# STATE OF TENNESSEE

## SPECIAL REPORT ON THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY OFFICE OF TRUSTEE

## FOR THE PERIOD JANUARY 1, 2007 THROUGH JULY 17, 2011

## Division of County Audit

TENNESSEE COMPTROLLER OF THE TREASURY

# SPECIAL REPORT ON THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY OFFICE OF TRUSTEE TABLE OF CONTENTS

STATE OF TENNESSEE
**COMPTROLLER OF THE TREASURY**
DEPARTMENT OF AUDIT
**DIVISION OF COUNTY AUDIT**

SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-1402
PHONE (615) 401-7841

October 7, 2011

To the Metropolitan Nashville Mayor,
 Metropolitan Nashville Trustee,
 and Metropolitan Council
Davidson County, Tennessee

On June 27, 2011, we received a fraud reporting form from the Metropolitan Nashville and Davidson County Office of Trustee related to an internal theft discovered in the spring of 2011. We contacted the Metropolitan Government of Nashville and Davidson County Office of Internal Audit and requested they investigate the incident with assistance from our office. This investigation disclosed that cash totaling $215,306.59 had been diverted from the trustee's office during the period January 1, 2007 through July 17, 2011. A cash shortage of $91,754.45 existed at July 17, 2011.

We reviewed the findings resulting from this special investigation with the trustee and the district attorney general. These findings, together with our recommendations and management's responses, are presented in this report.

Sincerely,

Jim Arnette, Director
Division of County Audit

cc: Honorable Victor S. Johnson, District Attorney General

# SPECIAL REPORT ON THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY OFFICE OF TRUSTEE

For the Period January 1, 2007 through July 17, 2011

Source of Allegation

The Metropolitan Government of Nashville and Davidson County Trustee (Metro Trustee), Mr. Charlie Cardwell, submitted a fraud reporting form to our office on June 27, 2011, related to a theft in the Trustee's Office that had been discovered in the spring of 2011. On July 5, 2011, we contacted the Metropolitan Government of Nashville and Davidson County Office of Internal Audit (Metro Internal Audit) and requested that they perform an investigative audit with assistance from our office. The findings and recommendations presented in this report were the result of this investigative audit.

Background

The metro trustee is charged with collecting real property, personal property, and public utility taxes from Davidson County property owners and businesses. The trustee's office employs approximately 28 staff to accomplish this mission. Cash, checks, and credit cards are accepted for payment of taxes.

In the spring of 2011, the Deputy Metro Trustee, Mr. Gerald Grigsby, stated he became aware of numerous suspicious cash payment reversal transactions and tax receivable adjustment transactions in the office's Manatron Taxman software application. He began to research the transactions and discovered they were associated with a Manatron Taxman system user ID assigned to employee Kenneth E. Fleming, Jr. Mr. Grigsby's initial review and tabulation determined $78,751 of collected real property taxes were missing. On May 27, 2011, Mr. Cardwell and Mr. Grigsby confronted Mr. Fleming concerning the transactions. Mr. Fleming admitted he had taken funds from the office without authorization. His employment with the trustee's office was terminated on June 1, 2011.

Employees of the trustee's office who perform the function of a cashier operate separate cash tills (cash drawers) that are balanced and counted separately each day to determine if the tills are over or short. Each cashier working and processing payments in the Manatron Taxman application is assigned an individual till number.

Mr. Fleming was employed by the trustee's office on August 16, 2004. His primary duties were to perform administrative tasks, collect tax payments from customers, and enter tax payment transactions into the Manatron Taxman system. He was also the primary interface with the Metropolitan Government of Nashville and Davidson County Office of Clerk and Master (Metro Clerk and Master) concerning individual delinquent tax payment transactions. Mr. Fleming was assigned a unique Manatron Taxman user ID and had his own private password associated with that ID. No other individuals were known to use his user ID. Based on system access capabilities assigned to his user ID, Mr. Fleming was initially given basic data entry capabilities. This access allowed him to enter payment transactions, reversal transactions (until the end of the day when all daily transactions had been posted to the reports, at which point a transaction could not be reversed), and adjustment transactions for fees and interest, but did not include the ability to make adjustments to taxes due. Sometime in the spring of 2010, Mr. Fleming was granted administrator rights to the software providing him the additional ability to adjust taxes due and also perform other administrative functions.

Mr. Grigsby stated he noticed suspicious cash reversal transactions sometime in the spring of 2011. He determined upon further research the user ID assigned to Mr. Fleming was associated with these transactions and some additional adjustment transactions that lowered the tax receivable amount to $0. Mr. Grigsby also stated he saw numerous cash transactions that were reversed but had been eventually repaid by Mr. Fleming by posting a payment transaction in the Manatron Taxman system and presumably placing a corresponding amount of cash in his cashier till/drawer (otherwise a cash shortage would have resulted with the daily till count). Mr. Grigsby stated he did not attempt to tabulate or document those particular transactions since the money had been returned.

Internal Audit Analysis

Metro Internal Audit obtained read only access to the Manatron Taxman system and access to the raw data that populates the application. Using various audit techniques, internal audit analyzed the property tax data and reviewed system transactions that occurred between January 1, 2007 and July 17, 2011. Their analysis identified two types of suspicious cash reversal transactions beginning October 9, 2007: Type 1 - cash reversal transactions were posted, and cash was removed from the office. At a later date a payment transaction was posted, and cash returned to the office, and Type 2 - cash reversal transactions that had no subsequent payment transaction entry for repayment of the original cash and presumably had never been repaid. All of these transactions (both types) had been preformed for no apparent reason as they were not immediately followed by a payment transaction that would have corrected an initial incorrect entry, as would be the case for legitimate cash reversal transactions. All such transactions identified as suspicious were performed by the user ID assigned to Mr. Fleming.

A total of 99 separate tax bills (a tax bill is for one property for one tax year) were affected by the transactions noted as a Type 1. A combined amount of $123,552.14 in cash had been reversed and later repaid. These transactions indicated the cash transactions had been reversed and the cash not included in the daily cash counts. If the cash had not been removed after the transaction was reversed, large cash overages would have occurred on a regular basis throughout the period. At various subsequent dates (ranging from five days to 13 months), all of the Type 1 transactions had been repaid by entering a payment transaction and returning cash to the user's cash till.

A total of 52 separate property tax bills were affected by the transactions noted as Type 2 with a combined cash amount of $91,754.45. These transactions indicated the cash transactions had been reversed and the cash not included in the daily cash counts. If the cash had not been removed after the transaction was reversed, large cash overages would have occurred on a regular basis throughout the period. No large cash overages were documented by the trustee's office. No subsequent payment transactions had been entered on these tax bills. However, an adjustment transaction had been entered by Mr. Fleming to reduce the tax bill to $0 on 14 of these 52 tax bills. There was no basis for reducing these tax bills. The first of such adjustment transactions was dated September 23, 2010.

## Summary

Kenneth E. Fleming, Jr., engaged in numerous suspicious transactions involving his user ID between October 2007 and May 2011, when his employment was terminated. A total of $91,754.45 is missing from 52 collected cash payments. Additionally, 99 accounts were affected by 216 transactions when cash totaling $123,552.14 was removed from the Trustee's Office and then returned to the office anywhere from five days to 13 months later.

Mr. Fleming was indicted by a Davidson County grand jury on July 15, 2011. He was charged with the misappropriation of cash associated with property tax payments.

## Findings and Recommendations

Findings and recommendations, as a result of the special investigation, are presented below. We reviewed these findings and recommendations with the metro trustee to provide an opportunity for his response. We have also reviewed this report with the district attorney general.

FINDING 11.01 **CASH TOTALING $215,306.59 WAS DIVERTED FROM THE OFFICE DURING THE PERIOD JANUARY 1, 2007 THROUGH JULY 17, 2011. A CASH SHORTAGE TOTALING $91,754.45 EXISTED AT JULY 17, 2011**
(Material Noncompliance Under *Government Auditing Standards*)

After performing a thorough investigation of property tax transactions associated with the Manatron Taxman application and interviewing employees in the Metro Trustee's Office, the Metro Internal Auditor determined that $91,754.45 was missing and $123,552.14 had been removed and returned using a technique commonly referred to as a lapping scheme. Lapping involves stealing a customer's property tax payment and then using a subsequent customer payment to cover the previous customer's tax bill. These deficiencies can be attributed in part to a lack of segregation of duties and management's lack of monitoring modifications made to the Manatron Taxman system.

## RECOMMENDATION

Management should take steps to liquidate the $91,754.45 cash shortage.

## MANAGEMENT'S RESPONSE – METRO TRUSTEE

We will work with Metro Finance and our insurance company to determine the course of action to implement the finding.

FINDING 11.02 **DUTIES WERE NOT SEGREGATED ADEQUATELY BETWEEN TWO INCOMPATIBLE FUNCTIONS OF THE OFFICE, AND MANAGEMENT DID NOT MONITOR ACCOUNT CHANGES MADE THROUGH THE MANATRON TAXMAN SYSTEM**
(Internal Control – Significant Deficiency Under *Government Auditing Standards*)

Kenneth E. Fleming, Jr. had the ability to make adjustments to account balances while simultaneously maintaining custody of one of the office tills. Mr. Fleming was given administrator rights to the Manatron Taxman system sometime between late 2009 and early 2010. Consequently, Mr. Fleming was able to reduce the tax balance on any taxpayer account to $0. Mr. Fleming was also responsible for one of the office cashier tills. This gave Mr. Fleming access to both cash assets and record keeping functions. Mr. Fleming was able to reverse taxpayer payments and to reduce the balance owed to $0. Accounting standards provide that internal controls be designed to give reasonable assurance of the reliability of financial reporting and of the effectiveness and efficiency of operations. This deficiency is a significant internal control weakness that increases the risk of unauthorized transactions, fraud, and theft.

The Metro Trustee's Office lacked a formal process whereby modifications/adjustments made to taxpayer accounts in the Manatron Taxman system, which alter the tax receivable, were reviewed and approved by management. Management did not produce periodic reports for review to ensure that all account modifications were authorized. Periodic scanning of a report of this type would enhance the ability of management to detect unauthorized changes that had been made. Had such a report been run and reviewed weekly or even monthly, the fraudulent adjustment of tax receivable accounts to $0 would easily have been detected. Sound business practices dictate that management properly monitor adjustments to account activity. This deficiency occurred because management failed to correct an internal control deficiency noted in a prior audit report. The possibility of unauthorized account activity is increased without management review of adjustment transactions.

RECOMMENDATION

Management should consider segregating the duties of any employee with administrator rights in the Manatron Taxman system and who also has access to taxpayer payments, especially custodial responsibility of a cashier till. In addition, management should periodically and consistently generate, review, and retain a report of all reversal and adjustment transactions made on taxpayer accounts.

MANAGEMENT'S RESPONSE – METRO TRUSTEE

We agree with the finding. We implemented the practice of segregation of duties immediately upon Kenneth Fleming's termination. Periodically we will monitor all modifications to the system, scan, and retain all reports.

FINDING 11.03 **DUTIES WERE NOT SEGREGATED ADEQUATELY**
(Internal Control – Significant Deficiency Under *Government Auditing Standards*)

Metro Internal Audit noted that since January 2011, the person responsible for reconciling and approving the amounts listed on the Daily Balance Report with actual payments submitted by various cashiers also operated their own cashier till and had administrator rights in the Manatron Taxman system.

Cashiers were required to run a Daily Balance Report at the end of each day. This report details the exact amount of money (cash, checks, credit cards) that was collected by the respective till for that day. The cashier ensures the actual amount in the drawer agrees with the report amount. Once agreed, the cashier submits the actual payments and report to a member of management who also counts the payments received and reconciles the amounts to the report. Since January 2011, the employee responsible for this task was Kenneth E. Fleming, Jr. Mr. Fleming also was responsible for operating his own cashier till, thus he was reviewing and approving his own work. Accounting standards provide that internal controls be designed to give reasonable assurance of the reliability of financial reporting and of the effectiveness and efficiency of operations. This deficiency is a significant internal control weakness that increases the risk of unauthorized transactions, fraud, and theft. The value of management reviewing and approving the amounts collected by cashiers and reconciling the amounts with the corresponding Daily Balance Report is significantly diminished when the reviewer is validating their own collections. The purpose of this management review is to detect errors and/or fraudulent acts.

RECOMMENDATION

Management should ensure staff members entrusted with management review responsibilities should not be in a position where they review their own work.

MANAGEMENT'S RESPONSE – METRO TRUSTEE

We agree with the finding. Staff members entrusted with management services will not be in a position where they review their own work.

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FINDING 11.04 **THE OFFICE DID NOT HAVE AN ADEQUATE PROCESS FOR PAYMENTS RECEIVED ON DELINQUENT TAX PAYMENTS**
(Internal Control – Significant Deficiency Under *Government Auditing Standards*)

Management did not have an adequate methodology for accepting payments and distributing receipts for payments made on delinquent property taxes. Payments made on delinquent taxes were handled through the metro clerk and master. However, the metro trustee accepted payments at their office as a courtesy to the taxpayer. Once a tax bill reaches delinquent status, cashiers at the trustee's office do not enter payment information in the Manatron Taxman system. If a taxpayer wishes to make a payment on a delinquent account at the trustee's office, a cashier will accept the payment, note the amount being paid, and provide the customer a screen print, which shows the amount due on the specific bill and the amount due in the Manatron Taxman system. The cashier will stamp the screen print, sign it, hand-write the amount paid by the taxpayer, and give it to the taxpayer for their records. The amount paid is not reflected in the Manatron Taxman system. A copy of the screen print and the payment are forwarded to a member of management, in the past Kenneth E. Fleming, Jr., who maintained a log of all delinquent payments received. A copy of the log, screen prints, and payments would be manually carried to the Metro Clerk and Master's Office for posting in the Manatron Taxman system. Accounting standards provide that internal controls be designed to give reasonable assurance of the reliability of financial reporting and of the effectiveness and efficiency of operations. This deficiency was the result of management decisions. The current methodology for handling delinquent taxes increases the risk of theft and loss. It is impossible to reconcile amounts received with receipts actually issued since delinquent tax payments are not updated in the Manatron Taxman system as they are received. Additionally, the party who has custody of logging all such payments also has custody of the respective assets. Cash or checks could be accepted from the taxpayer then never entered into the receipts log or forwarded to the metro clerk and master. When payments are accepted at the trustee's office, the clerk and master may be unaware of the transaction since no entry is made in the Manatron Taxman system. Taxpayers may be confused as to who is responsible for delinquent property tax accounts.

RECOMMENDATION

The metro clerk and master should receive all delinquent property tax payments for accounts already turned over to them from the trustee's office. The metro trustee should discontinue accepting payments for these accounts.

MANAGEMENT'S RESPONSE – METRO TRUSTEE

We agree with the finding. The Office of Trustee and the Office of Clerk and Master used to be located in the same office building, which was a convenience for the taxpayer. When the offices were relocated into different locales, in order to accommodate the taxpayer, the decision was made to permit the Office of Trustee to accept a delinquent tax payment and then, on behalf of the taxpayer, forward the payment to the Office of Clerk and Master for posting. In order to implement the recommendation, the taxpayers will be directed to the Clerk & Master's office to make a delinquent tax payment.

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FINDING 11.05 **CASHIERS HAD THE ABILITY TO POST-DATE TRANSACTIONS IN THE MANATRON TAXMAN SYSTEM**
(Internal Control – Significant Deficiency Under *Government Auditing Standards*)

Cashiers had the ability to post-date transactions in the Manatron Taxman system. This was evidenced by a transaction found in the database July 17, 2011, that contained Kenneth E. Fleming's user ID. The transaction was dated July 28, 2011 even though Mr. Fleming last used the system on May 27, 2011, two months earlier. No other forward transactions were noted for other users. This deficiency appears to result from a lack of sufficient application controls in the Manatron Taxman system and poor management oversight. The ability to post-date payments increases the risk of fraud and theft.

RECOMMENDATION

Management should ensure, with very limited exceptions (with prior authorization and approval), office staff does not have the ability to post-date Manatron Taxman transactions.

MANAGEMENT'S RESPONSE – METRO TRUSTEE

We agree with the finding. We have made the proper changes to Manatron Taxman. With the help of Manatron, a database change was implemented on August 8, 2011. This new release added a new requirement in Master Control to restrict the number of days before and the number of days after the current date that a cashier can declare cash or open a till.

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FINDING 11.06 **A FRAUD REPORTING FORM WAS NOT FILED PROMPTLY**
(Noncompliance Under *Government Auditing Standards*)

A Fraud Reporting Form was not filed with the state Comptroller's Office until June 27, 2011, a total of 17 working days after Kenneth E. Fleming, Jr. admitted he had taken funds. Management notified the Office of District Attorney General on May 27, 2011, but did not report the incident to the Comptroller's Office as required by state statute. It should be noted management initially became aware of suspicious transactions in the spring of 2011. Section 8-4-501, *Tennessee Code Annotated* (*TCA*), requires that a Fraud Reporting Form be filed within five working days of the time the official has knowledge that suspected unlawful conduct has occurred. The ability to preserve evidence and conduct a timely independent investigation or follow-up of alleged inappropriate activity will be diminished over time.

RECOMMENDATION

Management should file a Fraud Reporting Form in accordance with provisions of Section 8-4-501, et. seq., *TCA*, for any suspected fraud.

MANAGEMENT'S RESPONSE – METRO TRUSTEE

We agree that we didn't report on a timely basis to state Comptroller's Office in accordance with statutory requirements. We took immediate action by involving the Metro Legal Department and District Attorney General's Office. In the future, any suspicion of fraud will be reported to the Comptroller's Office in a timely manner.