

MCKEAN COUNTY
42-000

LIQUID FUELS TAX FUND
EXAMINATION REPORT

FOR THE YEAR ENDED
DECEMBER 31, 2007

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MCKEAN COUNTY
LIQUID FUELS TAX FUND
BACKGROUND
FOR THE YEAR ENDED
DECEMBER 31, 2007

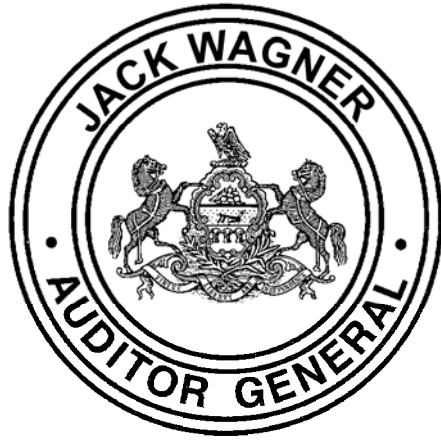
Background

The Liquid Fuels and Fuels Tax Act, Title 75 P.S. § 9010, provides counties with allocations of liquid fuels taxes from the Commonwealth of Pennsylvania's Liquid Fuels Tax Fund in June and December of each year.

The allocations are based on the ratio of a county's average gas consumption in the years 1927, 1928, and 1929 to the total statewide consumption in those years. These allocations must be deposited into a separate fund called the County Liquid Fuels Tax Fund, from which payments may be made for construction, maintenance, and repair of county roads and bridges. Additionally, the Act provides that counties may allocate money from this fund to the political subdivisions within the county for these same purposes. It also allows counties to encumber current funds for future road and bridge construction, reconstruction, and maintenance projects. Furthermore, counties are allowed to use up to ten percent of its Liquid Fuels Tax Fund allocation each year for indirect costs, including benefit costs, overhead and other administrative charges for those county employees directly engaged in eligible projects.

The Department of Transportation has been given the regulatory authority for the administration of these funds. In order to receive Liquid Fuels Tax Funds as scheduled, each county must submit an annual report showing receipts, expenditures, and encumbrances for the preceding 12 months.

Department of Transportation *Publication 9* contains the policies and procedures that govern the use of Liquid Fuels Tax Fund money. However, if there is a difference between *Publication 9* and any legislation, the legislation shall govern.



Independent Auditor's Report

The Honorable Allen D. Biehler, P.E.
Secretary
Department of Transportation
Harrisburg, PA 17120

We examined the accompanying Form MS-991 With Adjustments for the Liquid Fuels Tax Fund of McKean County for the year ended December 31, 2007. The county's management is responsible for the Form MS-991. Our responsibility is to express an opinion on the Form MS-991 With Adjustments based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and the standards applicable to attestation engagements contained in *Government Auditing Standards* issued by the Comptroller General of the United States. An examination includes examining, on a test basis, evidence supporting McKean County's Form MS-991 for the year ended December 31, 2007 and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

We are mandated by Section 403 of *The Fiscal Code*, 72 P.S. § 403, to audit each county's Liquid Fuels Tax Fund to ensure that funds received are expended in accordance with applicable laws and regulations. *Government Auditing Standards* issued by the Comptroller General of the United States include attestation engagements as a separate type of audit. An attestation engagement performed pursuant to *Government Auditing Standards* involves additional standards that exceed the standards provided by the American Institute of Certified Public Accountants. Accordingly, this attestation engagement complies with both *Government Auditing Standards* and Section 403 of *The Fiscal Code*.

As described in Note 4, the adjustments included on the Form MS-991 With Adjustments are made by the Department of the Auditor General.

Independent Auditor's Report (Continued)

In our opinion, the Form MS-991 With Adjustments presents, in all material respects, the information required by the Pennsylvania Department of Transportation for the Liquid Fuels Tax Fund of McKean County for the year ended December 31, 2007, in conformity with the criteria set forth in Note 1.

In accordance with *Government Auditing Standards*, we are required to report findings of significant deficiencies in internal control, violations of provisions of contracts or grant agreements, and abuse that are material to the Form MS-991 and any fraud and illegal acts that are more than inconsequential that come to our attention during our examination. We are also required to obtain the views of management on those matters. We performed our examination to express an opinion on whether the Form MS-991 is presented in accordance with the criteria described above and not for the purpose of expressing an opinion on the internal control over reporting on the Form MS-991 or on compliance and other matters; accordingly, we express no such opinions.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the McKean County's ability to initiate, authorize, record, process, or report data reliably in accordance with the applicable criteria such that there is more than a remote likelihood that a misstatement of the McKean County's Form MS-991 that is more than inconsequential will not be prevented or detected by the McKean County's internal control. We consider the deficiency described in the finding below to be a significant deficiency in internal control over reporting on the Form MS-991:

- Electronic Imaging Of Canceled Checks From The Bank Did Not Include The Back Of The Checks.

Independent Auditor's Report (Continued)

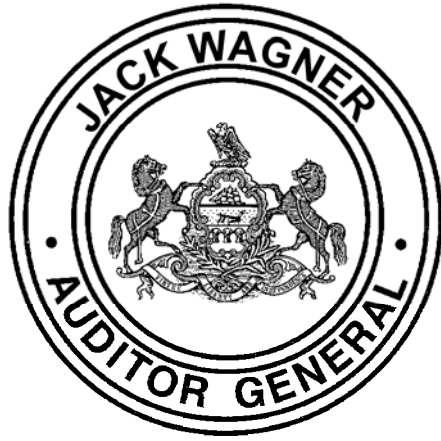
A material weakness is a significant deficiency or combination of significant deficiencies that results in more than a remote likelihood that a material misstatement of the Form MS-991 will not be prevented or detected by the McKean County's internal control. Our consideration of the internal control over reporting on the Form MS-991 would not necessarily disclose all matters in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. We consider the significant deficiency described above to be a material weakness.

The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Pennsylvania Department of Transportation and the management of McKean County and is not intended to be and should not be used by anyone other than these specified parties.

June 6, 2008

JACK WAGNER
Auditor General



MCKEAN COUNTY
LIQUID FUELS TAX FUND
2007 FORM MS-991
WITH ADJUSTMENTS
DECEMBER 31, 2007

| | <u>Reported</u> | <u>Adjustments (Note 4)</u> | <u>Adjusted Amount</u> |
|--|----------------------|---------------------------------|----------------------------|
| Balance, January 1, 2007 | \$ 376,201.41 | \$ - | \$ 376,201.41 |
| <u>Receipts:</u> | | | |
| State allocations | 282,169.30 | - | 282,169.30 |
| Interest (Note 3) | 22,094.23 | - | 22,094.23 |
| Reimbursable agreements (Note 5) | 55,949.00 | - | 55,949.00 |
| Miscellaneous | - | - | - |
| Total receipts | <u>360,212.53</u> | <u>-</u> | <u>360,212.53</u> |
| Total funds available | <u>736,413.94</u> | <u>-</u> | <u>736,413.94</u> |
| <u>Expenditures:</u> | | | |
| Construction | - | - | - |
| Maintenance and repair | 44,228.45 | - | 44,228.45 |
| Administrative | 5,213.00 | - | 5,213.00 |
| Grants to political subdivisions | 108,991.00 | - | 108,991.00 |
| Miscellaneous | - | - | - |
| Total expenditures | <u>158,432.45</u> | <u>-</u> | <u>158,432.45</u> |
| Balance, December 31, 2007 | 577,981.49 | - | 577,981.49 |
| Unpaid encumbrances (Note 1) | <u>255,690.00</u> | <u>(408.12)</u> | <u>255,281.88</u> |
| Unencumbered balance, December 31, 2007 | <u>\$ 322,291.49</u> | <u>\$ 408.12</u> | <u>\$ 322,699.61</u> |

Notes to Form MS-991 With Adjustments are an integral part of this report.

MCKEAN COUNTY
LIQUID FUELS TAX FUND
NOTES TO FORM MS-991 WITH ADJUSTMENTS
FOR THE YEAR ENDED
DECEMBER 31, 2007

1. Criteria

Form MS-991 With Adjustments provides a summary of Liquid Fuels Tax Fund receipts, expenditures, fund balance, encumbrances and unencumbered balance by category. Categories requiring explanation include:

- State allocations are generally received from the Department of Transportation during June and December of each year. The amount the county receives is based on the ratio of a county's average gas consumption in the years 1927, 1928, and 1929 to the total statewide consumption in those years.
- Reimbursable agreements are agreements with the Commonwealth of Pennsylvania or another entity to reimburse the county for money expended for construction, maintenance, and repairs of county roads and bridges.
- Encumbrances are funds reserved for future county road or bridge projects or grants to political subdivisions for these same purposes.

Basis Of Presentation

The financial activities of the county are accounted for in separate funds. The Liquid Fuels Tax Fund is used to account for state aid revenues from the Pennsylvania Department of Transportation used primarily for building and improving local roads and bridges. The financial presentation has been prepared in accordance with reporting requirements prescribed by the Pennsylvania Department of Transportation as a result of the County Liquid Fuels Tax Act of 1931, which does not constitute a complete presentation of the entity's assets, liabilities, expenses, and fund balance. Accordingly, the presentation of Form MS-991 With Adjustments is restricted to the Liquid Fuels Tax Fund, which represents a segment of the entity.

Basis Of Accounting

The accompanying Form MS-991 With Adjustments is prepared in accordance with the reporting requirements prescribed by the Pennsylvania Department of Transportation. Under this method, revenues are recognized when received and expenses are recorded when paid. In addition, counties are also permitted to encumber funds for county projects and grants to political subdivisions. As of December 31, 2007, \$255,281.88 was encumbered. This amount consists of \$139,591.88 for a county project and \$115,690.00 for grants to political subdivisions.

MCKEAN COUNTY
LIQUID FUELS TAX FUND
NOTES TO FORM MS-991 WITH ADJUSTMENTS
FOR THE YEAR ENDED
DECEMBER 31, 2007

1. Criteria (Continued)

General Fixed Assets

General fixed assets are recognized as expenditures at the time of purchase. No depreciation has been provided on the heavy equipment used to maintain and repair roads and bridges.

2. Deposits

The County Code, Title 16 P.S § 17067, authorizes the county to deposit its funds in the following:

- Deposits in savings accounts or time deposits, other than certificates of deposit or share accounts of institutions having their principal place of business in the Commonwealth of Pennsylvania and insured by the Federal Deposit Insurance Corporation (FDIC) or other like insurance. For any amount above the insured maximum, the depository shall pledge approved collateral.
- Certificates of deposit from institutions having their principal place of business in or outside the Commonwealth of Pennsylvania that are insured by the FDIC or other like insurance. For any amounts in excess of the insured maximum, such deposits shall be collateralized by a pledge or assignment of assets. Certificates of deposit may not exceed 20 percent of a bank's total capital surplus or 20 percent of a savings and loan's or savings bank's assets minus liabilities.

Deposits consist of receipts and deposits in a financial institution. Pennsylvania statutes require all deposits to be insured and, for any amount above the insured maximum, to be secured with approved collateral as defined.

There were no deposits exposed to custodial credit risk as of December 31, 2007. Custodial credit risk, as defined by GASB No. 40, includes deposits that are not covered by depository insurance and the deposits are uncollateralized, collateralized with securities held by the pledging financial institution, or collateralized with securities held by the pledging financial institution's trust department or agent but not in the county's name.

MCKEAN COUNTY
LIQUID FUELS TAX FUND
NOTES TO FORM MS-991 WITH ADJUSTMENTS
FOR THE YEAR ENDED
DECEMBER 31, 2007

2. Deposits (Continued)

Fund Balance

The fund balance consists of the following:

| | |
|------|---------------------|
| Cash | <u>\$577,981.49</u> |
|------|---------------------|

3. Interest Earnings

Our examination disclosed that the county deposited idle liquid fuels tax money in an interest-bearing account which earned \$22,094.23 during 2007, thus providing additional funds for road maintenance and repairs.

4. Adjustments

An adjustment of \$(408.12) was made to "Unpaid encumbrances" because the balance of encumbrance No. 06-42000-1000 was overstated.

5. Reimbursable Agreements

During our examination, we noted that the county entered into a reimbursement agreement with the Department of Transportation for the inspection of county bridges. During our current examination period, the county received \$55,949.00 as a result of this agreement. As of December 31, 2007, \$10,203.54 was due the Liquid Fuels Tax Fund.

MCKEAN COUNTY
LIQUID FUELS TAX FUND
FINDING AND RECOMMENDATIONS
FOR THE YEAR ENDED
DECEMBER 31, 2007

Finding - Electronic Imaging Of Canceled Checks From The Bank Did Not Include The Back Of The Checks

Our examination disclosed that the county made transfers from the Liquid Fuels Tax Fund to the Disbursement Account to reimburse the Disbursement Account for payroll expenses that could have been paid from the Liquid Fuels Tax Fund. Therefore, our disbursement test included checks from the Disbursement Account. During our testing, we discovered that the imaging of canceled checks from the Disbursement Account was not acceptable because the bank provides only the front side of the canceled checks. For us to properly complete our examination testing, we have to examine the front and back of the canceled checks.

Good internal controls and the Commonwealth of Pennsylvania Management Directive 210.11, dated June 16, 1997, require that imaging systems comply with the provisions of the Internal Revenue Service (IRS) procedures for record keeping with electronic imaging. To be acceptable, the documents provided by the system must meet IRS procedures governing size, content, format, and pattern. Those procedures require that all images produced by the imaging system exhibit a high degree of legibility and readability when displayed on paper. Legibility includes the ability to identify all letters and numerals positively and quickly. Readability includes the ability to recognize a group of letters or numerals as words or completed numbers. Imaged documents must include the front and back of a document in which both the front and back are used.

Further, good internal controls ensure that by having a county official review the front and back of the canceled checks, any errors or irregularities can be detected on a timely basis.

Without this control, the potential exists for errors or irregularities to go undetected for long periods of time.

The county obtained and provided us with copies of the backs of the canceled checks requested for examination.

Recommendations

We recommend that the county officials obtain images of the front and back of canceled checks in accordance with Directive 210.11. Additionally, county officials should review the front and back of each canceled check for any errors or irregularities.

MCKEAN COUNTY
LIQUID FUELS TAX FUND
FINDING AND RECOMMENDATIONS
FOR THE YEAR ENDED
DECEMBER 31, 2007

Finding - Electronic Imaging Of Canceled Checks From The Bank Did Not Include The Back Of
The Checks (Continued)

Recommendations (Continued)

We further recommend that, if the county's financial institution's check imaging process does not comply with Directive 210.11, original documentation must be obtained.

Management's Response

The county officials offered no formal response at this time.

MCKEAN COUNTY
LIQUID FUELS TAX FUND
SUMMARY OF EXIT CONFERENCE
FOR THE YEAR ENDED
DECEMBER 31, 2007

An exit conference was held June 6, 2008. Those participating were:

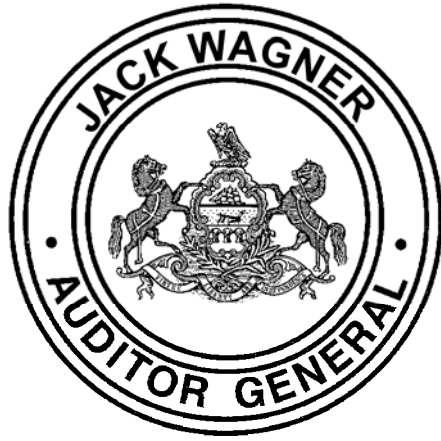
MCKEAN COUNTY

The Honorable Al J. Pingie, Vice-Chairman of the Board of Commissioners

DEPARTMENT OF THE AUDITOR GENERAL

Mr. John Cornely, Auditor

The results of the examination were presented and discussed in their entirety.



MCKEAN COUNTY
LIQUID FUELS TAX FUND
REPORT DISTRIBUTION
FOR THE YEAR ENDED
DECEMBER 31, 2007

This report was initially distributed to:

The Honorable Allen D. Biehler, P.E.
Secretary
Department of Transportation

Mckean County
500 West Main Street
Smethport, PA 16749

| | |
|-------------------------------------|--|
| The Honorable Joseph C. DeMott, Jr. | Chairman of the Board of Commissioners |
| The Honorable Nancy Evans | Treasurer |
| The Honorable Thomas E. Ball | Controller |
| Mrs. Audrey B. Irons | Chief Clerk |

This report is a matter of public record. Copies of this report may be obtained from the Pennsylvania Department of the Auditor General, Office of Communications, 318 Finance Building, Harrisburg, PA 17120. To view this report online or to contact the Department of the Auditor General, please access our web site at www.auditorgen.state.pa.us.