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Harmon Releases Audit of McLean County Fiscal Court

FRANKFORT, Ky. – State Auditor Mike Harmon has released the audit of the financial statement of the McLean County Fiscal Court for the fiscal year ended June 30, 2018. 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 McLean 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 McLean County Fiscal Court failed to implement adequate internal controls to ensure complete and accurate accounting records were maintained: This is a repeat finding and was included in the prior year audit report as Findings 2017-001, 2017-002, and 2017-004. There were no functioning internal controls in place over the work performed by the former county treasurer. The fiscal court failed to provide adequate oversight, allowing the former county treasurer complete control over the accounting and reporting functions. The following deficiencies and errors were noted during the performance of the audit:

- The fourth quarter financial report was incomplete and inaccurate:

- The total budgeted amount for general fund receipts per the approved budget did not agree to the amount reported as budgeted amounts per the fourth quarter report. Budgeted receipts were overstated by \$22,715.
- The former county treasurer failed to complete the summary/reconciliation page of the fourth quarter financial report.
- Receipts and disbursements were recorded to the incorrect funds on the fourth quarter financial report. For example, a reimbursement of \$16,170 was recorded in the Local Government Economic Assistance (LGEA) fund but should have been recorded in the general fund; insurance proceeds of \$97,794 and \$12,675, which should have been recorded in the road and ambulance funds, respectively, were recorded in the general fund; and retirement for the road fund in the amount of \$4,607 was recorded in the general fund. There were numerous other classification errors noted within the funds, which required audit adjustments to correct.
- Total disbursements per the fourth quarter report were overstated by \$24,641 when compared to the disbursements ledger.
- Prior year cash and fund balances were omitted from the fourth quarter financial report.
- A complete and correct fourth quarter financial report, including cash and fund balances as well as encumbrances was provided to the Department for Local Government (DLG) on August 10, 2018. This report was due on the 20th day following the close of the fourth quarter, which is July 20, 2018. The fourth quarter financial report that was submitted to DLG on August 10, 2018, and later provided to auditors did not include reconciled cash and fund balances or encumbrances.
- There were no receipt or disbursements ledgers maintained to support amounts reported on the fourth quarter financial statement due to the computer system losing all financial information for the 2018 fiscal year. These had to be recreated by the current treasurer and other staff.
- Liabilities were misstated on the fourth quarter report by \$727,642 (see Finding 2018-003).
- Bank reconciliations were not performed for Fiscal Year 2018 (see Finding 2018-002).
- The former county treasurer failed to present financial reports to the fiscal court for December 2017, January 2018, and May 2018.
- The jail, ambulance, 911, and senior citizens funds all had negative fund balances at June 30, 2018, in the amounts of \$67,604, \$532,451, \$185,909, and \$53,314, respectively.
- The protection to persons and property line item in the fire department and 911 funds were overspent by \$236 and \$218, respectively.

Additional internal control issues noted were:

- An emergency was declared for the approval and adoption of the Fiscal Year 2017-2018 budget on June 30, 2017, and then on June 29, 2018, for a Fiscal Year 2018 budget amendment.
- An emergency budget amendment was declared because there was not time to publish and advertise before the end of the fiscal year. Time constraints and lack of proper planning do not meet the definition of a legitimate emergency.
- Financial reports remitted to each fire district were inaccurate and did not agree to amounts remitted on quarterly financial statements.

- Accounting software back-up procedures were insufficient. When the accounting software crashed due to a corrupt file, the former county treasurer was unable to restore the activity for Fiscal Year 2018 from the back-up. The county's back-up system was not able to maintain the pertinent data since so much time had passed from the corruption event.

The McLean County Fiscal Court failed to implement a strong internal control system or provide proper oversight to ensure complete and accurate accounting records were maintained, and instead relied on a single person without adequate oversight. Additionally, the former county treasurer lacked sufficient understanding of all accounting concepts and responsibilities.

Due to the lack of oversight of the former treasurer's functions by the fiscal court and the treasurer's lack of understanding of her duties as prescribed by DLG's *County Budget Preparation and State Local Finance Officer Policy Manual*, the deficiencies, noncompliances, and undetected errors noted above pertaining to required record-keeping were allowed to occur. Additionally the fiscal court was unable to properly budget and plan for the following fiscal year due to inaccurate financial information being presented. The inaccurate and incomplete financial reporting also hid the deficits that were occurring in several county funds.

Strong internal controls over the reporting process are vital to ensure the fiscal court's financial reports accurately reflect the financial activity of the fiscal court, as well as, adherence to applicable laws and regulations.

KRS 65.905(2) states, "[t]he final quarterly report filed by a county within fifteen (15) days after the end of the last quarter of the fiscal year, in accordance with KRS 68.360(2), shall be deemed the uniform financial information report for that county for purposes of compliance with KRS 65.900 to 65.925."

KRS 68.260(1) states, "[t]he proposed county budget, tentatively approved by the fiscal court and approved by the state local finance officer as to form and classification, shall be submitted to the fiscal court for adoption not later than July 1 of each year. The budget as presented and amended shall be adopted as of July 1. The county judge/executive shall cause a copy of the proposed budget to be posted in a conspicuous place in the courthouse near the front door, and be published pursuant to KRS Chapter 424, at least seven (7) days before final adoption by the fiscal court."

KRS 68.020(4) states that county treasurer, "shall keep an accurate detailed account of all money received and disbursed by him for the county, and shall keep books of account of the financial transactions of the county in the manner required by the uniform system of accounting prescribed by the state local finance officer."

KRS 68.110(1) forbids expenditures in excess of revenues and states, "[t]he fiscal court shall not in any year expend any money in excess of the amount annually levied and collected for that year or levied, collected or appropriated for any special purpose."

KRS 68.210 gives the state local finance officer the authority to prescribe a uniform system of accounts. Pursuant to KRS 68.210, the state local finance officer has prescribed minimum accounting and reporting standards in DLG's *County Budget Preparation and State Local Finance*

Officer Policy Manual. The manual requires the county treasurer to “[p]repare a quarterly financial report for the State Local Finance Officer.” The manual also provide a format to be used when preparing the quarterly financial statement. This format includes reporting original budget estimates, budget amendments, and actual receipts and disbursements and totals available in each line item. The manual goes on to state, “[a] budget amendment is an ordinance and must be approved by the fiscal court in the statutorily prescribed manner including advertising and publishing requirements. All amendments to a county budget must be approved by the State Local Finance Officer as mandated by KRS 68.280.” It further states, “[a]ny amendments to a county budget submitted to the State Local Finance Officer on an emergency basis must strictly adhere to the provisions of KRS 67.078 and a photocopy of the fiscal court order naming and describing the emergency much accompany the budget amendment pursuant to KRS 68.280.”

In addition, KRS 68.360(1) states, “[t]he county treasurer shall balance his books on the first day of each month, so as to show the correct amount on hand belonging to each fund on the day the balance is made, and shall within ten (10) days file with the county judge/executive and members of the fiscal court a monthly statement containing a list of warrants paid by him during the month, showing all cash receipts and the cash balance at the beginning and at the end of the month, and certifying that each warrant or contract is within the budget appropriation.”

We recommend the McLean County Fiscal Court strengthen oversight and internal controls in order to ensure complete and accurate accounting records are maintained and that no one individual has control over the accounting functions without establishing checks and balances to verify amounts recorded and reported are accurate.

County Judge/Executive’s Response: The current McLean County Judge/Executive and Treasurer fully understand and realize the implications of insufficient internal controls regarding accounting records that were conducted during FY2018 by prior staff and elected officials. The Fiscal Court has approved, upon recommendation by the current Judge/Executive, the purchase and installation of improved financial management software. The software adheres to standards included in KRS 68.210 regarding the implementation of a uniform system of accounts.

In addition, the current Judge/Executive and treasurer also realize the brevity and necessity of following KRS 68.020, 68.110, 65.905, 68.260, and 68.360 regarding proper reporting, deadlines and budget creation. The strength and fiscal soundness of McLean County relies on having our fiscal house in order which has not been the case for a number of years.

Lastly, the Judge/Executive and Treasurer will continue to consult with neighboring counties for ideas and procedures to streamline duties and reporting procedures.

The McLean County Fiscal Court failed to implement adequate internal controls over cash processes and financial reporting: This is a repeat finding and was included in the prior year audit report as Finding 2017-010. The McLean County Fiscal Court had internal control weaknesses and noncompliances regarding cash processes and financial reporting. The following findings were noted with McLean County Fiscal Court’s cash processes and financial reporting:

- The former treasurer failed to perform monthly bank reconciliations for all bank accounts, including, the payroll revolving account for the entire fiscal year ending June 30, 2018. The former county treasurer stopped preparing monthly reconciliations in February 2016. The fiscal court entered into an agreement on December 18, 2018, with an outside CPA firm to prepare the bank reconciliations for Fiscal Years 2017-2018 and 2018-2019.
- The former county treasurer failed to record interest earned on certificates of deposit in the amount of \$249. This amount includes \$145 in interest earned in the Local Government Economic Assistance (LGEA) fund and \$104 earned in the fire department fund.
- The former county treasurer failed to record a \$100 withdrawal from the fire department fund truck account to the disbursement ledger.
- The former county treasurer failed to accurately maintain and report the financial activity for the justice center corporation. The former county treasurer netted the receipts and disbursements for March 2018, causing them to be understated \$215,844.
- The former treasurer presented \$311,725 of cash transfers for the months of July and August 2018 to the fiscal court in December 2018. These amounts do not agree to what was reported on the fourth quarter financial statement. Additionally, we noted one cash transfer in the amount of \$26,512 was never approved by the fiscal court.
- The former treasurer transferred \$76,206 from the fire department fund (a restricted fund) to various other funds. The general fund repaid \$10,646 back to the fire department fund.

The former county treasurer's lack of understanding of accounting concepts and responsibilities caused the findings noted above. Additionally, there were no internal controls implemented by the fiscal court to discover the aforementioned problems.

The failure to maintain accurate and detailed accounting information does not provide a true picture of the activities within the fiscal court's accounts and increases the risk that undetected misstatements due to error or fraud could occur. Furthermore, the McLean County Fiscal Court's lack of controls resulted in the LGEA fund and fire department fund cash balances being understated by \$145 and \$4, respectively, as well as, the financial activity of the justice center corporation being understated by \$215,844. Unallowable transfers from the fire department fund created a receivable from other funds due back to the fire department fund in the amount of \$65,560.

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* requires monthly bank reconciliations. Additionally, strong internal controls over bank reconciliations are vital in ensuring that cash balances have been accounted for properly. Strong internal controls are also important in safeguarding the county's assets and those given the responsibility of accounting for them. Furthermore, fire department funds are restricted for use per the county's fire dues ordinance and the nature of other fire department fund receipts.

We make the following recommendations to address these findings:

- Monthly bank reconciliations should be performed and submitted to the fiscal court for approval for all funds of the McLean County Fiscal Court.
- All interest earned on certificates of deposit should be recorded to the appropriate fund's receipts ledger.

- All financial activity for the justice center corporation should be accurately maintained by the county treasurer.
- All cash transfers should be approved by the fiscal court prior to the county treasurer making the transfer. Fiscal court approval of all transfers should be documented in the fiscal court orders.
- The fire department fund should be reimbursed for unallowable transfers of restricted funds.

County Judge/Executive's Response: Proper training and adherence to statutes regarding uniform budgeting and accounting procedures have historically been insufficient in McLean County. Since July of 2019, the McLean County Fiscal Court has approved substantial changes regarding adequate internal controls which have included changing staff, following proper cash accounting procedures, following proper budget transfers and amendments, and the presentation of reports prior to fiscal court meetings.

Lastly, proper adoption of procedures listed in KRS 68.210 gives an adequate framework for the treasurer and court to report cash activity. For FY2021 the Judge/Executive has implemented enhanced daily cash receipt tracking to help with proper documentation of receipts for each fund, site and department.

The McLean County Fiscal Court failed to implement adequate internal controls over debt and debt service: This is a repeat finding and was included in the prior year audit report as Findings 2017-004 and 2017-022. Material internal control weaknesses existed over the reporting of debt and debt service of the McLean County Fiscal Court, and the following discrepancies were noted:

- The June 30, 2018 outstanding debt balances reported on the fourth quarter financial report were materially misstated when compared to the actual debt balances confirmed with lenders. According to the fourth quarter financial report, total long-term liabilities were \$3,097,182 as of June 30, 2018. This balance is overstated for four debt issues, which included a balance for the 2017 excavator that was paid off in January 2018. The combined misstatement is \$727,642.
- Interest balances were overstated by \$621,366.
- The McLean County Fiscal Court borrowed \$115,858 in April 2018, to purchase a 2018 excavator. The loan proceeds were paid directly to the vendor on behalf of the fiscal court for this purchase. Therefore, it was not included in the county's financial statements as a budgeted disbursement for fiscal year ended June 30, 2018.
- The McLean County Fiscal Court failed to approve the financing for the 2018 excavator.

The county failed to implement a strong internal control system over debt and debt service, and instead relied on a single person without adequate oversight. Additionally, the former county treasurer was not aware that she needed to budget for or record loan proceeds when they were paid directly by the lender to the vendor, since she did not directly receive these funds. This lack of internal controls resulted in the county's fourth quarter financial report being materially misstated. Additionally, by not properly budgeting these items, the fiscal court overspent the roads line item by \$15,623 in the road fund.

Strong internal controls over outstanding debt and debt service are necessary to ensure accurate financial reporting. Also, KRS 68.210 gives the state local finance officer the authority to prescribe a uniform system of accounts for all counties and county officials. The *County Budget Preparation and State Local Finance Officer Policy Manual* outlines minimum requirements for the handling of public funds, including outstanding debt and liabilities. It also requires all borrowed money received and repaid must be reflected in the county budget. The county judge/executive is required to submit estimated receipts and proposed disbursements to the fiscal court by May 1 of each year. The budget is prepared by fund, function, and activity and is required to be adopted by the fiscal court by July 1.

We recommend the county strengthen internal controls over the reporting of debt service payments and outstanding liability 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 its lenders to verify outstanding debt balances are in agreement with the county's schedule of leases and liabilities. The fiscal court should also ensure that they properly budget and record all borrowed money and any related purchases. All financing arrangements should be approved by the fiscal court. Such practices will strengthen internal controls over liabilities and debt service and ensure that proper amounts are reported.

County Judge/Executive's Response: The McLean County Fiscal Court and Judge/Executive, as of FY21, have an accurate view of current debt and debt service due to the extensive work of new staff. Our review has allowed for current debts to be accurately reflected. Surprisingly, the debt load previously reported were grossly overstated which added fund restraints that did not exist at the level previous reported by former elected officials and prior treasurers.

Additionally, with the adoption of new accounting software, the court now possesses the assets necessary to effectively record the reduction in county debt and debt service. With training, assistance from the department of local government, and the state auditor's office, we feel that our representation of current county debt is accurate to date.

Regarding new debts, the county currently adheres to the completion of Notice of Intent to Finance documentation as required by KRS 68.210.

The McLean County Fiscal Court failed to implement adequate internal controls over maintenance of the capital asset schedule: This is a repeat finding and was included in the prior year audit report as Finding 2017-018. In fiscal year 2018, the McLean County Fiscal Court failed to record \$884,885 in additions and \$113,605 in deletions to their capital asset schedule. Capital asset beginning balances were misstated in the amount of \$2,091,620 and the capital asset schedule was not updated for changes from the previous audit. Therefore, the schedule was missing some of the previous year's additions and included some prior year deletions.

According to county personnel, there was some confusion on what items needed to be added and deleted. Without adequate controls, the risk of asset misappropriation increases or results in assets not being covered by insurance in the event of an accident or loss. Additionally, the fiscal court's

capital asset schedule was materially misstated and did not accurately reflect the assets held by the county.

Good internal controls dictate that assets be properly tracked and maintained to prevent theft or loss. These controls should also ensure compliance with applicable laws and regulations related to capital assets. Furthermore, per the fiscal court's capital asset capitalization policy all land, land improvements, buildings, building improvements, and infrastructure over \$25,000 should be capitalized and added to the fiscal court's capital asset schedule. In addition, all vehicles over \$10,000 and equipment over \$5,000 should also be capitalized and added to the fiscal court's capital asset schedule. When items on the capital asset schedule are sold or disposed, they should be deleted from the fiscal court's capital asset schedule.

Under the authority of KRS 68.210, the Department of Local Government (DLG) issued the *County Budget Preparation and State Local Finance Officer Policy Manual* which states that “[f]or purposes of internal control, an asset inventory listing must be maintained for all asset purchases/donations above a reasonable dollar amount, and have a useful life of greater than one year.”

We recommend the McLean County Fiscal Court implement internal controls to ensure all assets are being appropriately added and deleted from the capital asset schedule. We also recommend the fiscal court adhere to their capital asset policy.

County Judge/Executive's Response: The current Fiscal Court and Judge/Executive are aware of KRS 68.210 which outlines proper maintenance of capital asset schedules. Work began, regarding updating these schedules, when the new Judge/Executive took office in the fall of 2019. Current staff have been instructed to use court approved purchases, updated department inventories and active asset records to ensure proper documentation of assets relating to the McLean County Fiscal Court.

In addition, the integration of an improvement purchase order system has allowed for the proper documentation of purchases in order to document the best value and retention of purchases.

The current McLean County Judge/Executive and county treasurer declined signing the required certification of compliance with the Local Government Economic Assistance and development programs: This is a repeat finding and was included in the prior year audit report as Finding 2017-026. The current judge/executive and county treasurer did not sign the certification of compliance with the Local Government Economic Assistance (LGEA) and development programs. Since the judge/executive and county treasurer did not sign the certification, it is not included in the audit report. LGEA expenditures for Fiscal Year 2018 were \$463,757.

The current judge/executive and county treasurer did not feel comfortable certifying that the local government economic assistance and development program funds had been expended appropriately, since neither of them were the judge/executive or county treasurer for the fiscal year 2018. Furthermore, the former county treasurer and former county judge executive failed to maintain adequate records to document that the funds were expended for the intended purposes.

Funds may not have been expended for the intended purposes of the local government economic assistance and development program. Additionally, the fiscal court was not in compliance with KRS 42.460.

KRS 42.460, states, “[e]xcept as provided in KRS 91A.040(7)(b), any assistance granted under KRS 42.450 to 42.495 shall include an agreement that an independent annual audit shall be conducted and that the audit report shall include a certification that the funds were expended for the purpose intended. A copy of the audit and certification of compliance shall be forwarded to the Department for Local Government, in the case of assistance granted from the local government economic assistance fund or the local government economic development fund as allocated in KRS 42.4592(1)(a) and (b), or to the Cabinet for Economic Development and the Kentucky Economic Development Finance Authority, in the case of assistance granted from the local government economic development fund, within eighteen (18) months after the end of the fiscal year.”

We recommend the fiscal court maintain adequate records to determine that the funds expended under the local government economic assistance and development program were expended for the intended purposes, so that the county judge executive and treasurer can attest to the proper spending of those funds.

County Judge/Executive’s Response: The current Judge/Executive and Treasurer realize and believe that it is not in their best interests to certify the actions conducted by previous officials and staff. There are numerous issues with the FY2017, FY2018, and FY2019 budget reports, account totals and actions that are not verifiable to current staff and elected officials due to deficiencies in previous oversight, reporting and control. The current Judge/Executive and Treasurer believe that work conducted since their activation can be verified as required by statute and will attest to those procedures when those auditing requirements are completed for FY2021 forward.

The McLean County Fiscal Court failed to implement sufficient internal controls over their service organization’s collection of ambulance receipts: This is a repeat finding and was included in the prior year audit report as Finding 2017-013. The fiscal court failed to oversee the ambulance billing service organization that handled all of the billing and receipt collections for the McLean County Ambulance Service. In the fiscal year ending June 30, 2018, the amount of ambulance receipts reported on the quarterly report was \$504,638. The following findings were noted with the collection of receipts at the service organization:

- The county does not review the service organization’s billing and collections to ensure all the McLean County Ambulance Service runs and collections are accounted for properly. There was no documentation of the review of internal controls implemented at the service organization. The service organization did not have a Service Organization Report (SOC) Report. A SOC 1 report focuses on controls at the service organization that would be useful to user entities and their auditors for the purpose of planning a financial statement audit of the user entity and evaluating internal control over financial reporting at the user entity.
- The service organization failed to respond to numerous information requests from auditors. Two months after the last auditor inquiry, county officials were able to get the service organization to respond to information requests. The fiscal court has minimal oversight and

control over the collection of ambulance receipts process. Although the service organization sent a month end report to the fiscal court that documented charges, credits, the accounts receivable balance, and daily deposit amounts, the fiscal court was not able to determine if all amounts intended for them were actually collected and deposited since the total amount of ambulance runs and corresponding charges were not presented to the fiscal court. Because of the lack of detail in the service organization reports, the fiscal court was unable to verify the amount of ambulance revenue due to them.

The findings listed above are due to the lack of effective internal controls. Because of the lack of adequate internal controls over service organization activities, the ambulance billing receipts were left vulnerable to misappropriation and loss.

Strong internal controls over the collection of receipts are vital in ensuring that receipts are accounted for properly. Strong internal controls are also important in safeguarding the county's assets and those given the responsibility of accounting for them, as well as helping make certain the county is in compliance with state statutes.

We recommend the McLean County Fiscal Court strengthen internal controls regarding the ambulance service's service organization.

County Judge/Executive's Response: The realization of risk regarding the collection of ambulance receipts by a contract service organization is both troubling and a point of concern for the current Judge/Executive. The Treasurer and Judge/Executive have addressed the issue with the ambulance service and are in discussions with staff to improve redundant oversight of billing, which historically, has been deficient and has placed the ambulance service at risk for loss of receipts. Given the current financial state of the McLean County Fiscal Court, the adoption of improved internal control regarding ambulance receipts will be given top priority.

The McLean County Fiscal Court failed to implement adequate internal controls over the collection of receipts at off-site locations: This is a repeat finding and was included in the prior year audit report as Findings 2017-006 and 2017-016. The McLean County Fiscal Court has poor internal controls over the collection of receipts at off-site locations. The following findings were noted with McLean County Fiscal Court's collection of receipts at off-site locations:

- Receipts were not issued for all applicable transactions as required by KRS 64.840.
- Receipts collected at the road department and transfer site are not turned over to the county treasurer daily, as required by KRS 68.210.
- Copies of donation receipts at Eastern and South Eastern Fire Departments were not maintained by the fire departments.
- There were no records for receipts collected at the animal shelter for Fiscal Year 2018. As a result of a prior year audit finding, the animal shelter was closed during Fiscal Year 2018.

The findings listed above are due to the lack of effective internal controls. Because of the aforementioned findings, receipts were left vulnerable to misappropriation and loss. Also, the McLean County Fiscal Court failed to issue and maintain required documentation as prescribed by state statutes.

Strong internal controls over the collection of receipts are vital in ensuring that receipts are accounted for properly. Strong internal controls are also important in safeguarding the county's assets and those given the responsibility of accounting for them, as well as helping make certain the county is in compliance with state statutes. KRS 64.840(1) states, in part, "all county officials shall, upon the receipt of any fine, forfeiture, tax, or fee, prepare a receipt that meets the specifications of the state local finance officer, if the fine, forfeiture, tax, or fee is paid:

- (a) In cash;
- (b) By a party appearing in person to pay; or
- (c) By check, credit card, or debit card account received through the mail, if the party includes an addressed, postage-paid return envelope and a request for receipt.

KRS 64.840(2) states, "[o]ne (1) copy of the receipt shall be given to the person paying the fine, forfeiture, tax, or fee and one (1) copy shall be retained by the official for his own records. One (1) copy of the receipt shall be retained by the official to be placed with the daily bank deposit." Also, KRS 68.210 states, in part, "[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 system of uniform accounts for all counties and county officials[.]"

We make the following recommendations to address these findings:

- Pre-numbered, triplicate receipts should be issued for all applicable transactions according to KRS 64.840.
- All receipts collected at off-site locations should be turned over to the county treasurer daily to be deposited according to KRS 68.210.
- All off-site locations should keep a receipts ledger to document all types of receipts, dates received, and amounts collected.

County Judge/Executive's Response: The McLean County Fiscal Court and Judge/Executive are currently conducting a review of procedures and equipment that will help to improve internal controls regarding the collection of receipts at off-site locations.

The McLean County Fiscal Court was not in compliance with bid laws and failed to implement adequate internal controls over the bid process: This is a repeat finding and was included in the prior year audit report as Finding 2017-008. In Fiscal Year 2018, the McLean County Fiscal Court failed to follow bid laws and regulations. The McLean County Fiscal Court made multiple purchases from two vendors during Fiscal Year 2018. Payments to each vendor exceeded the \$20,000 bid requirement included in the county's administrative code. One vendor was paid \$26,415 for computer maintenance and supplies. Another vendor was paid \$ 23,699 for culverts. Also, the fiscal court failed to properly procure three capital asset additions. As a result of the aforementioned items, the McLean County Fiscal Court had \$182,118 in purchases that were not bid.

There was a lack of knowledge and internal controls over bidding procedures and bid laws. County personnel were not aware of all the elements surrounding bidding requirements. Additionally, it was an oversight the purchases of capital assets were not bid. Since bidding procedures were not followed, it is possible that the county did not get the lowest rate for purchases. This also puts the

county at higher risk for potential fraudulent purchases. Additionally, the county was not in compliance with KRS 424.260.

Strong internal controls require management to monitor disbursements and purchase orders to ensure compliance with bid laws. During the audit period, KRS 424.260(1) stated, “[e]xcept 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.” Additionally, the county’s administrative code states, “Any expenditure or contract 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) shall be subject to competitive bidding.”

We recommend the fiscal court implement internal controls to monitor all procurement in order to ensure that all required elements of bidding procedures are followed.

County Judge/Executive’s Response: As of January 2020, the current Judge/Executive has revised and implemented an enhanced purchase order system and bid process. The fiscal court continues to implement a \$20,000.00 bid threshold due to fiscal constraints. The court also seeks guidance from the county attorney on matters related to statute requirements regarding state contract pricing and procedures which were not conducted previously. The currently policy also requires quotes for expenses over the \$500.00 baseline. These guidelines have helped to insure proper expenditures of county funds.

The McLean County fiscal court does not have adequate internal controls over payroll processing: The McLean County Fiscal Court failed to implement adequate internal controls over payroll and timekeeping processes. The following findings were noted during testing of McLean County Fiscal Court’s payroll:

- Two employees were not paid according to the approved salary schedule, and were paid \$.25 an hour over their approved hourly rate for the time period tested.
- One employee timesheet did not include the employee or supervisor’s signature.
- One employee paid overtime did not have a timesheet available to support the hours worked.
- Twelve employees did not have the current withholding forms in their personnel file.
- One employee did not have the correct amount of local withholding withheld.
- Five employees did not have support for leave balances used during the tested period.
- Two employees received health insurance benefits while receiving workers compensation insurance. The county paid the \$2,980 employee portion of the premiums and also \$10,483 in employer premiums for a total of \$13,463 paid on behalf of these two employees.
- One employee was paid compensatory time in the amount of \$3,355 for 250 hours accrued which was more than the hours allowable to accrue per the county’s administrative code.

- Two employees accrued sick time totaling 581 hours resulting in \$8,250, while not working full time, one of which was paid in excess of the 60 days allowable to accrue permitted by the county's administrative code.

Based on county records there was a lack of segregation of duties over payroll preparation and no independent review of payroll items before processing and disbursing payroll. Due to the lack of internal controls over payroll, payments for payroll were not properly supported, employees received benefits for which they were not entitled, payroll taxes were not properly withheld, and the fiscal court made payments in violation of the county's administrative code. Failure to maintain timesheets also resulted in the county not being in compliance with KRS 337.320.

Strong internal controls over payroll and timekeeping are vital in ensuring the payroll amounts are calculated and accounted for properly. Strong internal controls are also important in safeguarding the county's assets and those given the responsibility of accounting for them, as well as helping make certain the county is in compliance with state statutes.

The McLean County Administrative Code, Section 5.35 states, “[a]s of January 1, 2016, a County employee engaged in work in excess of thirty seven and half (37.5) hours, may accrue, not more than forth (40) hours of compensatory time.”

The McLean County Administrative Code Section 5.27(2) states, “[f]ull time employees shall be eligible to accrue sick leave at the rate of one day per month accruing at the end of each month for each full month worked.” Also, section 5.27(3) states, “[s]ick leave may be accumulated from year to year up to 60 days.”

Lastly, KRS 337.320(1) requires employers to maintain a record of “[t]he hours worked each day by each employee.”

We make the following recommendations to address these findings:

- An individual independent of the payroll process should review payroll calculations, withholding amounts, etc., to verify that all amounts have been calculated properly and that they are properly supported.
- All timesheets should be signed by the corresponding employee and his or her supervisor.
- Personnel files should be updated regularly.

County Judge/Executive's Response: The McLean County Fiscal Court is in the process of approving payroll processing and accounts at monthly fiscal court meetings. This will be a new process that has not been in place previously. The Judge/Executive and Treasurer believe this process will increase transparency and oversight of this process. In addition, the current staff also realize that previous payroll processing was not conducted properly nor reconciled correctly.

As listed in the audit findings, the current Judge/Executive also believes that the lack of adherence, by previous administrations, has created a risk to the county regarding employee time accounts and lacks equitable distribution of funds to county employees outside the bounds of approved procedures. The current Judge/Executive has installed timeclocks for employees and has

integrated the purchase of new time management software to better safeguard the county from previously mentioned risks. In addition, the Judge/Executive is also researching third-party options to independently verify employee payroll account totals to further improve oversight of these accounts.

The former McLean County Treasurer failed to reconcile the payroll revolving account: This is a repeat finding and was included in the prior year audit report as Finding 2017-019. The McLean County Fiscal Court uses a clearing bank account for payroll processing. Payroll revolving accounts are established in order to process individual payroll transactions and should zero out or reconcile to a minimal carrying balance. Deposits are made into the bank account from the county's operating accounts to pay for salaries, taxes, matching portion of taxes, retirement, health insurance, and other payments to benefit vendors. The former county treasurer stopped preparing monthly reconciliations in February 2016. The fiscal court entered into an agreement with an outside CPA firm to prepare the bank reconciliations for Fiscal Years 2017-2018 and 2018-2019. However, the payroll account was not properly reconciled to zero. As of June 30, 2018, a balance of \$26,092 existed in the account.

The former county treasurer neglected her duty to reconcile bank accounts monthly as described in the *County Budget Preparation and State Local Finance Officer Policy Manual*. There were no internal controls in place to ensure the payroll account was properly reconciled each month. The payroll revolving account should zero out at the end of the year or reconcile to a minimal carrying balance. However, because the account had not been reconciled, the payroll revolving account had an ending balance of \$26,092 as of June 30, 2018. Funds held in a clearing account when they are not needed to pay liabilities removes those funds from accounts where they could be used in the regular operations of the county. Additionally, a lack of payroll reconciliation to the ledgers on a regular basis increases risk of misstatement in the financial statements, and can result in undetected errors or fraud occurring.

Good internal controls require timely, accurate reconciliations for bank accounts and all other reports concerning payroll, to ensure all funds are properly accounted for and to prevent misappropriation of funds and inaccurate financial reporting. Due to the nature of revolving accounts, only the funds necessary to pay employees and government agencies are transferred from other funds. Therefore, the reconciled balance each month of the payroll revolving account should be zero. Also, 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* requires monthly bank reconciliations.

We recommend the payroll revolving account be properly reconciled on a monthly basis. Because the payroll revolving account is a clearing account, this account should reconcile to a zero ending cash balance or a minimal carrying balance at the end of each month.

County Judge/Executive's Response: The McLean County Fiscal Court, Judge/Executive and Treasurer have adopted proper controls regarding the reconciliation and control of the payroll revolving account in accordance with County Budget Preparation and State Local Finance Office Policy Manual. Changes include keeping a minimum balance in the clearing account and reporting such activity to the fiscal court.

The former McLean County Treasurer failed to prepare an annual settlement s required per KRS 68.020(5) And KRS 68.030: The former McLean County Treasurer failed to prepare an annual treasurer’s settlement for the fiscal year ending June 30, 2018. The former county treasurer lacked understanding of her job responsibilities. The fiscal court was not presented with the cumulative information for the fiscal year ending June 30, 2018. The lack of a treasurer’s settlement also hid the deficits that were occurring in several county funds, and the lack of proper accounting for all county financial activity. Additionally, by not submitting the treasurer’s settlement, the fiscal court was not in compliance with KRS 68.020(5) and KRS 68.030.

KRS 68.020(5) states, in part, “[t]he county treasurer shall, when required by the fiscal court, settle his accounts as county treasurer, and within thirty (30) days after the close of each fiscal court, he shall, unless his immediate predecessor has done so, make a full and complete settlement for the preceding fiscal year with the fiscal court or with a person or persons whom the fiscal court, by order of record, appoints to make settlement with him[.]” Additionally, KRS 68.030, states, in part, “[e]ach settlement made by the county treasurer shall be approved by the fiscal court in open court, and shall, by order of the fiscal court, be recorded by the county clerk in a book kept for that purpose[.]” Strong internal controls are also important in safeguarding the county’s assets and those given the responsibility of accounting for them.

We recommend the fiscal court ensure the treasurer’s annual settlement is prepared and approved in accordance with KRS 68.020(5) and KRS 68.030.

County Judge/Executive’s Response: The current county treasurer is knowledgeable of required duties and has completed required reports to-date.

In addition, the treasurer also understands the requirements to seek training and guidance on reporting standards and due dates.

The former McLean County Judge/Executive failed to require encumbrances be properly reported on the fourth quarter financial report: This is a repeat finding and was included in the prior year audit report as Finding 2017-007. McLean County’s encumbrances at year-end were not properly reported on the fourth quarter financial report. Upon further examination, it was determined that a list of encumbrances had not been maintained as of June 30, 2018.

The former county judge/executive failed to require encumbrances be properly reported on the fourth quarter financial report. By not properly reporting encumbrances, the fiscal court is not in compliance with reporting requirements per the Department for Local Government (DLG). In addition, failure to report encumbrances will not accurately reflect cash balances and alert management to any possible cash flow issues.

KRS 68.360(2) states, in part, “[t]he county judge/executive shall within (15) days after the end of each quarter of each fiscal year, prepare a statement showing for the current fiscal year to date actual receipts from each county revenue source, the totals of all encumbrances and expenditures charged against each budget fund, the unencumbered balance of the fund, and any transfers made to or from the fund[.]” Furthermore, the *County Budget Preparation and State Local Finance*

Officer Policy Manual requires the county to disclose encumbrances on the face of the fourth quarter financial report. Good internal controls dictate the fiscal court monitor line items to ensure that there is ample cash and budget prior to approving payment of bills.

We recommend the county maintain an encumbrance listing and properly report encumbrances on the fourth quarter financial report in order to accurately disclose unencumbered fund balances.

County Judge/Executive's Response: *The current Judge/Executive is aware of the duties and responsibility of county elected officials. The Judge/Executive also realizes that accurate representation of encumbrances to the fiscal court is crucial to effective decision-making procedures. The current Judge/Executive has thorough understanding and has installed the new financial software on his computer in order to view encumbrances weekly.*

The McLean County Fiscal Court did not have adequate controls over disbursements and ACH transactions: This is a repeat finding and was included in the prior year audit report as Finding 2017-011. During our review and testing of four monthly credit card statements, we noted the following exceptions:

- Two transactions were missing invoices, totaling \$2,411.
- Sales tax totaling \$90 was paid on four transactions.
- Thirty of the 156 transactions on the fuel credit card were missing invoices.

Additionally, auditor tested 25 of the 266 ACH transactions and found there were no documented controls in place over these transactions. The former finance officer was paying most utilities bills for July and August of 2017 by ACH, while they were declining, she still continued to pay some utility bills for September through December of 2017.

The McLean County Fiscal Court failed to implement internal controls over disbursements to ensure proper handling and compliance with applicable laws. In addition, the former county treasurer failed to enforce that sales tax should not be paid on purchases. The former finance officer was unaware that disbursements were only to be made by check.

The lack of controls increases the risk of undetected errors or fraud occurring. By failing to maintain adequate documentation, the fiscal court is increasing the risk of paying invoices for goods or services that were not provided to the fiscal court. In addition, vendors were given access to the county's bank accounts without sufficient monitoring in place over these transactions.

Good internal controls dictate that adequate supporting documentation be maintained for all disbursements. The McLean County Fiscal Court should be exempt from paying sales tax because the fiscal court is a governmental entity. KRS 139.470(6) and (7) exempts local governments from paying state sales tax on goods and services.

Under the authority of KRS 68.210, the Department of Local Government (DLG) issued the *County Budget Preparation and State Local Finance Officer Policy Manual*, which states, “[d]isbursements by checks only.”

We recommend the fiscal court implement internal control procedures to ensure that all disbursements are properly supported. Also, per KRS 13.470(6) and (7) the fiscal court should ensure sales tax is not being paid on purchases. Lastly, all disbursements should only be made by check and agreed to supporting documentation prior to payment.

County Judge/Executive's Response: The Finance Officer, Treasurer and Judge/Executive have adopted an improved policy regarding the denial of request for purchase for any item that includes state sales tax, electronic purchase methods and other deficiencies. In addition, all purchase shall be paid by check only according to state regulations. Exceptions include ACH transactions for payroll.

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

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