finding relates to the comment that there were material weaknesses over reporting of liabilities and debt. Outstanding debt balances were reported without the KIA loan because the loan was not yet closed and completed. This misstatement is largely the result of turnover of the entire Treasurer's office in the last month of the 2019 fiscal year. Planned corrective actions include verifying outstanding loan balances and include any future loans that have yet to be closed. Further, collaborative researching efforts between the Treasurer's Office, the County Judge/Executive and Deputy Judge will occur prior to external reporting of outstanding debt.

The Marshall County Fiscal Court failed to have a written security agreement with the bank: As of June 30, 2019, $4,719,911 of the county's funds were not properly secured by pledged securities. While the bank did confirm sufficient securities were pledged to cover deposits, these pledges were not valid as there was no properly executed written agreement between the county and bank in place. In June 2018, Marshall County bid out its banking services. According to bank personnel, the pledge of securities agreement was overlooked when setting up the new accounts. The fiscal court was not in compliance with KRS 41.240, since the requirements of the statute were not met.

According to KRS 41.240, the depository institution should pledge or provide sufficient collateral which, together with Federal Deposit Insurance Corporation (FDIC) insurance, equals or exceeds the amount of public funds on deposit at all times. In order to be valid against the FDIC in the event of failure or insolvency of the depository institution, this pledge or provision of collateral should be evidenced by an agreement between the fiscal court and the depository institution, signed by both parties, that is (a) in writing, (b) approved by the board of directors of the depository institution or its loan committee, which approval must be reflected in the minutes of the board or committee, and (c) an official record of the depository institution. These requirements were not met, as the fiscal court did not have a written agreement with the bank. We recommend the county comply with KRS 41.240 by obtaining a properly executed security agreement with the bank.

County Judge/Executive's Response: This finding relates to the comment that the Court failed to have a written security agreement with the bank. The bank that holds the county's funds DID, in fact, maintain sufficient securities pledged to cover the deposits of the county. However, the signed documentation of the agreement to do so was overlooked in the process of setting up the new accounts. This matter was already corrected during the audit review process with the signing of a written agreement.

The Marshall County Fiscal Court has deficiencies with their purchase order system and reporting of encumbrances: The Marshall County Fiscal Court's purchase order system does not work as designed. Throughout the fiscal year, purchase orders were created after invoices were received, as opposed to being obtained before the purchase was made. The county also listed no encumbrances at the year end, despite invoices dated for the 2019 fiscal year being paid in the 2020 fiscal year.

Orders and purchases were made without first obtaining a purchase order from the finance office. Due to the system not working as designed, risk of misappropriation is elevated, and control over expenditures is reduced. Encumbrances are also misstated on the fourth quarter financial statement and are not tracked properly.

A purchase order system that is designed and works effectively creates strong internal controls over expenditures, and will aid in correctly reporting encumbrances. We recommend the fiscal court strengthen internal controls over the purchase order system. Purchase orders should be acquired from the finance office before making any order or purchase. Invoices should then be matched to purchase orders and then claims can be made. Once the fiscal court approves the claims, payment can be made.

County Judge/Executive's Response: This finding relates to the comment that the Court has deficiencies with their purchase order system and reporting of encumbrances. The current purchase order practice has been followed for many years. However, the Treasurer's office is anticipating a transition to update financial software sometime at the end of April 2020. With the *software transition, the purchase order system will be changed to comply with the auditor recommendations.*

The Marshall County Detention Center has a lack of segregation of duties over jail commissary operations: This is a repeat finding and was included in the prior year audit report as Finding 2018-005. The Marshall County Detention Center lacks adequate segregation of duties over the jail commissary operations. Due to a limited number of staff and the diversity of operations, the bookkeeper is required to perform multiple tasks such as posting to the receipts and disbursements ledgers, preparing bank deposits, preparing bank reconciliations, and preparing financial reports.

A lack of segregation of duties or strong oversight increases the risk that errors or fraud could occur and not be detected. Segregation of duties over these tasks, or the implementation of compensating controls when limited by staff, is essential for providing protection from asset misappropriation and helping prevent inaccurate financial reporting. Additionally, proper segregation of duties protects employees in the normal course of performing their daily responsibilities.

We recommend the jailer separate the duties of collecting receipts, deposit preparation, bank reconciliations, and other accounting functions. If these duties cannot be separated due to limited staff, then strong oversight should be provided to employee or employees responsible for these duties.

County Jailer's Response: Due to limited staff and diversity of operations the bookkeeper is required to perform multiple tasks. Some of these duties cannot be separated due to limited staff, there we have implemented strong oversight of the employee or employees responsible for these duties.

The audit report can be found on the auditor's website.

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