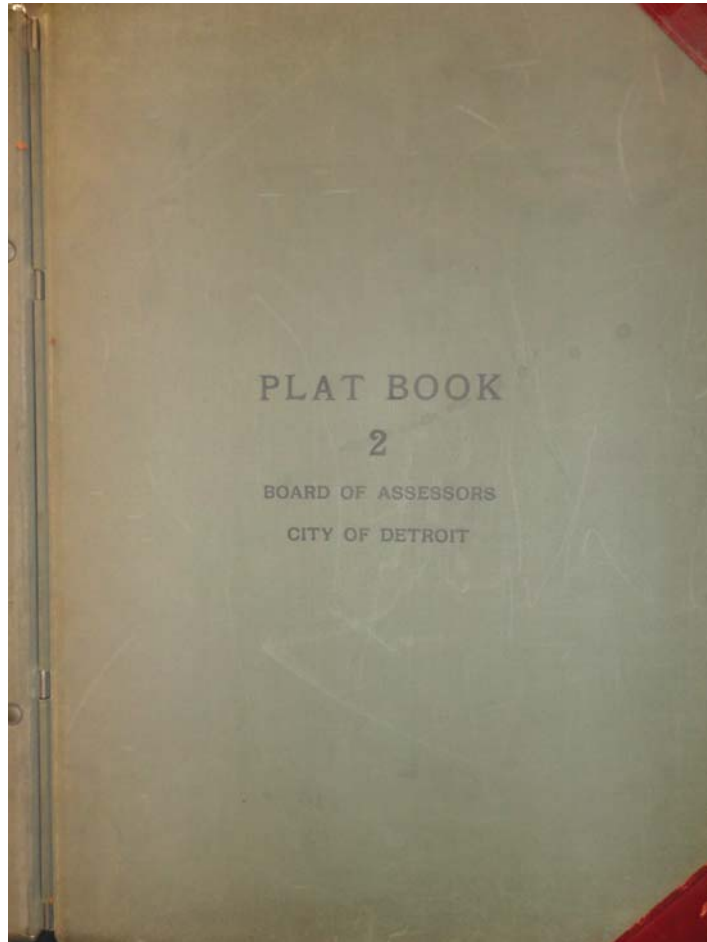


City of Detroit

OFFICE OF THE AUDITOR GENERAL



Audit of the Finance Department Assessments Division Cash Receipts

July 2008 – June 2011



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Mark Lockridge
DEPUTY AUDITOR GENERAL

MEMORANDUM

DATE: September 10, 2012

TO: Honorable City Council

FROM: Mark Lockridge, CPA, CIA, CGAP *M.L.*
Deputy Auditor General

RE: Audit of the Finance Department Assessments Division Cash Receipts

CC: Mayor Dave Bing
Cheryl Johnson, Group Executive/Finance Director
Jack Martin, Chief Financial Officer

Attached for your review is our report on cash receipts of the Finance Department Assessments Division. This report contains our audit purpose, scope, objectives, methodology, and conclusions; background; our audit findings and recommendations; and the response from the Assessments Division and Finance Department. The report of the performance audit of the Assessments Division is published under separate cover.

Responsibility for the installation and maintenance of a system of internal control that minimizes errors and provides reasonable safeguards rests entirely with the Assessments Division and the Finance Department. Responsibility for monitoring the implementation of recommendations is set forth in Section 7.5-105(4) of the City Charter which states in part:

Recommendations that are not put into effect by the department shall be reviewed by the Finance Director who shall advise the Auditor General and the City Council of the action being taken with respect to the recommendations.

We would like to thank the employees of the Assessments Division and the Finance Department for their cooperation and assistance extended to us during this audit.

Copies of all of the Office of the Auditor General reports can be found on our website at <http://www.detroitmi.gov/CityCouncil/LegislativeAgencies/AuditorGeneral/tabid/2517/Default.aspx>

**Audit of the Finance Department Assessments Division Cash Receipts
July 2008 – June 2011**

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AUDIT PURPOSE, SCOPE, OBJECTIVES, METHODOLOGY AND CONCLUSIONS

AUDIT PURPOSE

The audit of the cash receipts of the Finance Department Assessments Division was performed in accordance with the Office of the Auditor General's (OAG) charter mandate to make audits of the financial transactions, performance and operations of City agencies based on an annual risk-based audit plan prepared by the Auditor General, or as otherwise directed by the City Council, and report findings and recommendations to the City Council and the Mayor.

AUDIT SCOPE

The scope of this audit was an independent review and assessment of the Finance Department's Assessments Division's internal controls over cash receipts during the period of July 1, 2008 through June 30, 2011.

Our audit was conducted in accordance with Government Auditing Standards issued by the Comptroller General of the United States, except for the completion of an external peer review of the Office of the Auditor General within the last three years.

AUDIT OBJECTIVES

The overall audit objective was to assess the Assessments Division's internal controls related to cash receipts.

AUDIT METHODOLOGY

To accomplish our audit objectives we:

- Read the prior audit report(s);
- Reviewed prior audit workpapers, DRMS reports, the department's budget reports, organization charts, ordinances, and Finance Directives;
- Gathered the department's policies and procedures relating to cash receipts;
- Developed questions regarding the department's cash receipts, controls, functions, records, and personnel;
- Interviewed department personnel;
- Documented and tested processes.

CONCLUSIONS

Based on our audit of cash receipts, we have concluded that the Assessments Division did not effectively manage its cash receipts and the lack of internal controls resulted in the loss of cash and revenues for the City.

We also concluded that the Finance Department lacks an effective citywide cash management policy.

EXECUTIVE SUMMARY

The Finance Department's Assessments Division authority is derived from the State of Michigan Constitution, the statutes of the State of Michigan, and is authorized under the City Charter Section 6-304. The Assessments Division is located in the Coleman A. Young Municipal Center (CAYMC) and is headed by a three member Board of Assessors; the current Board has one vacancy due to a retirement in June 2011:

1. Linda M. Bade, Chief Assessor
2. Frederick Morgan, Assessor
3. (Vacant), Assessor

The Assessments Division has revenues resulting from the following assessments and sales of services:

- Penalties associated with late filing of Property Tax Affidavits:
A Property Tax Affidavit (PTA) is the document which records transfer of property ownership in the State of Michigan. PTA's are filed at the Division's Customer Service Counter and must be filed by the new homeowner with the City within 45 days of the transfer. If the transfer is not filed timely, the property owner is assessed a penalty of \$5 per day, up to a \$200 maximum.
- Neighborhood Enterprise Zones (NEZ) filing fees;
- Sales of photocopies and other reproduction services of property records;
- Sales revenue from property searches via an online internet service provided by a third-party supplier.

The following table shows the Assessments Division actual and budget for fiscal years ended 2009, 2010, and 2011.

Fiscal Year	Total Revenues (In Thousands)		
	Budget	Actual	Over (Under) Budget
2008-2009	\$ 200.0	\$ 212.8	\$ 12.8
2009-2010	200.0	243.3	43.3
2010-2011	200.0	238.0	38.0

Revenues (cash) are received from customers at the Assessments Division's Customer Service Counter and also through incoming mail. As a result of our audit of cash receipts, we found material weaknesses in both the Assessments Division's and the Finance Department's cash management practices. The lack of effective cash management resulted in missing cash of \$309,885, summarized below:

<u>Source of Cash Receipts</u>	<u>Amount of Missing Cash</u>
Customer Service Counter	\$159,014
Incoming Mail	150,871
Total Amount of Missing Cash From All Sources	<u>\$309,885</u>

Cash is the most liquid and negotiable of all assets. One of the many challenges facing the Assessments Division is the lack of human resources necessary to achieve proper segregation of duties. In addition, the absence of policies and procedures governing cash management, and the lack of a comprehensive citywide cash management policy contributed significantly to losses of cash due to errors, misappropriation, and theft.

This audit report cites several weaknesses in the Assessments Division's and the Finance Department's cash management practices.

AUDIT FINDINGS AND RECOMMENDATIONS

1. Lack Of Effective Management Over Cash Receipts At The Customer Service Counter

The Assessments Division lacks effective management over cash received at its Customer Service Counter. The Division:

- Did not have adequate internal controls that safeguard the City's cash assets and it did not ensure that all monies collected are deposited into the City's accounts;
- Did not have adequate policies, procedures, or practices governing cash management;
- Lacked adequate segregation of duties in the handling of cash receipts.

The lack of effective management over cash receipts resulted in large discrepancies between cash register receipts and cash deposited in the City's bank account.

Missing Cash Receipts

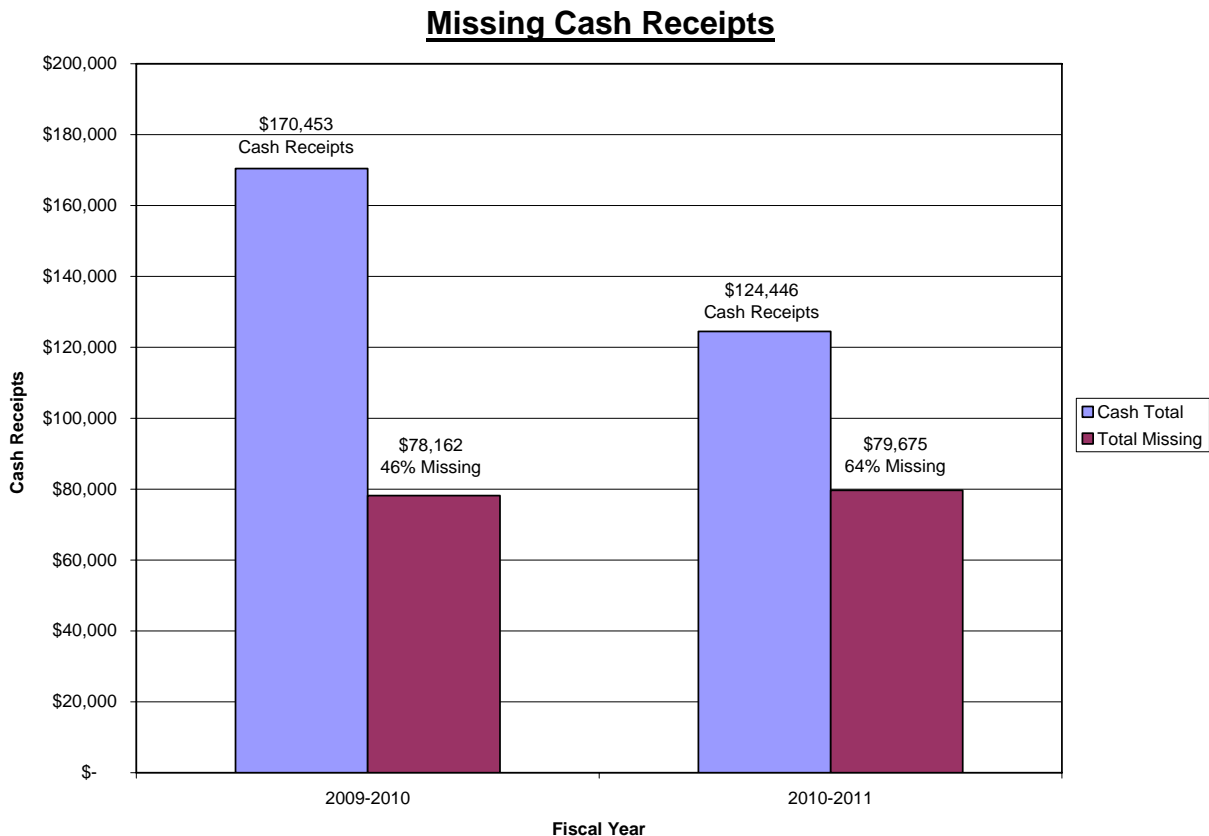
The Assessments Division provides a variety of customer services at its main counter located in the Coleman A. Young Municipal Center. They receive cash, checks, and money orders from customers for payment of penalties and fees for filing and photocopy services. A 100% audit of cash receipts for the following periods revealed a significant amount of cash that was received but not deposited in the City's bank account summarized below:

<u>Period Covered</u>	<u>Total Amount of Missing Cash</u>
July 2009 – June 2010	\$ 78,162
July 2010 – June 2011	79,675
September 2011 & December 2011	<u>1,177</u>
Total Amount of Missing Cash From Cash Receipts at the Customer Service Counter	<u><u>\$159,014</u></u>

- During fiscal year 2009-2010, \$65,476 was received but not deposited based on cash register receipts and amounts deposited;
- During fiscal year 2009-2010, an additional \$12,686 was computed as missing based on a comparison of all cash register receipts versus the amount actually deposited in the bank;
- During fiscal year 2010-2011, \$34,377 was received but not deposited based on cash register receipts and amounts deposited;

- During fiscal year 2010-2011, an additional \$45,298 was computed as missing based on a reconciliation of the grand total running balances from the daily closing register reports.
- After notifying the Division of the missing amounts and internal control weaknesses, subsequent audits of cash receipts was performed in fiscal year 2011-2012:
 - In the period from 8/29/2011 to 9/29/2011, \$977 was missing;
 - In the period from 11/30/2011 to 12/12/2011, another \$200 was missing.

The following is a graph of the amounts of missing cash compared to total cash receipts for fiscal years 2009-2010 and 2010-2011.



Cash Registers

The Division has two cash register machines, and the following internal control weaknesses were found:

- Staff members were not properly trained on cash register operations and could not properly program the cash register (e.g. – they could not program the current date to print on the receipts);
- The two cash register machines located in the Assessments Division have a starting balance of \$50 each. The Assessments Division could not provide proof

that the starting balances totaling \$100 was authorized by the Finance Accounting Division;

- During a surprise cash count, one cash register's starting balance was over by \$71.89.
- Cash register receipts did not have printed transaction dates;
- The final daily report of cash register receipts was not reconciled to journal vouchers or bank deposits;
- Errors made on customer cash transactions were manually corrected and were not voided or corrected in the cash register.

Lack of Segregation of Duties

The Assessments Division's Data Management Section is responsible for providing customer service at the Customer Service counter. An analysis of the roles and responsibilities of the ten active employees in this activity/section revealed that:

- Ten or 100% of the employees had access to cash and cash items from over-the-counter transactions and cash received through the mail, along with unsupervised access to the cash register.
- In addition to receiving cash, four or 40% of the Data Management staff could run cash register reports, prepare journal vouchers, and make deposits.

Because cash is the most liquid and negotiable of all assets, adequate internal controls must be in place to safeguard the city's cash receipts.

According to the City's cash handling procedures, all departments should insure that all cash and checks are deposited in the bank and recorded in the City's financial system within 48 hours of receipt.

Written policies and procedures should be stated clearly, communicated to the appropriate employees, and designed to reduce the possibility of errors. Written policies and procedures should be periodically reviewed and revised as circumstances change.

Cash and checks require a series of special controls:

- Access to cash receipts and cash receipt records should be suitably controlled to prevent or detect within a timely period the interception of unrecorded cash receipts or the abstraction of recorded cash receipts;
- The cash register is an inherent point of weak control because the person authorizes and records the transaction and then takes custody of the cash:
 - Only one employee at a time should be responsible for a cash register. Each cash register employee should begin each shift with a fixed amount of money, and at the end of the shift, the register receipts should equal the total cash in the register minus the initial fixed amount and properly authorized voids;

- The person responsible for each specific register should not have access to the register's special functions, such as totaling, subtotaling, transaction voiding, customer refunding, and the opening of the cash drawer without ringing up a sales transaction.
- Only one employee at a time should have custody of cash. When cash changes hands, it should be counted by the transferor and the transferee, and both employees should sign a transfer form indicating the details of the transfer.

The State of Michigan Department of Treasury requires that formal evidence be created for each collection (such as a printed sequentially numbered cash receipt ticket, cash register receipt, etc.) and provided to payors where practical.

Internal control is achieved through the organizational structure. Responsibilities should be divided so that no one person will control all phases of any transaction. To reduce the possibility of fraud and error, key duties and responsibilities need to be divided and procedures should be so coordinated that one employee's work is automatically checked by another who is independently performing separate prescribe duties. This should include separating the responsibilities for authorizing transactions, processing and recording them, reviewing transactions, and handling any related assets. In essence, a good internal control technique and procedure is to ensure segregation of duties between access to cash receipts and keeping records of cash receipts.

Regarding receipts, the Government Finance Officers Association (GFOA) and the State of Michigan Department of Treasury recommends as a best practice that collections should be reconciled by an individual not involved in the receipting process.

The lack of effective internal controls resulted in the Assessments Division not being able to account for a total of \$159,014 of cash received at the customer service counter from July 2009 to June 2011, September 2011, and December 2011.

Failure to monitor and deposit cash receipts on a timely basis increases the risk of undetected errors, misappropriation, theft, or loss.

Failure to periodically review and revise procedures to comply with higher level policies significantly weakens internal controls and increases the possibility of errors.

The Assessments Division does not have the capacity to implement adequate internal controls that safeguard the City's cash assets or ensure that all monies collected are deposited into the City's bank accounts.

Assessments Division personnel reported that they did not have an instruction manual for the cash register, and they were not properly trained on its operations and functionality. Division representatives also explained that power surges deleted protocols such as date stamps, which they had programmed into the cash register.

Recommendations

We recommend the Assessments Division consult with the Chief Financial Officer regarding acceptance of cash and cash items as payment for services. In our professional judgment the Division should discontinue accepting cash and cash items when the penalty or service fee is greater than \$10. Payments for these penalties and fees should be made directly to the Finance Department Treasury Division cashiers and a paid transaction receipt rendered to the customer. Customers can then present paid receipts to the Assessments Division to pay penalties, fees, and receive services.

The Assessments Division should implement accounting reconciliation procedures and work closely with the Treasury Division to ensure that revenues received from assessment activities are appropriately accounted for in the City's subledgers.

The Division should create or update policies and procedures to reflect the new operating environment for the handling of cash receipts.

In addition, we recommend that the Assessments Division:

- Obtain authorization from the Finance Department for the starting balances of \$100 currently in their cash registers;
- Install mitigating monitoring controls such as video cameras to monitor over-the-counter transactions for the protection of the staff and the public.

See **Appendix A** for the Office of the Auditor General's recommended flows for cash receipts at the Customer Service Counter.

2. Lack Of Effective Management Over Cash Received Via Incoming Mail

The Assessments Division lacks effective management over cash received via incoming mail.

- The Division did not maintain cash receipt logs of payments received through the mail (for delinquent taxes, property tax affidavits penalties, and other Assessments related activities);
- The endorsement stamp for checks did not include the City's bank account information;
- There is no system of checks and balances to ensure that all monies received is accounted for and deposited into the City's bank account.

In addition, there is a lack of segregation of duties for persons opening mail and making deposits:

- The same person in the Division opens the mail for delinquent property tax payments, prepares the cash receipts to be deposited, and is responsible for taking the deposit to the Finance Treasury Division;
- The same person who opens incoming mail for the Assessments Division, processes cash receipts and uses the cash register.

Missing Internet Services Revenue

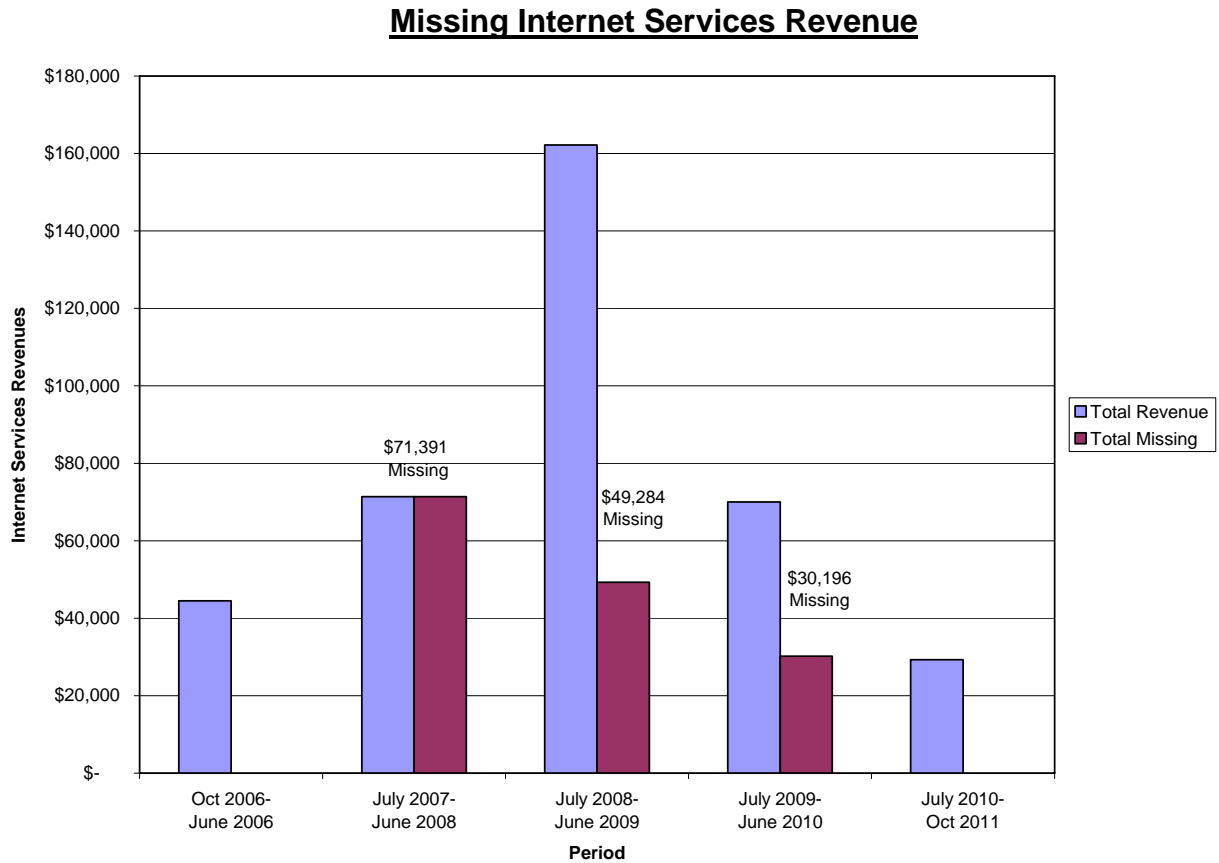
The Assessments Division receives sales revenue from property searches via a "pay-per-hit" online internet service. Detroit property owners are not charged a fee for the online search services; however, all other non-property owners are required to pay a per-transaction fee. The City receives 30% of the revenues generated through the professional services revenue-sharing contract. Under terms of the contract approved October 2006, the service provider remits revenues to the Assessments Division by sending monthly checks made payable to the City of Detroit.

Based on reports of revenues from the service provider, it was determined that the Assessments Division could not account for \$150,871 or 40% of the \$377,470 total amount remitted to the City.

<u>Period Covered</u>	<u>Total Revenue</u>	<u>Amount Deposited</u>	<u>Total Missing</u>	<u>% Missing</u>
Oct 2006 - June 2006	\$ 44,530	\$ 44,530	\$ -	0%
July 2007 - June 2008	71,391	-	71,391	100%
July 2008 - June 2009	162,237	112,953	49,284	30%
July 2009 - June 2010	70,009	39,814	30,196	43%
July 2010 - Oct 2011	29,303	29,303	-	0%
Total Internet Services Revenues	<u>\$ 377,470</u>	<u>\$ 226,599</u>	<u>\$ 150,871</u>	<u>40%</u>

A review of cancelled checks revealed that the checks were misappropriated from incoming mail addressed to the Assessments Division and subsequently fraudulently cashed.

The following is a graph of the amounts of missing cash since the effective date of the revenue contract October 2006:



Regarding receipts, the Government Finance Officers Association (GFOA) and the State of Michigan Department of Treasury recommends as a best practice that when possible, someone other than the person who writes receipts or posts the accounting records should be responsible to verify that collections received in the mail are properly receipted.

Checks or other cash items that are received through the mail which are not properly recorded on remittance advices are susceptible to misappropriation, theft, of loss.

Representatives from the Assessments Division stated that there are no written policies and procedures on how to handle incoming mail, nor did they receive any training, and that handling the mail is a “simple” task. They reported that maintaining a mail log was never suggested and it was not their current practice. No written policies and procedures existed for collecting delinquent property taxes because the policies and procedures changed with each new Finance Administration.

According to Division management, the overall lack of human resources is a roadblock to implementing the best practice procedure of having two people open incoming mail (an opener and a recorder), creating a mail log and remittance listing which summarizes all incoming checks received.

Recommendation

We recommend that the Assessments Division discontinue the practice of opening incoming mail containing cash or cash items. This process is the responsibility of the Finance Department Treasury Division. The Assessments Division should implement accounting reconciliation procedures and work closely with the Treasury Division to ensure that revenues received from assessment activities are appropriately accounted for in the City's subledgers.

See **Appendix B** for the Office of the Auditor General's recommended flows for cash received via incoming mail.

FINDING RELATED TO THE FINANCE DEPARTMENT

1. Lack Of An Effective Citywide Cash Management Policy

The Finance Department continues to lack an effective citywide cash management policy. Also, its Assessments Division's operations do not ensure that the City's revenues and cash receipts are adequately safeguarded:

- The Finance Department Purchasing Division does not adequately monitor revenue contracts. In addition, they do not ensure that revenue generating services are processed as separate contracts apart from other professional services contracts;
- The Finance Department did not correct the accounting for cash receipts to ensure that they were recorded in an appropriate revenue account;
- The Finance Department Account Division does not account for used and unused "Cash Receipt Books" which they distribute to city agencies and departments;
- There is no citywide policy on acceptable payment methods;
- The Finance Department does not adequately train agencies and departments on processing and safeguarding cash;
- The Finance Department Treasury Division does not ensure that cash received in the mail is properly deposited in the City's bank accounts.

According to the City's Charter, the Finance Director shall direct and coordinate the financial activities of the Accounts Division, Assessments Division, Treasury Division, and the Purchasing Division. The Finance Director shall also secure and maintain compliance with all laws pertaining to the financial controls for the protection of public funds.

In a report to City Council on the City's Cash Management Practices (July 2007), the Office of the Auditor General (OAG) reiterated recommendations of internal controls and best practices for the handling and processing of cash for the Finance Department and various agencies and departments. The recommendations summarized prior audit findings over the prior ten years. Responsibility for implementing recommendations, including internal control procedure recommendations rests with the management of the agency or department with the assistance of the Finance Department. Section 7.5-105(4) of the Charter of the City of Detroit requires the Finance Director to review all recommendations of the Auditor General which are not put into effect by the agencies and to advise the Auditor General and the City Council of action being taken with respect to the recommendations.

The Finance Purchasing Division is responsible for overseeing all contracts for personal services, grant-funded contracts, and all revenue contracts regardless of the dollar amount and including contracts for services rendered by the city, its departments, and agencies.

The State of Michigan Department of Treasury requires that the local unit of government use and adhere to the Uniform Chart of Accounts to assure responsible local officials and the general public that similar transactions are recorded in the same manner within all local units.

The Government Finance Officers Association (GFOA) and the State of Michigan Department of Treasury recommend that automated systems be used when available for faster processing and efficiency. However, in a manual receipting system using a three-part receipt form, the recommended distribution of the triplicate receipts is:

- Original Copy: for the payor
- Duplicate Copy: for the clerk (in this case the Assessments Division)
- Triplicate Copy: retained by the treasurer (should not be removed from the receipt book.)

To achieve good internal controls, checks received in the company mail should be received under the authority of the treasury function:

- They should be immediately endorsed restrictively “for deposit only” to the company’s account;
- Whoever opens the incoming mail should prepare a remittance list for the checks received
- If the checks are given to a second person, the second person should sign a copy of the remittance list acknowledging receipt of the listed checks.

In addition, the Finance Department (treasurer) must account for numerically all receipt books issued to other departments; the system must include controls to ensure that every receipt is to be included in a periodic listing of cash receipts.

The lack of effective written policies and adequate internal controls over the handling of revenue contracts and cash receipts does not ensure that all cash collected is deposited in the City bank accounts; therefore, cash receipts are not properly safeguarded and are subject to loss, theft, and misappropriation.

The Finance Department Accounts Payable Division management feels that agencies and departments are responsible for monitoring their own contracts regardless of the type of contract (i.e. – expenditure or revenue). The Finance Department Purchasing Division management was largely unfamiliar with revenue contracts and primarily dealt with sales of excess city assets and equipment. In the past revenue contracts were generated by departments based on services offered which can lead to revenue for the city.

The lack of good cash management practices resulted in cash receipts that were credited against contract services (instead of an appropriate revenue account) because the staff followed the written procedure. The lack of an effective policy for handling cash received via incoming mail resulted in the loss of revenues of \$150,871.

Assessments Division management believes the Treasury Division does not have good cash management policies and procedures. Division management also believes that “netting” revenue against amounts owed to the supplier is the most feasible solution at this time because:

- The City is slow in paying our bills;
- Eliminates the issues with tracking, receiving, and handling checks; it is the safest way currently;
- The Division has reduced its staff by eight persons including the Business Systems Support Specialist (BSSS) who was responsible for contract administration.

Further management stated that they have considered electronic funds transfers, “...but doesn’t trust the 8th Floor accounting, especially since the City has laid off so many accountants including the one that is responsible for wire transfers.”

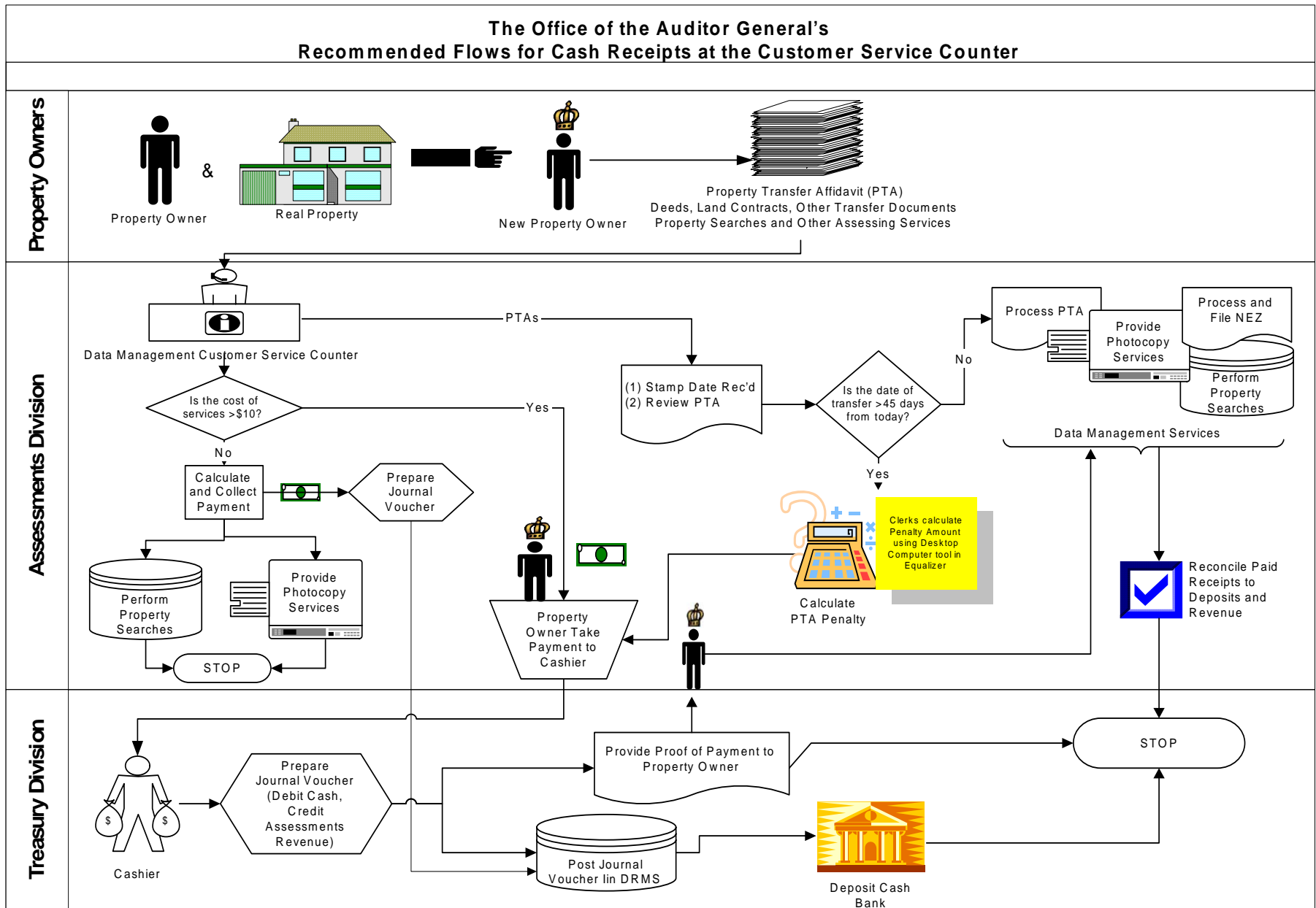
Recommendations

We recommend that the Finance Department:

- Develop and implement a citywide cash management policy, emphasizing strong internal controls over in the cash handling and safeguarding these assets;
- Provide cash management training to appropriate city employees;
- Purchasing Division develops and implements policies and procedures governing revenue contracts. Provide training to city agencies and departments on what is revenue, how to look for opportunities to generate revenue, etc. Purchasing should work closely with the Finance Department Accounts Division to implement appropriate financial accounting for the City’s revenues;
- Monitor all revenue contracts and incoming revenue to ensure that city assets are protected;
- Reconcile “Cash Receipt Books” distributed to city agencies and departments and require return of used books and unused books no longer needed;
- Develop and implement an effective citywide policy process for cash received via incoming mail which includes:
 - Segregation of incompatible duties;
 - Proper retention of mail logs and remittance listings;
 - Independent reconciliation of cash receipts to journal vouchers and bank deposits.

In addition, we recommend the Finance Department comply with its own procedure to hold employees handling cash strictly accountable for cash shortages and overages and to take appropriate action as warranted by the circumstances, including requiring the restitution of funds.

The Office of the Auditor General's
Recommended Flows for Cash Receipts at the Customer Service Counter



The Office of the Auditor General's
Recommended Flows for Cash Receipts via Incoming Mail

