



City of Norfolk

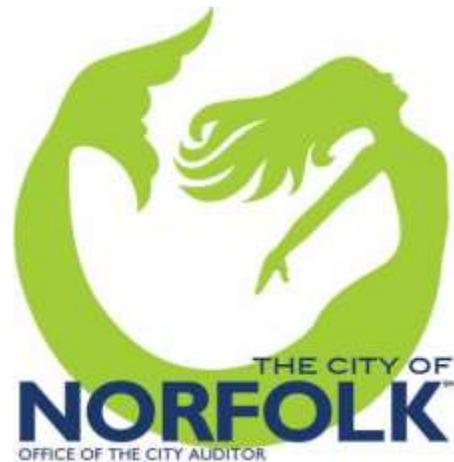
TO: Honorable Council Members FROM: John H. Sanderlin, Jr., City Auditor *JHS*

DATE: June 28, 2016 SUBJECT: City Treasurer-Audit of Management Controls

Please find attached our final audit report on the management controls in the City Treasurer's Office. Consistent with our normal practice and required by Government Auditing Standards, we held an exit conference today with Mr. Burfoot providing him our results and a copy of our draft report. Should you have any questions please feel free to contact me at 664-4045.

NORFOLK CITY TREASURER
Audit of Management Controls

June 28, 2016



John H. Sanderlin, Jr.
City Auditor

Tammie Dantzler
Deputy City Auditor
Auditor-in-Charge

June 28, 2016

Honorable Council Members

Subject: Audit of the Norfolk City Treasurer Management Controls (Report No. 16-4R)

The attached report contains the results of our audit of the adequacy of the controls in the City Treasurer's Office. We appreciate the cooperation and assistance of the City Treasurer and his team members during the audit.

Respectfully submitted,

John H. Sanderlin, Jr

John H. Sanderlin, Jr., CPA, CIA, CGFM, CFE, CGMA
City Auditor



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Executive Summary

At the request of the City Council, we conducted an audit of the Office of the City Treasurer. The City Treasurer (Treasurer) is entrusted with significant responsibilities to provide the citizens with the assurance that the cash collected from them and on their behalf is properly accounted for, safeguarded, and deposited; and adequately managed regarding its depository. A 100% of the overall collections of the city's revenues, some collections for the Commonwealth of Virginia and the safeguarding and investment of cash responsibilities reside with the Treasurer. Consequently, it is essential the Treasurer designs and implements an internal control system to mitigate the risk of loss, theft or misappropriations effectively. Having the public interest in mind, we established as our overall objective to ascertain whether adequate controls exist in the Office of the City Treasurer to ensure public funds are properly accounted for and not misappropriated.

During the period of our audit, there were 45 bank accounts used for cash and investments in the custody of the Treasurer. However, nine of these accounts were closed by June 30, 2015. Based on the two most recent Statement of Financial Conditions Report¹ that the Treasurer submitted to the Virginia Auditor of Public Accounts on June 30th of Fiscal Years (FY) 2014 and 2015, the Treasurer reported he had in his custody, assets totaling approximately \$334M and \$350M, respectively. These amounts included cash on hand, deposits in transit, cash in banks and investments for the City of Norfolk as well as collections due to the Commonwealth of Virginia. With this in mind, it is essential for the Treasurer to maintain adequate management controls for the daily operation of his office to ensure accountability and the proper handling of City monies, which promote public trust.

Management controls are systematic measures used to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance. Management controls comprise of plans, methods and policies and procedures used to fulfill the mission and address risk. Specifically, the Treasurer implemented activities such as dual signatures, bank reconciliations, information systems, and cash drawer balancing to conduct day-to-day operations in an efficient manner, safeguard assets and resources, deter and detect errors, fraud, and theft and ensure accuracy and completeness of its accounting data. In the regular activities of a business or organization, there are risks related to cash management responsibilities. The Institute of Internal Auditors defines risk as the possibility of an event occurring that will have an impact on the achievement of objectives. Risk is measured in terms of likelihood and impact. Also, according to the Business Dictionary (In *BusinessDictionary.com*, Retrieved June 26, 2016, from <http://www.businessdictionary.com/definition/inherent-risk.html>), an inherent risk is the probability of loss arising out of circumstances or existing in an environment, in the absence of any action to control or modify the circumstances. We recognized two inherent risks within the context of our audit objective. The first risk is cash as an asset is easily susceptible to theft and misappropriation. The second risk is the ability of the Treasurer to override or circumvent established controls such as policies and procedures. We also identified risks related to the bank and investment accounts in the custody of the Treasurer. We noted the sole responsibilities for monitoring and reconciliations of a significant number of accounts resided in the Treasurer's Office without any additional oversight provided by the Department of Finance and others.

¹ This report is mandated and is to be submitted annually to the Auditor of Public Accounts by Treasurer at the close of each fiscal year as a Statement of Financial Condition – June 30th.



Specifically, an employee in the Treasurer’s Office performs the deposits, approvals for disbursements and reconciliations. As of June 30, 2015, based on the most recent Statement of Financial Conditions Report, 28 of the 45 bank accounts fell in this category.

To assess the control system in place to mitigate the risks identified above, as we deemed them to have the greatest exposure and significance, we focused our audit on the following areas:

- vault and cash drawer access and security
- customer payments processing and posting
- cash counting and daily cash drawer reconciliations
- bank deposit preparations
- bank accounts reconciliations
- physical security of the Treasurer’s area
- checks written from bank accounts

Based on our review of these areas, details and results of which are provided in the “Conclusion Section” of this report, we found the Treasurer implemented adequate management controls to ensure public funds are safeguarded against theft or misappropriation. Also, there was no indication that he used his control of day-to-day operations to influence or circumvent established management controls (established policies and procedures, or practices). However, maintaining documented evidence of proper segregation of duties and timeliness of the bank reconciliation process is one enhancement to existing controls that is needed.

We met with the City Treasurer on June 28, 2016 to discuss the results of our audit. Deputy City Auditor, Tammie Dantzler, the principal auditor, and other audit staff, under the direction of City Auditor John Sanderlin, conducted the audit. We appreciate the courtesies and cooperation extended to us during the audit by the department.

Background

The collection of taxes is the responsibility of the Treasurer’s Office. The citizens of Norfolk elect the Treasurer as a constitutional officer of the City to serve a four-year term. The City’s current Treasurer assumed responsibilities of the City Treasurer’s Office in January 2014. At the time of our audit, the City Treasurer’s Office consisted of 30 employees including the following key positions of Treasurer, Chief Deputy Treasurers, Accounting Manager, Division Accounting Supervisor and Business Manager. In accordance with Norfolk City Code Section 74, the Treasurer is:

Subject to the supervision of the city manager, he shall collect and receive all city taxes, levies, assessments, license taxes, rents, water rents, fees and all other revenues or moneys accruing to the city, and for that purpose shall be vested with any and all powers which are now or may hereafter be vested in such city treasurer as collector of state taxes. He shall be the custodian of all public money of the city, and of all other money coming into his hands as city treasurer. The City Treasurer shall keep and preserve such moneys in such banks or trust companies as may be determined by ordinance or by the provisions of any law applicable thereto. When



city monies have been deposited in such banks or trust companies as designated by ordinance, the city treasurer shall not be liable for any loss sustained as to funds of the city so deposited. It shall be the duty of said city treasurer to conduct all of the proceedings and render all services necessary to perfect the sale and transfer of real estate in said city where the same shall be sold or advertised for sale for the nonpayment of any taxes or assessments imposed by the council. He shall perform such other duties, have such powers and be liable to such penalties as are now or may hereafter be prescribed by law or ordinance.

The Treasurer also has the following authority:

- waive penalty and fees;
- perform force collection on taxes that are 90 days delinquent;
- set-up a payment plan for tax obligations;
- write off uncollectable tax debt once the statute of limitation has expired.

To ensure automated controls are in place to facilitate and provide efficient operations while servicing the public, the Treasurer's Office uses a window-based application called Revenue Collection System (RCS). This system accelerates cash receipting, minimizes cash handling losses, and improves overall accountability. This system generates reports such as the Activity Tender Total Summary, Daily Cash Balance, Daily Cash Summary, Daily Cashier Detail (flash report), Cashier Over/Under, Suggested Deposit, and the Daily AFMS Transactions.

As a mitigating control, the Department of Finance receives a copy of the Daily Cash Summary report at the end of the daily closing process, which details cash receipts and ensures applicable payments are accounted for in the city's financial system. This system also endorses and images checks when received in the Treasurer's office. The system creates an electronic image of the checks, which are automatically transmitted to the bank; hard copies of the checks are retained in the Treasurer's office. As of the time of our audit, there were 81 City bank and investment accounts under the responsibility of the Treasurer. Fifty-three of those accounts have shared oversight by employees in other departments with the remaining 28 bank accounts are in the sole custody of the Treasurer, which means all of the deposits, disbursements authorization and reconciliation responsibilities reside in the Treasurer's office.

Objective, Scope and Methodology

The overall objective of the audit was to ascertain adequate controls existed in the Office of the City Treasurer and ensure public funds were properly accounted for and not misappropriated. Based on our objective and from our planning of the audit, we focused on the following areas:

- vault and cash drawer access and security
- customer payments processing and posting
- cash counting and daily cash drawer reconciliations
- bank deposit preparations
- bank accounts reconciliations



- physical security of the Treasurer's area
- checks written from bank accounts

The audit period covered January 2014 to January 2016, the time the Treasurer has been in office and was conducted between February 5, 2016 and June 3, 2016. To adequately address the audit objective, we did the following:

- reviewed bank statements, checks, invoices, billings, and other supporting documentation as evidence. Specifically:
- developed an internal control questionnaire to gain an understanding of the processes and to assist in the analysis of the accounting manual to determine potential internal control risk areas
- physically observed customers making payments through the cashier's window
- performed a walk-through of the daily closing processes with the Accounting Technicians and Supervisors
- observed the Corporate Account section daily cash interim close-out balance process
- observed the Corporate Account Daily Close out process
- observed the daily process of preparing deposits for Brinks pickup for bank delivery
- observed the daily close-out activities performed by the Accounting Manager, to include deposit completion and the combining of the cashier's prior day close into the deposit
- reviewed the accounting policies and procedures to gain an understanding of the processes
- reviewed organization chart of the Treasurer's Office
- reviewed bank accounts reconciliations for January 2014-January 2016
- physically observed the camera system to ensure security measures are in place to safeguard the cash adequately from possible theft while being processed, counted and stored in the Treasurer's Office

We also performed testing procedures to include:

- sampled checks to verify proper authorization
- verified accounts were used for their intended purpose
- traced checks written to transfer money to an existing bank account to the intended account, and requested and reviewed supporting documentation for sample checks
- reviewed the APA Commonwealth Auditor of Public Accounts (APA) Report for 2014-2015 and the APA Turnover Attestation Report December 31, 2013 to determine any potential risks directly related to the current audit objective
- performed an analytical review of the Treasurer's accounts listed in the annual Accountability Report and tested disbursements to ensure the City funds were accounted for
- analyzed bank accounts to determine their purpose and level of activities
- tested a random sample of disbursement activities to determine if they were adequately authorized and supported
- evaluated a judgmentally selected sample of checks made payable to in the City Treasurer's surname to ensure that City assets were accounted for



We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusion based on our audit objective. We believe that our evidence provides a reasonable basis for our findings and conclusions based on our audit objective.

Conclusion

In the City of Norfolk, the position of City Treasurer is a constitutional officer. As a constitutional officer of the city, the individual in this position is accountable directly to the voters. This in itself is challenging as the public expectation is for the ethical and honest exercise of one's action in carrying out duties and responsibilities. Therefore, since City's cash is the main asset under the purview of the Office the City Treasurer, it is vital that the Treasurer designs and implements adequate controls to maintain the public trust by ensuring the protection of public funds from theft or misappropriation. It is also imperative for additional oversight to ensure adequate "checks and balances" of the Treasurer's operations such as through City Code or by the Department of Finance, external agencies (the external auditors and the Virginia Auditor of Public Accounts).

During the audit, we did not observe an opportunity for the Treasurer to circumvent the day-to-day operations of cash management as established by policies and procedures, which we found adequate and effective; and were being strictly adhered to by staff. We found the Treasurer implemented management controls to mitigate the identified risks of the misappropriation and theft of cash and management override for which we considered as significant for our audit approach. We based our conclusion on the seven focus areas of the audit details of which follows.

Vault and Cash Drawer Access and Security - The City Treasurer implemented strong controls to ensure while the Accounting Technicians store and retrieve cash drawers, monies, and personnel are properly safeguarded. We physically observed that one of three Chief Deputies with the combination to the safe opened the vault to begin the process as another employee that is not a part of the cash handling process provided security on the outside of the vault. The Accounting Technician Supervisor entered the vault and called in the Accounting Technicians one at a time to store or retrieve their cash drawer. We found this process adequate and satisfactory.

Customer Payments Processing and Posting - There are sufficient automated controls in place to ensure customer payments were processed and posted at the time of the transaction. We physically observed customers making payments to the Accounting Technicians in the Treasurer's Office. The Accounting Technician verified each customer's information, accepted the payment, and verified the cash received or imaged the check(s) and gave the customer a receipt at the end of processing the transaction. We did not observe an opportunity for the Treasurer to intervene or circumvent processing customers' payments. Transactions are automatically posted to the customer's account as well as the City's general ledger. Accordingly, we were adequately satisfied that monies received from citizens or City Departments were properly accounted for and posted. Furthermore, the Accounting Technician Supervisor opened all mailed payments and distributed batches to all of the Accounting Technicians to process in RCS. If a customer who mailed in a payment wants a receipt, they must send a self-addressed stamped envelope.



Cash Counting and Daily Cash Drawer Reconciliations (Balancing Process) - Overall cash controls for this process are strong. We found there is zero tolerance for Accounting Technician cash shortages. We physically observed this process as each Accounting Technician entered the designated balancing area to reconcile their daily cash receipts. The Accounting Technicians printed a flash report of cashiering totals before they enter the balancing area. In the balancing area, the Accounting Technician counts the cash and reconciles to the flash report. The Accounting Technician Supervisor recounted the cash drawer, subtracted the till and reconciled the cash drawer to the system generated flash report. If an Accounting Technician's cash drawer was short, the Accounting Technician was responsible for paying the shortage out of pocket before the balance report is completed. We did not observe an opportunity for the Treasurer to intervene or influence this process. Therefore, we found this process sufficient and satisfactory.

Bank Deposit Preparation - There are adequate controls in place to ensure proper segregation of duties for the preparation of bank deposits. We physically observed the preparation of bank deposits for Brink Security pickups. There are two separate function areas within the Treasurer's Office that deal with cash, the Front Line area that handles customer's tax payments and the "Corporate" area that process cash receipts from city departments.

- **Front Line** - The Accounting Technician Supervisor prepared a deposit slip immediately after the balancing process is completed. The Accounting Technician Supervisor and the last cashier who completed balancing take the money to the safe for storage. This is an example of a dual control to ensure proper safeguarding of the city assets until the Accounting Manager retrieved the money to prepare the bank deposit for Brinks Security pick-up.
- **Corporate Section (Area)** - The Accounting Technician prepared the deposit slips for the daily transaction totals after the supervisor verified the daily totals. The monies are stored in the safe until the Accounting Manager retrieved the money to prepare for the Brinks Security pick up.

Bank Accounts Reconciliations - We requested and reviewed approximately 775 bank reconciliations for the period January 2014 - January 2016 for 34 banks accounts, 28 of which there is no additional oversight outside the Treasurer's Office, to ensure reconciliations were complete. Although the bank reconciliations were completed, preparers did not date or sign off to identify who completed them or that they were done timely. According to the Treasurer's Office Accounting Policy and Procedure Manual, bank statements should be disseminated to accounting staff (individuals without check signing rights) to reconcile the bank accounts using the approved reconciliation form. Therefore, to enhance the existing control process of bank reconciliations, we informed the Treasurer that an additional process should be implemented that requires the initially and dating of complete bank reconciliations.

Physical Security of the Treasurer's Area - We physically observed and counted 13 active, very easily identifiable security cameras in the treasurer's area. The position of the cameras directly captures all cash handling activities such as customers, cashiering, cash drawer balancing, and inputting and retrieving funds from the two secured safes. The cameras recorded activities on real-time, and the videos are retained for 30 days for review if needed. There are two monitor systems;



one in the Treasurer's office and one in a closet located in the cashier's area. We found the physical security controls are adequate and sufficient.

Cash Written from bank accounts - Strong controls are in place for checks written from bank accounts, such as dual signature authority, proper authorization and retention of supporting documentation for review and audit purposes. We selected a sample of 46 checks totaling \$3,634,209 to test the implementation of the established controls. We noted that the Treasurer implemented the established controls. Dual signature authority properly authorized all 46 checks and supporting documentation were available for testing. The sample also included 22 transactions where checks were written to deposit funds into other existing city bank accounts. We were able to trace all 22 of those transactions to other bank accounts as well as the general ledger account in the city's financial system. The sample transactions revealed that the Treasurer is using the bank accounts for their intended purpose and found no instances of monies being improperly withdrawn for non-city or unofficial business.

In addition to our audit, the Treasurer is an integral part of the City's annual financial audit conducted by the external auditors. As part of their audit, they assess the control over cash receipts and conduct various tests of the bank account balances and investments. The APA also conducts an annual review to ensure the Treasurer maintains accountability over Commonwealth collections; adequate internal controls are in place; and compliance with state laws and regulations. Our review of their audit did not disclose any areas of concerns that impacted our audit results.

Other Observations - We noted that Real Estate Expense account used for the cost and expense of the real estate sale transactions includes the Treasurer's surname. Specifically, the account owner title is City of Norfolk VA, Anthony Burfoot City Treasurer. This is the only account that we noted that has the City Treasurer's name as part of the account owner. We noted that this was the case during the tenure of the previous Treasurer. It appears, there is no additional oversight of this account outside the Treasurer's Office such as by the City's Finance Department. Although we did not identify indications of fraud or abuse, we recognize the potential risk of fraud or abuse because the City Treasurer has the capabilities to perform any transactions concerning this account without question since he is identified as the account owner.