



Auditor of Public Accounts  
Mike Harmon

**FOR IMMEDIATE RELEASE**

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

**FRANKFORT, Ky.** – State Auditor Mike Harmon has released the audit of the financial statement of the Estill 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 Estill County Fiscal Court in accordance with accounting principles generally accepted in the United States of America.

Our responsibility is to express an opinion on this financial statement based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and the *Audit Guide for Fiscal Court Audits* issued by the Auditor of Public Accounts, Commonwealth of Kentucky. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statement is free from material misstatement. Because of the issues described in the Basis for Disclaimer of Opinion paragraph, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Audit evidence indicated intentional override of internal controls by management and employees that had a potentially material effect on the financial statement. The Estill County Fiscal Court had serious weaknesses in the operation of its internal control procedures and failed to implement effective oversight and review procedures to prevent and detect errors, misstatements, and fraud in the county’s financial activities. The absence of effective internal controls, oversight, and review procedures created an environment in which funds were misappropriated and financial records were manipulated. Based on these conditions, we determined the fraud risk to be too high and were unable to apply other procedures to mitigate this risk. The significant of these issues, in the aggregate, prevents us from placing reliance on the financial activities contained in the Estill

County Fiscal Court's Fourth Quarter Financial Statement and from expressing an opinion on the financial statement of the Estill County Fiscal Court.

Because of the significance of the issues described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient, appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the financial statement.

Finding 6 of the audit report will be referred to the Kentucky Office of the Attorney General.

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 Estill County Fiscal Court's internal control environment is ineffective:** This is a repeat finding and was included in the prior year audit report as Finding 2018-001. The fiscal court and management failed to establish adequate internal controls, oversight, and review procedures for material financial processes, namely for information technology, receipts, disbursements, and payroll. Additionally, management intentionally circumvented existing controls. The fiscal court has numerous internal control and non-compliance issues that are discussed in detail in Findings 2019-002 through 2019-013 that result in significant errors, misstatements, violations of statutes, and violations of the Estill County Administrative Code. Furthermore, there is no assurance that transactions processed are allowable, adequately supported, and a proper use of taxpayer funds.

Management did not adequately assess and identify risks associated with inadequate segregation of duties over revenues, expenditures, and payroll. Management was aware of non-compliance issues reported in previous audit reports. Management failed to implement effective corrective action procedures to ensure these issues did not continue. The lack of corrective action resulted in repeat findings and numerous significant issues.

Failure to establish adequate controls, oversight, and review procedures increases the risk that undetected fraud or other errors will occur. The combination of the findings reported results in a control environment that is ineffective to produce financial information that is complete, accurate, and free from material misstatement. Furthermore, management circumventing existing controls resulted in misappropriated taxpayers funds.

Due to the pervasiveness of inadequate controls, management's intentional override of existing controls, and lack of oversight/review of significant processes, we cannot issue an opinion on the financial statement. Testing was expanded in all areas to address the risks noted, but audit procedures could not overcome the risk of undetected errors, fraud, and misstatements and we cannot place reliance on the financial data. A disclaimer of opinion will be issued.

It is the fiscal court and management's responsibility to ensure adequate internal controls and procedures are in place to ensure complete and accurate financial reporting and to ensure taxpayers resources are used efficiently, effectively, and for intended purposes. There are numerous statutes

and requirements outlined in the Department for Local Government's (DLG) *County Budget Preparation and State Local Finance Officer Policy Manual* that govern county operations and are detailed in the current year findings.

We recommend the fiscal court and management review all current year findings and determine adequate corrective action to ensure the issues will be corrected timely. Further, we recommend the fiscal court and management review all internal control processes to address any weaknesses noted and implement policies and procedures to ensure financial information is complete, accurate, and free of material misstatement.

*County Judge/Executive's Response:*

1. *Better purchase order system in place.*
2. *Claims are reviewed by Finance Officer and Treasurer, presented to Judge and Fiscal Court for review and approval, before payments are made.*
3. *Payroll account has been reconciled. Reports are being completed and submitted timely. Time sheets are reviewed by department heads, then by Finance Officer and Treasurer, then to County Judge if questions. All leave time is entered and balances maintained.*
4. *Receipts – Implemented more structured reporting at Animal Shelter and Senior Center. Preparing to implement software program for receipts at both sites.*
5. *Implemented more structure reporting of Occupational Tax receipts. Utilizing software program for more detailed accounting and notifications.*
6. *Added more line items to budget and educated personnel for better coding of items.*
7. *Passwords and access to financial software programs has been changed. Working with IT support to improve security.*
8. *Financial statements and quarterly reports are submitted to Fiscal Court.*
9. *All bids are advertised as required, reviewed and awarded or denied by Fiscal Court (recommendations are received from departments involved).*

*The new administration has worked together to address issues as we become aware of them and to improve all day to day operations.*

**The Estill County Fiscal Court does not have adequate controls over Their financial accounting software program:** This is a repeat finding and was included in the prior year audit report as Finding 2018-002. The fiscal court utilizes a financial accounting software program to post financial transactions. This system is shared among several employees on a computer network. The employees that have access to this system do not have unique user names and passwords. One username and password is shared among several employees.

Management failed to identify the risk associated with financial accounting data and failed to implement adequate policies and procedures to protect such data and ensure that it is complete, accurate, and free of material misstatement.

Shared usernames and passwords increase the risk that undetected fraud, errors, and misstatements will occur. Without proper controls over financial data, it is harder to determine which employees

are responsible for problems that may arise. Employees are also in violation of the county's administrative code as it pertains to passwords.

The Estill County Administrative Code page 77 under "Security" states, "[p]asswords and sign on access codes shall not be shared with anyone including co-workers, family members, or other unauthorized personnel."

Further, strong internal controls require each employee to have a unique user name and password that is changed at regular intervals. Computer programs should have a log that lists changes to data and the person performing such changes so that an appropriate level of management can periodically review to ensure all changes are necessary and approved. Passwords should never be shared among employees and employees should be restricted to certain parts of the program they can access based on their job duties.

We recommend the fiscal court review the policies and procedures regarding computer information and implement adequate controls to ensure data is complete, accurate, and free of material misstatement.

*County Judge/Executive's Response: The financial software program has four (4) programs. Each program has password to access the program and passwords for each area within the program. Tax program is used for Occupational Tax by the occupational Tax Clerk and the Treasurer. Pay is used for payroll by the Payroll Clerk and the Treasurer. Books is used for purchase orders, claims, bank reconciliation, etc by the Finance Officer and Treasurer. Express is used for filing Quarterly Reports to DLG and W2's by the Treasurer. Each person has passwords for the areas they use within the programs. Treasurer has access to all.*

*Currently working with IT Support to create stronger security, tracking capabilities and backup.*

**The Estill County Fiscal Court failed to implement adequate internal controls and oversight for disbursements:** This is a repeat finding and was included in the prior year audit report as Finding 2018-003. Our tests of disbursements included an examination of 119 disbursements from the county's operating funds. We noted numerous noncompliance issues:

- Twelve disbursements totaling \$253,833, or about 10% of our test sample, did not have appropriate supporting documentation.
- One disbursement totaling \$5,992 did not have proper signatures on cancelled checks. This disbursement was signed by the former treasurer but was not signed by the former county judge/executive or designee.
- Seventeen disbursements totaling \$193,187, or about 15% of our test sample, were not presented to the fiscal court before payment.
- Seventeen disbursements were not recorded correctly in the ledgers. Of these, six disbursements totaling \$142,931 were recorded in an incorrect account code or line item; one disbursement was recorded in the ledger as one amount but the cancelled check revealed a different amount - a variance of \$13,530; ten disbursements totaling \$83,894 were recorded as a payment to the revolving payroll account but the cancelled check revealed a different payee.

- Thirty-four disbursements totaling \$851,316, about 29% of our test sample, were not paid timely (within 30 working days of receiving the invoice or bill), some of which were more than 12 months overdue.
- One hundred thirteen disbursements totaling \$1,883,193, about 95% of our test sample, did not have a properly executed purchase order because the description of items being purchased was vague or incomplete, the account code listed was absent or incorrect, and the estimated amount for the purchase was not filled out until after the purchase order had been issued. Additionally, encumbrances (i.e. outstanding purchase orders) were not tracked, totaled, and included on the year-end financial report.
- Bidding requirements were not followed. The fiscal court did not follow competitive bidding requirements for two different types of goods/services (repairs/maintenance and diesel fuel) that were purchased from two vendors.

The fiscal court did not implement adequate procedures and oversight regarding the documentation, preparation, and authorization of disbursements. The county's administrative code outlines proper procedures for disbursements. However, management overrode these procedures and the fiscal court did not exercise adequate oversight to ensure these procedures were followed. The former finance officer received, processed, and maintained all supporting documentation for disbursements.

The former county judge/executive and former treasurer did not review supporting documentation, including purchase orders, before signing checks printed by the former finance officer. In addition, neither fiscal court members nor management reviewed invoices or bank statements to ensure proper procedures had been followed including: all disbursements included proper signatures, were properly recorded, were included on the claims list that had been presented to the fiscal court, were paid timely, were supported by a properly executed purchase order, and were in compliance with competitive bidding requirements. Management was aware that purchase orders were required for all purchases and that encumbrances must be reported on the year-end financial statement, but did not adhere to these requirements.

The fiscal court's failure to establish effective internal controls over disbursements resulted in numerous instances of noncompliance, violations of statutes, and violations of the county's administrative code as reflected above. Lack of proper accounting practices, internal controls, and oversight increases the risk that undetected misstatements and fraud will occur.

Failure to present a complete and accurate claims list to the fiscal court results in the fiscal court being unaware of all financial activity being processed, which can impact their decision making abilities and impairs the ability to effectively oversee financial activity.

Failure to pay obligations timely is indicative of poor financial management practices and can result in late fees and finance charges, which are a wasteful use of taxpayer resources. We noted \$11,099 of late fees and finance charges that were incurred. It is also a violation of statute for failure to pay invoices within 30 working days of receipt of the invoice or bill.

The risk of overspending the budget or spending in excess of funds available increases significantly without an effective purchase order system in place. Failure to report encumbrances

results in inaccurate cash balances reported on the year-end financial statement and can lead to improper financial decision making by the fiscal court. It is also a violation of Department for Local Government (DLG) regulations for disbursements to be processed without a purchase order and for failure to report encumbrances on the year-end financial statement.

Without proper procedures in place to mitigate the risks discussed above, the fiscal court is exposing public resources to potential misstatements and fraud. Due to the pervasiveness of the noncompliance issues noted above (among other issues outlined in other findings), a disclaimer of opinion was issued on the financial statements for fiscal year ended June 30, 2019.

Effective internal controls provide for adequate segregation of duties and prevent the same person from having a significant role in incompatible functions. Segregation of duties and proper oversight helps prevent fraud and misappropriation of assets and protects employees in the normal course of performing their daily responsibilities. Effective internal controls and proper oversight also help ensure compliance with laws, regulations, and grant agreements.

The most basic requirement of strong internal controls is to maintain adequate supporting documentation to substantiate disbursements. Additionally, KRS 68.020(1) states, “[t]he county treasurer shall receive and receipt for all money due the county from its collecting officers or from any other person whose duty it is to pay money into the county treasury, and shall disburse such money in such manner and for such purpose as may be authorized by appropriate authority of the fiscal court. He shall not disburse any money received by him for any purpose other than that for which it was collected and paid over to him, and when he pays out money he shall take a receipt therefor.”

Regarding proper signatures on checks, KRS 68.020(1) states, “[a]ll warrants for the payment of funds from the county treasury shall be co-signed by the county treasurer and the county judge/executive.” Another basic component of internal controls is that the date, payee, and amount recorded in the financial accounting software (i.e. general ledger, disbursements ledger, check register, etc.) must agree to the actual information on the cancelled check.

Guidance concerning presentation of disbursements (i.e. a claims list) to the fiscal court is outlined in statute. KRS 68.275(2) states, “[t]he county judge/executive shall present all claims to the fiscal court for review prior to payment and the court, for good cause shown, may order that a claim not be paid.”

KRS 65.140 stipulates timely payments to vendors by stating, “[u]nless the purchaser and vendor otherwise contract, all bills for goods and services shall be paid within thirty (30) working days of receipt of a vendor’s invoice except when payment is delayed because the purchaser has made a written disapproval of improper performances or improper invoicing by the vendor or by the vendor’s subcontractor.”

Purchase order requirements are outlined by the DLG. 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*, page 57, requires purchasing procedures including the following:

1. Purchases shall not be made without approval by the judge/executive (or designee), and/or a department head.
2. Purchase requests shall indicate the proper appropriation account number to which the claim will be posted.
3. 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.
4. Each department head issuing purchase requests shall keep an updated appropriation ledger and/or create a system of communication between the department head and the judge/executive or designee who is responsible for maintaining an updated, comprehensive appropriation ledger for the county.

Furthermore, KRS 68.360(2) states “[t]he county judge/executive shall, within fifteen (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....”

Competitive bidding ensures that the fiscal court procures materials and services at the best price available. KRS 424.260 states, “[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 for 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.” Effective June 27, 2019, the bid threshold established in KRS 424.260 was increased to \$30,000.

In addition, page 69-70 of the Estill County Administrative Code under “Procedures for Sealed Bidding” states, “[a]ny expenditure or contract for materials, supplies, equipment, or for contractual services other than professional, involving an expenditure of more than \$20,000 shall be subject to competitive bidding. The County Judge/Executive shall post the bid advertisement through a form of electronic media at any point from the time the bid is drafted until the bid opening. The County Judge/Executive shall place an advertisement in the newspaper of the largest circulation in the County at least once, no less than seven nor more than twenty-one days, before bid opening in accordance with Kentucky Revised Statutes. The advertisement shall include the time and place where the specifications may be obtained. If the durability of the product, the quality of service or other factors are to be considered in bid selection, such factors shall be stated in the advertisement. The County Judge/Executive shall open all bids publicly at the time and place stated in the advertisements and shall select the best bid by the qualified bidder to be recommended to the Fiscal Court for approval. If specifications need to be checked or verified, the Estill County Fiscal Court shall accept all the bids into the minutes through the appropriate procedures and allow the County Judge/Executive, department head, and other technical specialists review the bids for compliance with the specifications and determine the best bid. The County Judge/Executive checks all bids against the specifications to ensure that all bids are considered on an equal basis and to ensure that all bids meet the minimum specifications. After analyzing each bid with the assistance of the appropriate supervisor, department head or technical expert, the County Judge/Executive

creates a written recommendation as to the best bid by a responsible bidder. The Estill County Fiscal Court then decides whether or not to award the bid. If the lowest bid is not selected, the reasons for the selection shall be stated in writing. The Estill County Fiscal Court may reject all bids if none are satisfactory.”

We recommend the fiscal court implement adequate and effective internal control procedures for disbursements, including segregation of duties, to address each of the areas previously discussed. Additionally, strong management oversight and review procedures should be implemented to prevent and detect errors or fraud. Effective review procedures could be achieved if performed by an employee independent of the person or department initially performing those functions. All oversight and review procedures should be properly documented by initialing source documents, ledgers, reports, or other supporting documentation.

*County Judge/Executive’s Response: Purchase orders are required for all purchases. They are issued through Books before purchase can be made, where they appear as an encumbrance on all financial reports.*

*Before claims are presented to Fiscal Court for approval, a signed delivery ticker/invoice has been received and reviewed. Payments are issued after Fiscal Court approval. Checks are signed by the Judge and Treasurer. Claims are presented to Fiscal Court at the monthly meeting, unless there are questions or issues with the invoice. Special Court Meetings are called if an immediate payment is needed.*

*State bid guidelines are followed for purchases over \$30,000.00 as required.*

*When items are coded incorrect, they are corrected upon detection.*

**The Estill County Fiscal Court did not adhere to fourth year disbursement restrictions:** The original budget for the jail fund was \$899,300. No budget amendments were filed during the fiscal year. As of December 31, 2018, jail fund disbursements totaled \$757,789, which is 84% of the total jail budget.

Former officials did not have adequate controls and oversight procedures in place to monitor fourth year disbursements.

As a result, the incoming administration only had 16% of the jail budget available to utilize while still having half of the fiscal year to operate. This creates financial pressure on incoming officials that were not involved in the financial decision making prior to taking office.

Statutes limit expenditures in the first half of each fourth year (local official election years) to avoid situations in which outgoing officials spend the entire budget or a substantial portion of the budget before leaving office in December before the new administration takes office in January, resulting in incoming officials facing financial hardships from the beginning of their term of office. Furthermore, good internal controls require constant monitoring of budgeted expenditures to actual expenditures to manage the cash flow and operations of the county to ensure the best financial decisions are made.

KRS 68.310 states, “[e]xcept in case of an emergency concerning which the county judge/executive, the fiscal court and the state local finance officer unanimously agree in writing, and, except for encumbrances or expenditures from the county's road fund, no county shall, during the first half of any fourth fiscal year, beginning with the fiscal year 1998-1999, encumber or expend more than sixty-five percent (65%) in any fund budgeted for that fiscal year, not counting as current funds any budgetary allotments for or payments of principal and interest of bonded indebtedness. Prior to encumbering or expending any funds from the road fund during the first half of any fourth fiscal year which exceed sixty-five percent (65%) of the amount budgeted, the fiscal court shall assure that there are sufficient funds remaining in the general fund to provide for the excess encumbrance or expenditure from the road fund on a dollar for dollar basis. Those excess funds shall remain in the general fund until on or after January 1 of that fiscal year.”

We recommend management ensure that adequate internal controls and oversight procedures are in place to monitor budgeted and actual expenditures at all times but especially in each fourth year in order to comply with statutory requirements.

*County Judge/Executive’s Response: We are aware of KRS 68.310 and adhere to those guidelines. Expenditures are monitored regularly.*

**Internal controls over occupational tax collections are not adequate:** This is a repeat finding and was included in the prior year audit report as Finding 2018-005. Occupational tax collections comprise about 52% of the county’s general fund operating revenue - by far the single biggest source of revenue for this fund. Internal controls over occupational taxes are not adequate to ensure amounts reported are complete, accurate, and free of material misstatement due to the following issues:

- Occupational taxes are sometimes batched and posted to the ledgers in a lump sum rather than listing each individual taxpayer.
- Occupational taxes are not reconciled to the ledgers by someone independent of receiving and posting occupational tax receipts.
- Delinquent occupational tax notices are not sent out with any regularity or consistency.
- Records could not be located to support occupational tax payments handled in person (i.e. three part receipt books).
- There are no effective review or oversight procedures for occupational tax collections.

The fiscal court failed to adequately assess risk associated with occupational tax collections and has not implemented effective internal controls, review procedures, or oversight for occupational tax collections.

Failure to implement adequate controls over occupational tax collections increases the risk that undetected material misstatements and fraud will occur, especially considering occupational taxes comprise such a large portion of general fund revenues.

Strong internal controls over occupational taxes require each transaction be recorded separately so that finding errors and discrepancies is possible. Additionally, a log or receipt books should be

maintained that list each transaction so that a comparison can be made to deposit slips and to the ledgers by someone independent of the receiving and posting functions. Delinquent notices should be sent out regularly and consistently in order to collect amounts owed to the county and to detect any misstatements, errors, or misappropriation of funds. The delinquent notices should direct any questions or concerns to someone independent of occupational tax collections so that discrepancies can be investigated and resolved without risk of alteration of records by staff involved in the collection process.

In order for internal controls to be effective in preventing and detecting errors, misstatements, and fraud, the functions of any significant area should be separated. If segregation is not possible or practical, the fiscal court should implement and document compensating controls to reduce the risk associated with inadequate segregation of duties. A strong compensating control could include review of deposit tickets, tax returns, and occupational tax ledger by someone independent of occupational tax collections. This could be documented by initialing all supporting documentation after the review is complete.

We recommend the fiscal court implement effective internal controls, review procedures, and oversight for occupational tax collections and document the procedures performed that ensure recorded amounts are complete, accurate, and free of material misstatement.

*County Judge/Executive's Response: We are working on Occupational Tax Collection at this time. Most of the issues are resolved. Returns/Receipts are entered daily, posted from Tax to Books and deposits made daily. Occupational Tax Clerk enters information and Treasurer reviews and makes deposits. IRS extension to file returns in 2020 and 2021 was accepted. Taxpayers have been notified that late fees/penalties would be effective after this date. Notices are being sent. Working to bring accounts up-to-date, reviewing past due and carry forward credits. Any cash payments received are issued a receipt. Return is processed and funds deposited with that days entries.*

**Cash collected offsite was missing from deposits:** This is a repeat finding and was included in the prior year audit report as Finding 2018-006. The animal shelter collects receipts for adoption fees. The former animal shelter director issued receipts for these transactions and periodically batched amounts collected to take to the county judge/executive's office for deposit. The former animal shelter director listed the total checks and total cash he collected and the county judge/executive's office issued a receipt for the funds he remitted. Receipts issued to the former animal shelter director were signed by either the former deputy judge/executive or the former county treasurer. The checks documented by the former animal shelter director were deposited and recorded in the ledgers. Comparison of the former animal shelter director's available records and the deposits of animal shelter funds revealed \$5,810 of cash that was accounted for by the former animal shelter director but was never deposited into the county's bank accounts after it was turned over to the county judge/executive's office.

Additionally, cash and checks are sometimes collected for rental of the senior citizens center. The senior citizens center supervisor did not keep complete records of rental fee collections. When reviewing the limited number of receipts that were maintained by the senior citizens supervisor,

we noted two different cash transactions and one check transaction (totaling \$300) could not be traced to the receipt ledgers or a bank deposit.

The fiscal court and management failed to implement effective internal controls, review procedures, and oversight for offsite collections, especially as it relates to cash receipts.

At least \$5,810 of fees generated from the animal shelter and \$300 generated by the senior citizens center may have been stolen or misappropriated and this was undetected by management. Due to lack of records and inconsistent recordkeeping, we could not determine if additional amounts were unaccounted for.

Strong internal controls require three part receipts be maintained for all revenues. All receipt numbers should be accounted for and compared to the total listing of receipts to ensure completeness. Deposits should agree to the batched receipts for cash and check totals. The amounts collected should be accurately reflected in the receipts ledger. Cash collected should be recounted by at least two people, with each signing and agreeing to the amount collected.

Further guidance on issuance of receipts can be found in KRS 64.840, which states, “(1)...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. (2) One (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.”

We recommend the fiscal court establish effective internal control procedures to ensure all revenues are adequately documented, recorded, and deposited. We recommend the fiscal court comply with KRS 64.480 regarding receipts and ensure that these records are maintained for an appropriate time period. This matter will be referred to the Kentucky Office of the Attorney General.

*County Judge/Executive's Response: Cash is received at two (2) offsites.*

*Upon detection of missing funds responsible employee was suspended immediately pending investigation. Prior to dismissal employee sent in resignation.*

*Animal Shelter issues receipt with one copy going to individual, one copy with receipts turned in at Judge's office and copy kept at Shelter. Receipts are turned in weekly, receipt issued at office when turned in, and deposit made.*

*Senior Center receives rental and donation monies. Receipts are issued to individual, copy turned in with funds and copy kept at Center. Receipts are turned in bi-weekly, receipt issued at office when funds turned in and deposit made.*

*We are preparing to implement the use of a receipt software program.*

**Interfund transfers were not approved by the fiscal court:** This is a repeat finding and was included in the prior year audit report as Finding 2018-009. The fiscal court utilized interfund transfers to move money between funds as the necessity arose. The fiscal court transferred a total of \$1,723,352 among funds during the fiscal year. We could only confirm fiscal court approval for \$694,500, leaving \$1,028,852 of interfund transfers that were not approved by the fiscal court.

The fiscal court does not properly utilize a purchase order system, which limits the ability to properly plan and anticipate expected expenses. Without proper procedures in place to track upcoming expenses, the fiscal court is never entirely sure how much money is available in each fund, which is indicative of poor financial management practices and can result in cash flow issues. This sometimes requires unanticipated transfers between funds to cover expenses. Management has not established proper controls, review procedures, and oversight to ensure all cash transfers are approved by the fiscal court in amounts that agree to actual transfers made.

The fiscal court is not fully informed of the financial activity of the county and cannot exercise adequate oversight with incomplete information. In addition, cash flow issues that contribute to the cash transfers have a significant impact on the county's ability to provide services to citizens and to meet financial obligations timely. Finally, improper oversight and inadequate controls over interfund transfers increases the risk of undetected improper transfers, such as transfers from restricted funds that are not returned by fiscal year end or transfers in excess of allowable amounts.

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* states "All transfers require a court order." In addition, a strong and properly implemented internal control system requires approval and oversight of all financial activity, especially moving money between funds.

We recommend the fiscal court implement proper controls, review procedures, and oversight for interfund transfers to ensure all are approved properly and are in compliance with applicable restrictions.

*County Judge/Executive's Response: Interfund transfers are presented to Fiscal Court for approval before being completed. They are made for specific claims and amounts.*

*Fiscal Court approved standing order for interfund transfer from General Fund to Jail Fund to meet bi-weekly payroll.*

**The Estill County Fiscal Court did not properly record and classify all debt related disbursements:** This is a repeat finding and was included in the prior year audit report as Finding 2018-016. The fiscal court entered into a financing obligation in the amount of \$1,410,000 to consolidate debt and pay off outstanding bills, including a \$500,000 tax anticipation note from the prior year. Part of this transaction was not reflected in the county's bank activity or fourth quarter financial report as part of these funds were paid directly to financing institutions to payoff outstanding debt by the financing entity. The bank statements and fourth quarter report reflected

\$633,618 of this activity. The proceeds from this debt was also used to pay off a vehicle loan, which was recorded in an operating line item instead of being recorded in a debt service line item.

The former treasurer was not sure how to record transactions that were handled by third parties. There was an error made by the former finance officer that went undetected regarding recording debt payments in operating line items. The fiscal court failed to implement adequate internal controls, oversight, and review to ensure debt payments were properly recorded and classified.

As a result, the fiscal court failed to record \$776,382 in debt related receipts and disbursements for the fiscal year and misclassified \$24,035 in debt disbursements. Additionally, the risk of material misstatements and undetected errors increases when proper internal controls, oversight, and review procedures are not implemented.

KRS 68.210 gives the state local finance officer the authority to prescribe a uniform system of accounts. The uniform system of accounts is set forth in the *County Budget Preparation and State Local Finance Officer Policy Manual*, which requires all borrowed money that is not part of the original budget be amended into the budget and be properly reflected on the financial report. Further, KRS 68.280 states, “[t]he fiscal court may make provision for the expenditure of receipts unanticipated in the original budget by preparing an amendment to the budget, showing the source and amount of the unanticipated receipts and specifying the budget funds that are to be increased thereby.”

Furthermore, good internal controls over the processing and review of financial reporting could eliminate these errors. It is important to separate debt payments (which are ongoing obligations) from operating expenditures in order to properly budget, plan, and allocate resources in accordance with the needs of the county. It is easier to ensure debt payments are being made timely and it is easier to ensure the county doesn’t over-extend financial resources when all expenditures are properly classified.

We recommend the fiscal court implement adequate internal controls, oversight, and review procedures to ensure all debt service payments are recorded in the correct classification. In addition, we recommend the fiscal court comply with regulatory reporting requirements recording all debt activity, including those transactions handled by a third-party lender.

*County Judge/Executive’s Response: Debt related disbursements are entered correctly to the best of our understanding. Liability summary is maintained as required.*

**Internal controls, review procedures, and oversight for payroll processing are not adequate:** This is a repeat finding and was included in the prior year audit report as Finding 2018-010. The following issues were noted for payroll processing:

- Amounts paid to the County Employees Retirement System (CERS) were not accurate (see Finding 2019-010 for additional detail).
- The fiscal court did not provide the same level of health insurance coverage to all employees (see Finding 2019-012 for additional detail).

- Health insurance premiums, state withholdings, and local withholdings were not paid timely.
- Leave time taken by employees was not properly reflected in leave balances. Two instances were noted in which employees had leave time documented on timesheets but leave balances were not properly reduced.
- Pay rates were not properly implemented and documented. The fiscal court approved a salary schedule for all employees on August 20, 2018, but the pay rates and ranges approved were not implemented and applied to all employees and these wage rate changes were not documented in personnel files

The fiscal court failed to adequately assess the risk associated with payroll processing and failed to implement adequate internal controls regarding the documentation, preparation, and authorization of payroll. Segregation of duties is not adequate since the former finance officer performed all payroll calculations, prepared all payroll reports, remitted all payroll withholding and matching payments, and maintained all documentation for payroll. There were no significant review procedures in place nor adequate oversight for the majority of the audit period to ensure the completeness and accuracy of payroll information.

Failure to implement adequate controls over payroll increases the risk that undetected material misstatements and fraud will occur, especially considering payroll accounts for a large portion of the county's budget. Numerous undetected errors were noted for payroll processing and the fiscal court is in violation of various statutes.

In order for internal controls to be effective in preventing and detecting errors, misstatements, and fraud, the functions of any significant area should be separated. If segregation is not possible or practical, the fiscal court should implement and document compensating controls to reduce the risks associated with inadequate segregation of duties. A strong compensating control could include review of payroll reports, review of payroll payments, comparison of payroll documentation to amounts recorded, and reconciliation of withholding and matching reports to supporting documentation. Further, review procedures and oversight should be exercised consistently to detect errors and to reconcile payroll to supporting documentation.

We recommend the fiscal court implement effective internal controls, review procedures, and oversight for payroll processing to ensure the completeness and accuracy of all payroll information.

*County Judge/Executive's Response: CERS payments are reconciled monthly by Finance Officer and Treasurer. Payments are made timely. Corrections made as needed. Past due invoices for old penalties and one spiking invoice are still being worked on - other amounts are current at this time.*

*Health coverage is being addressed at this time - will be fixed by July 1, 2021.*

*Health insurance premiums, state and local withholdings, federal withholdings are being reported and paid timely. All employer match benefits are being transferred to payroll accounts with each bi-weekly payroll and reconciled with each payment.*

*Leave time, both vacation and sicktime, is entered with each payroll and leave balances are reduced with each payroll.*

*The August 2018 salary schedule was implemented and backpay was made to all employee affected (completed latter part of 2019). Pay rates/raises are currently being approved by Fiscal Court before employee receives a change in pay or classification. Pay rates are implemented and documented as they are approved. Notes are entered in payroll system when changes are made and court minutes are kept for record of same. Personnel files are being worked on, and will be maintained.*

*Time cards are reviewed and approved by department heads; then Finance Officer and Treasurer review for accuracy and compliance. Department heads are contacted when questions arise, if not resolved discuss with Judge for further action.*

**Amounts paid to County Employees Retirement System (CERS) for retirement deductions and matching contributions were not accurate:** This is a repeat finding and was included in the prior year audit report as Finding 2018-011. Several small discrepancies were noted during testing in the amounts reported as retirement wages on payroll summaries (amounts on employee paychecks) compared to retirement wages reported to County Employees Retirement System (CERS). Employees who retire or otherwise sever employment are not being removed from CERS reports timely.

Due to inadequate controls over payroll, as discussed in finding 2019-009, the amounts reported to CERS do not agree to payroll ledgers. These errors went undetected due to the lack of reconciliations between the payroll summaries and retirement reports. Management has not established policies and procedures for adequate supervisory review of the data entered into the retirement reporting system to be compared to data from the payroll system for accuracy and completeness.

The Estill County Fiscal Court owed more than \$50,000 to CERS for retirement reporting errors. On July 2, 2020, the county paid \$40,830 toward this liability but still owes a balance, which includes \$6,000 of penalties for failure to report timely. The amount of wages reported to CERS determines employees' retirement benefits.

It is imperative that the reported wages are complete, accurate, and supported by payroll documentation. Failure to pay accurate amounts to CERS timely can result in penalties and interest charges, which are not an efficient use of taxpayer resources.

KRS 78.625 states, "(1) The agency reporting official of the county shall file the following at the retirement office on or before the tenth day of the month following the period being reported: (a) The employee and employer contributions required under KRS 78.610, 61.565, and 61.702; (b) The employer contributions and reimbursements for retiree health insurance premiums required under KRS 61.637; and (c) A record of all contributions to the system on the forms prescribed by the systems. (2) (a) If the agency reporting official fails to file at the retirement office all contributions and reports on or before the tenth day of the month following the period being

reported, interest on the delinquent contributions at the actuarial rate adopted by the board compounded annually, but not less than one thousand dollars (\$1,000), shall be added to the amount due the system. (b) Delinquent contributions, with interest at the rate adopted by the board compounded annually, or penalties may be recovered by action in the Franklin Circuit Court against the county liable or may, at the request of the board, be deducted from any other moneys payable to the county by any department or agency of the state. (3) If an agency is delinquent in the payment of contributions due in accordance with any of the provisions of KRS 78.510 to 78.852, refunds and retirement allowance payments to members of this agency may be suspended until the delinquent contributions, with interest at the rate adopted by the board compounded annually, or penalties have been paid to the system.”

We recommend the fiscal court continue to resolve reporting errors and pay amounts owed as determined by CERS. We also recommend the fiscal court implement an independent review/reconciliation process for comparison of CERS retirement reports to supporting payroll documentation to ensure accuracy and completeness.

*County Judge/Executive's Response: CERS reporting is currently being done correctly and timely. Reports are completed by Finance Office and reviewed and submitted by Treasurer. Monthly payments for contributions and invoices are made by 10<sup>th</sup> of month as required.*

**The revolving payroll account reconciliation was not complete and accurate:** This is a repeat finding and was included in the prior year audit report as Finding 2018-015. Bank reconciliations prepared for the revolving payroll account do not include receivables and liabilities that resulted from errors in payroll processing as noted in Finding 2019-010. There are receivables in the revolving payroll account due from the general fund for retirement and federal matching amounts the fiscal court paid on behalf of the former county clerk. These transfers from the general fund to the revolving payroll account have not occurred since March 2016. Additionally, the fiscal court pays health insurance premiums for other governmental agencies and is supposed to be reimbursed for those amounts. The former finance officer did not maintain records to determine if reimbursements were made timely and could not determine the balance due at year-end. Some agencies reimburse periodically and had not made the required reimbursements for a significant period of time. These issues affect the true balance in the revolving payroll account.

The fiscal court did not implement adequate procedures and oversight regarding the payroll process. The former finance officer received, processed, and maintained all supporting documentation for payroll. No effective review or oversight procedures were in place, resulting in undetected errors and misstatements. These errors and misstatements affect the revolving payroll account balance.

Failure to account for all items affecting the revolving payroll account balance, including receivables and liabilities not yet processed in the accounting system, increases the risk that these items are never properly resolved, especially if only one person has any knowledge of their existence.

Strong internal controls over the revolving payroll account require all items that affect the account to be properly summarized and included on the reconciliations whether or not those transactions have occurred or are due to occur in the future.

We recommend the fiscal court implement effective internal controls and oversight procedures regarding the revolving payroll account reconciliations to ensure completeness and accuracy.

*County Judge/Executive's Response: Payroll account has been reconciled and is monitored. Payroll matches are made with each bi-weekly payroll for employer contributions and fringe benefits. ASO payment and retirement invoice amounts are pulled as needed from correct accounts.*

*Health reimbursement from other agencies is being reconciled. Statements are sent and payment received timely at this time. EDA reimbursement for one person is being reviewed.*

*County clerk's payroll is processed through revolving payroll account. Matching amounts and deductions are received from county clerk for each payroll, with payroll checks issued by him to his employees. This allows us to consistently make accurate and timely reports.*

**The Estill County Fiscal Court did not provide the same level of health insurance coverage to all county employees:** Three county employees, whose compensation and benefits are reimbursed by the federal Chemical Stockpile Emergency Preparedness Program (CSEPP), received health insurance coverage that was not made available to all other county employees. County employees are provided individual health insurance coverage. If the employee chooses to elect additional coverage for a spouse, children, or family coverage they may do so but are responsible for the cost of the health insurance premium that exceeds the individual coverage premium. For Fiscal Year 2019, the cost of an individual health insurance premium was \$500. Three employees elected to add coverage for dependents, which was an additional \$399 per month per employee. This additional cost was not paid by the employees via payroll deduction. The county paid this cost and then sought reimbursement from CSEPP. CSEPP allows reimbursement for eligible wages, salaries, and employee benefits.

The fiscal court did not have adequate internal controls in place to ensure health insurance benefits were applied equally among all classes of employees and that proper wage deductions were applied to employees that requested coverage in excess of standard county employee coverage. Management's understanding was that CSEPP would not reimburse expenses that are unallowable. However, management failed to understand that those benefits could have been allowable had the employee benefits been applied to all county employees equally.

The fiscal court has applied employee benefits in an inequitable manner and received federal reimbursement for unallowable expenses, resulting in federal questioned costs of \$13,179 for Fiscal Year 2019. Additionally, county funds are being spent for the personal benefit of select employees that could have been expended on other items to benefit the entire county.

In order for an expense to be allowable under federal grant guidelines, the expense must be in compliance with all federal, state, and local laws, regulations, policies, and procedures. Since the

local procedure for health insurance benefits provides single/individual coverage, the amount in excess of that is not an allowable expense of the program.

OAG 94-15 states, “[t]he 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.”

Federal guidance outlined in 2 CFR 200.431 states, in part, “(a) Fringe benefits are allowances and services provided by employers to their employees as compensation in addition to regular salaries and wages. Fringe benefits include, but are not limited to, the costs of leave (vacation, family related, sick or military), employee insurance, pensions, and unemployment benefit plans. Except as provided elsewhere in these principles, the costs of fringe benefits are allowable provided that the benefits are reasonable and are required bylaw, non-Federal entity-employee agreement, or an established policy of the non-Federal entity.... (c) The cost of fringe benefits in the form of employer contributions or expenses for social security; employee life, health, unemployment, and worker's compensation insurance (except as indicated in §200.447 Insurance and indemnification); pension plan costs (see paragraph (i) of this section); and other similar benefits are allowable, provided such benefits are granted under established written policies. Such benefits, must be allocated to Federal awards and all other activities in a manner consistent with the pattern of benefits attributable to the individuals or group(s) of employees whose salaries and wages are chargeable to such Federal awards and other activities, and charged as direct or indirect costs in accordance with the non-Federal entity's accounting practices.”

We recommend management ensure that employee benefits are applied equally among all employees and that proper amounts are withheld from employees’ wages for elective/optional employee benefits. Further, we recommend management contact CSEPP officials to determine how to resolve the questioned costs for fiscal year 2019.

*County Judge/Executive’s Response: Employees are being notified they will be responsible for cost of any coverage other than employee health premium effective July 1, 2021.*

**The Estill County Fiscal Court did not provide the same level of health insurance coverage to all county employees:**

*Federal Program: CFDA #97.040 – Chemical Stockpile Emergency Preparedness Program  
Award Number and Year: Multiple Years – CSEPP Grants  
Name of Federal Agency and Pass-Through Agency: U.S. Department of Homeland Security  
Pass Through Agency: Kentucky Department of Military Affairs  
Compliance Requirements: Allowable Costs/Cost Principles  
Type of Finding: Compliance and Internal Control  
Amount of Questioned Costs: \$13,179  
Effect on Audit Opinion: Not applicable – disclaimer of opinion*

See detail for this finding in the *Financial Statement Findings Section* at Finding 2019-012.

*Federal Program:* CFDA #97.040 – Chemical Stockpile Emergency Preparedness Program  
*Award Number and Year:* Multiple Years – CSEPP Grants  
*Name of Federal Agency and Pass-Through Agency:* U.S. Department of Homeland Security  
*Pass Through Agency:* Kentucky Department of Military Affairs  
*Compliance Requirements:* Activities Allowed or Unallowed, Allowable Costs/Cost Principles, Cash Management, Equipment and Real Property Management, Procurement and Suspension and Debarment, Reporting  
*Type of Finding:* Compliance and Internal Control  
*Amount of Questioned Costs:* None  
*Effect on Audit Opinion:* Disclaimer of Opinion

Estill County expended \$997,132 for the Chemical Stockpile Emergency Preparedness Program (CSEPP) during fiscal year ending June 30, 2019. Due to issues found during the audit of the financial statement of the Estill County Fiscal Court, we cannot rely on the design and implementation of the internal controls over compliance with the types of requirements that could have a direct and material effect on CSEPP. Our testing revealed one questioned cost as described in Finding 2019-012 and we note that the internal control structure and management override of controls as discussed in Finding 2019-001 increases the risk associated with federal awards since these transactions are processed in the same internal control environment as other county expenditures where numerous problems have been noted.

The issues found during the audit of the financial statement were caused by a lack of internal controls or by override of controls by the management of the Estill County Fiscal Court. As a result, there is an increased risk that the Estill County Fiscal Court is not in compliance with the requirements that have a direct and material effect on CSEPP. In order to comply with Uniform Guidance requirements regarding federal grants, the entity must establish adequate internal controls to ensure compliance with each major program’s applicable compliance requirements.

We recommend the fiscal court ensure that internal controls exist over federal awards and design and implement internal controls that will ensure material compliance with applicable requirements for all federal awards.

*County Judge/Executive’s Response:* Federal funds are spent according to guidelines. Purchase orders are required, expenditures over \$30,000 are bid by state guidelines. All contracts and agreements are presented to Fiscal Court for approval as well as all claims.

*Both CSEPP and FEMA funds are monitored and properly documented for audits as required to the best of our knowledge.*

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

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