

**SPECIAL PURPOSE EXAMINATION OF THE RECORDS
OF THE CITY OF ROCKWOOD
FOR THE PERIOD JULY 1, 1998, THROUGH DECEMBER 31, 2000**

After receiving information regarding apparent discrepancies in the City of Rockwood's accounting records, the State of Tennessee, Comptroller of the Treasury, Division of Municipal Audit, began a special purpose examination of the city on December 5, 2000. Our examination was conducted in conjunction with the local District Attorney General's Office, the Tennessee Bureau of Investigation, and the Rockwood Police Department. The results of our examination are presented below.

City elections held in May 2001 (subsequent to the scope of our examination) resulted in several changes in the make-up of the Rockwood City Council. The current mayor and city council have been asked to respond to the findings presented in the Findings and Recommendations section of this report.

LEGAL ISSUES

1. **ISSUE: Apparent misappropriation of at least \$425,681.59**

During the period July 1, 1998, through November 27, 2000, the former recorder/judge, Howard Butler, apparently misappropriated at least \$425,681.59 from the City of Rockwood. After the city's independent auditors made inquiries about accounting discrepancies in the city's records, Mr. Butler admitted to the former mayor, a former councilman, and the city's independent auditors that he had taken city money without authorization and received the benefit of it.

Our examination indicated that \$422,831.67 of the misappropriation occurred when Mr. Butler prepared at least 272 unauthorized city checks and received the proceeds of the unauthorized checks (most of which were cashed at local banks) for his personal use. For examples of these checks, refer to Exhibits Section. Mr. Butler apparently signed the checks and used a signature stamp in his possession to affix the former mayor's signature. It appeared that Mr. Butler attempted to conceal the misappropriation by incorrectly recording or not recording numerous fraudulent financial transactions in the city's accounting records.

NOTE: Our cursory review of City of Rockwood disbursement records for the period July 1, 1997, through June 30, 1998 (the fiscal year prior to the scope of our examination), revealed a similar pattern of apparently fraudulent disbursement activity totaling over \$50,000. This amount is not included in the misappropriation noted above.

In addition to the fraudulent disbursements, at least \$2,849.92 of city collections and transfers from city bank accounts was deposited directly into Mr. Butler's personal bank account.

Summary of Money Apparently Misappropriated by Howard Butler for the Period July 1, 1998, through November 27, 2000:

Apparent fraudulent disbursements by former recorder/judge	\$422,831.67
Apparent misappropriation of collections by former recorder/judge	<u>2,849.92</u>
Total amount apparently misappropriated by former recorder/judge	<u>\$425,681.59</u>

Further investigation revealed that Mr. Butler turned over all or most of the misappropriated money to a long-time acquaintance. This acquaintance stated that Mr. Butler had turned City of Rockwood money over to him. He further stated that he had deceived Mr. Butler as to the purpose for which City of Rockwood money was to be used. This individual used misappropriated City of Rockwood money for the personal benefit of himself and others.

This matter was referred to the district attorney general's office. As a result, the Roane County Grand Jury indicted Mr. Butler's acquaintance on 21 counts of theft, including one count of theft over \$60,000. In addition, the Roane County Grand Jury indicted an associate of the acquaintance for one count of theft over \$60,000 due to his involvement. Mr. Butler was deceased prior to this matter being referred to the district attorney general.

At least 214 unauthorized, apparently fraudulent checks totaling \$375,478.86 were cashed at one local bank. Forty-eight of these cashed checks, totaling \$58,603.66, were not endorsed. Documentation located at city hall and discussion with city officials revealed that surety bond coverage for the former recorder was only \$10,000. We recommend the city obtain adequate bond coverage. We further recommend the city seek legal counsel in order to determine and pursue all possible means of redress.

2. **ISSUE: Additional missing city collections of at least \$11,046.35**

In addition to the misappropriation noted in Legal Issue 1, during the period July 1, 1998, through December 4, 2000, city collections of at least \$11,046.35 were not recorded in city records or deposited into city bank accounts. Although our examination revealed that Mr. Butler was directly responsible for at least part of the missing collections, we were unable to determine that Mr. Butler was solely responsible for the entire amount. Therefore, we chose not to include this amount in Legal Issue 1.

3. **ISSUE: Apparent misappropriation of city money by means of city checks payable to and endorsed by director of parks and recreation**

In addition to the misappropriation noted in Legal Issue 1, during the period July 1, 1998, through October 2, 2000, the former recorder/judge, Howard Butler, prepared at least 10 unauthorized city checks totaling \$12,405.40 payable to David Woods, Director of the Rockwood Parks and Recreation Department. The amounts on the individual checks approximated Mr. Woods' authorized weekly and/or bi-weekly salary. However, these checks were in addition to Mr. Woods' regular payroll checks. All of the checks were cashed at a local bank. In two separate interviews with state auditors, Mr. Woods denied any knowledge of these checks. However, Mr. Woods eventually admitted that he endorsed all of these checks. Mr. Woods continued to deny that he cashed the checks or received the proceeds of the checks. Mr. Woods stated that Mr. Butler had asked him to endorse the checks because he (Mr. Butler) "needed to move money around."

Mr. Woods' bank account number was written under Mr. Woods' endorsement on all of the checks. Based on interviews with bank tellers, Mr. Woods' customer account number written by the tellers on the cashed checks indicated that Mr. Woods cashed the checks.

This matter was referred to the district attorney general's office. As a result, the Roane County Grand Jury indicted Mr. Woods on four counts of official misconduct.

NOTE: A cursory review of city disbursement records for the period July 1, 1996, through June 30, 1998, revealed a similar pattern of apparent misappropriation of city money. During this period, Mr. Butler prepared at least eight additional checks, totaling \$9,354.63, payable to and apparently endorsed by Mr. Woods. All of these checks were cashed. This amount is not included in the misappropriation noted above.

Summary of Apparent Misappropriation

Apparent misappropriation by former recorder/judge	\$425,681.59
Missing collections	11,046.35
Apparent misappropriation of city money related to director of parks and recreation	<u>12,405.40</u>
Total apparent misappropriation	<u>\$449,133.34</u>

FINDINGS AND RECOMMENDATIONS

As noted previously, the Comptroller of the Treasury has prescribed a minimum system of bookkeeping for all municipalities. Section 9-2-102, *Tennessee Code Annotated*, requires municipal officials to adopt and use this system. However, City of Rockwood officials apparently failed to provide adequate management oversight to ensure that the procedures required by law were established and followed. This failure resulted in a pervasive lack of adequate internal controls. The following findings address some of the most critical internal control weaknesses that allowed the misappropriations and other irregularities noted in Legal Issues 1 through 3 to occur and not be detected timely.

MANAGEMENT'S OVERALL STATEMENT:

The City of Rockwood has taken steps to improve the management and operation of its city office. Specifically, it has hired a new and well-qualified financial director, implemented new clerk levels, and has purchased a new computer system from Local Government Data Processing Corporation. The new computer system will provide a sound basis for better internal controls in the accounting functions as well as more efficient and accurate accounting records. Modules purchased include: General Ledger, Accounts Payable, Purchase Orders, Municipal Court, Property and Business Tax, and Miscellaneous Receipting.

1. **FINDING: Inadequate separation of duties**

Although the city had several employees, city records and interviews with city officials and employees indicated the former recorder had complete control over most city financial transactions. The former recorder opened mail, received collections, recorded collections, prepared collections for deposit, delivered deposits to the bank, and reconciled bank statements. The former recorder was also the second signature on city checks and maintained custody of the mayor's signature stamp, allowing him to write checks without any controls or supervision. The former recorder, who also served as city judge, posted dispositions of traffic citations to the city court docket and collected and recorded fines and court costs. Because city officials failed to exercise adequate management oversight and ensure that duties were adequately separated, the former recorder was able to misappropriate City of Rockwood money noted in Legal Issue 1 without being detected timely. The *Internal Control and Compliance Manual for Tennessee Municipalities*, Title 1, Chapter 2, Section 2, states:

Municipal officials should enforce division of duties to provide a system of checks and balances so that no one person has control

over a complete transaction from beginning to end. Work flow should be established so that one employee's work is automatically verified by another employee working independently. . . .

Title 1, Chapter 2, Section 4, of the manual states:

Municipal officials should ensure that automatic proof techniques are applied whenever possible. These techniques include the use of an employee without prior access to the records to . . . reconcile bank accounts . . . periodically test . . . daily balancing of cash receipts . . . open mail and prelist mail receipts . . . perform routine duties of other employees . . . for at least one vacation period per year.

RECOMMENDATION:

To decrease the risk of future misappropriations or other undetected irregularities or errors, city officials should review employees' responsibilities and properly separate duties to ensure that no employee has control over a complete transaction.

MANAGEMENT'S RESPONSE:

Mayor and Members of the City Council:

Management concurs with the finding and has implemented corrective actions. Specifically, the city finance director/recorder is in charge of developing a professional finance department for the City of Rockwood. The finance director/recorder does not have signature authority at the city's banks. No signature stamps are available or used and all banking transactions require two original signatures. The court docket is maintained by a city clerk with oversight by the newly appointed city judge and finance director. In addition, city fines and court costs are controlled at the service, cashier windows.

Finance Director:

Response is the same as that of the mayor and council.

2. **FINDING: Disbursements not made by prenumbered check**

City of Rockwood officials did not require and ensure that all applicable city disbursements were made by prenumbered check. With the knowledge of some city officials, city checks were taken to a local bank, cashed, and the cash was then used for the following:

- a) Christmas bonuses to city employees in 1998 and 1999;
- b) City firemen compensation in lieu of compensatory time;
- c) Volunteer firemen quarterly salaries; and
- d) Firemen and police officers compensation for in-service training.

These payroll-related payments, which totaled over \$60,000, were paid in cash apparently to avoid payment of required federal taxes by the city. Also, in some instances, parks and recreation department personnel used department cash collections to pay lifeguards for some additional hours worked at the city's pool (again, to avoid federal taxes) and to purchase concessions supplies. Finally, cash loans were apparently made to city employees using city collections.

City officials' failure to require and ensure that all municipal disbursements be made by prenumbered check may have increased the former recorder's opportunity to cash city checks and retain the proceeds for his personal benefit without timely detection, as discussed in Legal Issue 1.

Section 6-56-111, *Tennessee Code Annotated*, states:

- (c) Every municipal official authorized to disburse public funds shall be required to make disbursements of such public funds by consecutively prenumbered checks, warrants or other generally accepted negotiable instruments drawn on the municipality's official bank account or accounts.
- (d) A violation of this section is a Class C misdemeanor.

Section 40-35-111(e), *Tennessee Code Annotated*, states, "The authorized terms of imprisonment and fines for misdemeanors are: . . . (3) Class C misdemeanor, not greater than thirty (30) days or a fine not to exceed fifty dollars (\$50.00), or both, unless otherwise provided by statute."

The Internal Revenue Service considers bonuses, regular pay, payments in-lieu of comp time, and in-service payments to be compensation for services and, therefore, taxable income. Failure to withhold federal taxes and report all taxable income may result in the city being charged fines and interest on unpaid taxes.

The *Internal Control and Compliance Manual for Tennessee Municipalities*, Title 2, Chapter 2 and Chapter 3, provides additional guidance for disbursing municipal funds. Title 2, Chapter 3, Section 11, of the manual states, "Municipal officials should note that local governmental units are required to report total salaries and make payment of income taxes withheld in the same manner as other employers. . . ."

RECOMMENDATION:

To document that disbursements are for valid municipal purposes, comply with federal tax law, and prevent undetected errors and irregularities (such as the misappropriation noted in Legal Issue 1), city officials should require the use of consecutively prenumbered checks for all disbursements, including payroll-related payments. Applicable federal taxes should be withheld from all payments to employees for compensation for services.

MANAGEMENT'S RESPONSE:

Mayor and Members of the City Council:

Management concurs with the finding and has implemented corrective actions. Specifically, consecutively prenumbered checks are used for all disbursements, including payroll-related payments. No cash payments are made for payroll-related payments and all federal taxes are withheld from all payments to employees for compensation for services. In addition, employees are required to sign time sheets and supervisors sign for payroll checks.

Finance Director:

Response is the same as that of the mayor and council.

3. **FINDING: Improper petty cash procedures**

City officials did not ensure that city personnel followed required procedures for petty cash disbursements and reconciliation. During the period July 1, 1998, through November 27, 2000, the former recorder, who was also the petty cash custodian, issued checks to "Petty Cash" totaling \$58,603.09. Of this total, supporting documentation could be located for only \$11,596.43. According to city employees, city collections were routinely used to make petty cash purchases. We were unable to determine whether the former recorder reconciled petty cash and city collections. The *Internal Control and Compliance Manual for Tennessee Municipalities*, Title 2, Chapter 4, establishes rules governing petty cash. Title 2, Chapter 4, Section 2, of the manual states:

Municipal officials should ensure that . . . petty cash disbursements are made only as needed and that **an invoice or petty cash voucher, prepared in ink, showing the items purchased, and signed by the person receiving the cash, is required in each case.** The amount of cash on hand and petty cash vouchers written must total to the originally authorized amount of the funds. (Emphasis added)

Title 2, Chapter 4, Section 4, of the manual states:

Municipal officials should ensure that . . . someone other than the person responsible for handling the petty cash fund inspect, approve, date, initial, and mark each voucher “PAID” to prevent reuse. Municipal officials should enforce the following restrictions:

- (a) The petty cash fund should be maintained at the lowest amount possible and should be replenished only after the strictest scrutinizing of all supporting documentation for the petty cash disbursements.
- (b) Under no condition should the petty cash fund be commingled with personal funds of a city official or employee or used to cash personal checks or to make advances to employees. . . .

Because city officials failed to ensure that required petty cash procedures were followed, the former recorder was able to divert the proceeds of petty cash checks totaling \$37,085.38 for his personal benefit. (This amount is included in the \$425,681.59 amount noted in Legal Issue 1.)

Summary of Petty Cash Disbursements

Petty cash disbursements supported by adequate documentation	\$11,596.43
Petty cash disbursements without adequate supporting documentation not included in Legal Issue 1	9,921.28
Apparently fraudulent petty cash disbursements included in Legal Issue 1	<u>37,085.38</u>
Total petty cash disbursements	<u>\$58,603.09</u>

RECOMMENDATION:

To provide greater accountability for city collections, ensure that each disbursement is for a valid municipal purpose, and help decrease the risk of future misappropriations, city officials should ensure that city employees establish and follow required petty cash procedures as set forth in the *Internal Control and Compliance Manual for Tennessee Municipalities*. Adequate supporting documentation, including invoices and vouchers signed by petty cash recipients, should be maintained in the city’s files for each disbursement. Before replenishing petty cash, someone other than the petty cash custodian should review and approve all petty cash disbursement documentation. City officials should strictly prohibit the use of city collections for making petty cash purchases.

MANAGEMENT'S RESPONSE:

Mayor and Members of the City Council:

Management concurs with the finding and has implemented corrective actions. Specifically, management has established and follows required petty cash procedures as set forth in the *Internal Control and Compliance Manual for Tennessee Municipalities*. Adequate supporting documentation is maintained. No city collections are used for petty cash purchases. Further, petty cash disbursement and replenishment requires two signatures.

Finance Director:

Response is the same as that of the mayor and council.

4. **FINDING: Collections not properly reconciled and collection reports not properly prepared**

City personnel did not properly reconcile recorded collections with amounts deposited. Receipted general city collections were generally summarized by source on daily collection reports (DCRs). However, city personnel failed to ensure that totals on DCRs agreed with totals on corresponding deposit slips as well as the total of all applicable receipts as required by the *Internal Control and Compliance Manual for Tennessee Municipalities*. Our examination revealed that some receipted amounts were not recorded on DCRs, prenumbered receipts were not issued for all amounts recorded on DCRs, and totals on DCRs did not always agree with totals on corresponding deposit slips. Also, DCRs were not signed by the preparer.

The former recorder did not retain a predetermined amount of change in the general government cash drawer or record the amount retained for change on DCRs. In addition, the former recorder failed to record overages or shortages on DCRs or other accounting records. Instead, it appears that daily fluctuations in the amount of change retained were used to conceal shortages (missing collections) in the cash drawer. Based on documentation attached to several city checks totaling over \$1,000, the average monthly shortage in the cash drawer between April 13, 1999, and March 6, 2000, was nearly \$100.

Although the golf course manager prepared DCRs, they were not prepared daily. Instead, the reports were apparently completed when collections were prepared for deposit. We also noted that the golf course manager did not sign the reports and failed to record overages and shortages on the DCRs, as well as the predetermined amount of change.

The *Internal Control and Compliance Manual for Tennessee Municipalities*, Title 3, Chapter 1, Section 5, states, "Municipal officials should ensure that . . . at the end of the

day, the cashier counts the cash and checks on hand, **leaving only the predetermined amount in the change fund. . .**” (Emphasis added)

Section 6 of the manual states:

Municipal officials should ensure that . . . each day the cashier summarizes all cash collections by source on a daily collection report, clearly indicating the amount to be deposited, the amount retained for change, and the amount of cash over or short. Each report should be dated, and the date should be recorded on the corresponding deposit slips. The total on the daily collection report should agree with the total of the corresponding deposit slips as well as with the total of all applicable receipts. The cashier should sign the daily collection report. Each cashier should be assigned a separate cash drawer that is accessible only to that cashier.

Section 8 of the manual further states that “Municipal officials should ensure that . . . duplicate, prenumbered receipts are marked and property tax receipts and billing stubs are filed according to the deposit to which they correspond.”

RECOMMENDATION:

To better account for collections and decrease the risk of undetected errors and irregularities, a predetermined amount of change should be retained and recorded on DCRs. Amounts over or short should be documented on DCRs and in other applicable accounting records. City officials should ensure that collections are reconciled and that totals on DCRs agree with totals on the corresponding deposit slips as well as the total of all applicable receipts. DCRs should be signed and should clearly identify the source of each collection.

MANAGEMENT’S RESPONSE:

Mayor and Members of the City Council:

Management concurs with the finding and has implemented corrective actions. Specifically, each clerk maintains sole custody of their cash drawer and prepares a daily cash collection report indicating collections, receipt numbers, and amounts over or short and amounts to be deposited. Also, the clerks are balancing daily transactions to the register Z tape. Further, the Local Government Data Processing System will enable the clerks to be more automated and will provide computer-generated cash balancing at the end of each day.

Finance Director:

Response is the same as that of the mayor and council.

5. **FINDING: Inadequate internal controls for receipt of mail**

City officials failed to establish adequate internal control procedures to ensure prompt receipt and deposit of city collections received by mail. Failure to follow these required procedures allowed the fraudulent disbursements and misappropriated collections noted in Legal Issues 1 and 2 to occur without timely detection.

The *Internal Control and Compliance Manual for Tennessee Municipalities*, Title 3, Chapter 1, Section 4, states:

Municipal officials should ensure that . . . office mail is delivered intact (unopened) to an employee who is assigned the duty of immediately opening the mail and preparing an itemized bank deposit slip in duplicate for all money received. All checks should be stamped "FOR DEPOSIT ONLY." The deposit slip and checks received through the mail should be given to the cashier. Regardless of whether the remittance is received by mail or paid directly to the cashier, EACH CHECK SHOULD BE LISTED SEPARATELY TO SUPPORT THE DEPOSIT SLIP TOTAL.

RECOMMENDATION:

To better safeguard collections, city officials should assign responsibility for receiving unopened mail, including mailed collections, to an employee that is not involved in posting payments to the city's records. The designated employee should prepare receipts for all mailed collections and prepare itemized bank deposit slips, in duplicate, for all mailed collections received. The original deposit slip and corresponding collections should be turned over to the cashier for deposit. As noted in Finding 7, the transfer of mailed collections to the cashier should be documented by prenumbered receipt, or other adequate documentation signed by the cashier and the employee turning over mailed collections, to indicate concurrence with the amount transferred.

MANAGEMENT'S RESPONSE:

Mayor and Members of the City Council:

Management concurs with the finding and has implemented corrective actions. Specifically, a clerk prepares a daily mail receipts report and deposit. All checks are stamped FOR DEPOSIT ONLY. Input of mail receipts to the cash register is performed by another clerk who also verifies the amounts received in the mail. All checks received are listed separately on daily check listings for each clerk.

Finance Director:

Response is the same as that of the mayor and council.

6. **FINDING: Inadequate receipt records**

City officials did not ensure that adequate internal control procedures for receipting city collections were established and followed. Our examination revealed the following deficiencies in the city's receipt records:

- a) Parks and recreation employees did not issue receipts for some collections. Of the receipts issued, some were not prenumbered.
- b) Duplicate, prenumbered receipts were not issued for fees charged for copies of accident reports, repayment of most employee loans, or room rental at the city library.
- c) Business licenses, which also served as receipt of payment, were not prenumbered and did not indicate whether the form of remittance was cash or check.
- d) Airport receipts were not contained in a well-bound book and duplicate copies of receipts issued by airport personnel were not retained.
- e) Building permits were not prenumbered.
- f) Prenumbered general fund receipts, property tax receipts, and billing stubs for solid waste and sanitation collections did not indicate whether payment was by cash or check.
- g) Prenumbered general fund receipts were not marked to indicate dates deposited.

Failure to require that all receipts be prenumbered and issued in duplicate increased the risk that the misappropriation noted in Legal Issue 2 could occur and persist without timely detection. Inadequate receipt procedures may have also aided the former recorder in perpetrating and concealing the misappropriation noted in Legal Issue 1.

Section 9-2-103, *Tennessee Code Annotated*, states:

Each state, county and municipal official who receives any sum or sums in such official's capacity shall issue to the payer thereof a receipt and shall retain a duplicate thereof in the office of such official . . .

Section 9-2-104, *Tennessee Code Annotated*, states:

- (a) The receipt shall be issued in duplicate and a copy thereof shall be retained by the person so receiving such money and shall be available to the state auditors upon demand.

- (b) The receipts shall be in a well-bound book, or on a form approved by the comptroller of the treasury, and shall be prenumbered consecutively.

Section 9-2-106, *Tennessee Code Annotated*, states, “Any person violating any of the provisions of §§ 9-2-103 - 9-2-105 commits a Class C misdemeanor.” Section 40-35-111(e), *Tennessee Code Annotated*, states, “The authorized terms of imprisonment and fines for misdemeanors are: . . . (3) Class C misdemeanor, not greater than thirty (30) days or a fine not to exceed fifty dollars (\$50.00), or both, unless otherwise provided by statute.

The *Internal Control and Compliance Manual for Tennessee Municipalities*, Title 3, Chapter 1, Section 2, states:

Municipal officials should ensure that . . . prenumbered receipts for each revenue source are issued as required by Section 9-2-103, *Tennessee Code Annotated*, and all unused or voided receipts are accounted for. Collections from customers evidenced by stubs from utility bills and property tax bills do not require an additional receipt. However, if the bill is not presented with payment, the cashier should prepare a duplicate. Each bill stub should be stamped or marked “PAID,” dated by the cashier, and marked to identify whether the form of remittance is cash or check. . . .

The *Internal Control and Compliance Manual for Tennessee Municipalities*, Title 3, Chapter 2, Section 3, states, “Municipal officials should ensure that . . . collection of business tax, regulatory license fees, and permit fees are recorded on prenumbered forms designed for the specific purpose, using similar internal control procedures as for other cash receipts.” Title 3, Chapter 1, Section 8 of the manual states, “Municipal officials should ensure that . . . duplicate, prenumbered receipts are marked and property tax receipts and billing stubs are filed according to the deposit to which they correspond.”

RECOMMENDATION:

To better account for revenue and help prevent misappropriations or other irregularities or errors, city officials should require city employees to issue duplicate, prenumbered receipts or prepare other permissible collection documentation for each collection. Duplicate receipts should provide adequate details to identify sources of revenue and form of payment. Business licenses and building permits should be prenumbered and all receipts should be marked to identify whether the form of remittance was cash or check.

MANAGEMENT'S RESPONSE:

Mayor and Members of the City Council:

Management concurs with the finding and has implemented corrective actions. Specifically, clerks issue duplicate, prenumbered receipts for each collection type. All receipts are marked cash or check according to the form of remittance. Business licenses and building permits are prenumbered. Further, the Local Government Data Processing System provides for specific types of receipts and license forms. The system will enable better transaction accuracy and documentation as manual receipting is cumbersome and can cause errors.

Finance Director:

Response is the same as that of the mayor and council.

7. **FINDING: Prenumbered receipts not issued when money transferred between city employees**

City officials failed to ensure that duplicate, prenumbered receipts were issued when city collections or other city money was transferred between city employees. Although the utility department employees shared office space with general government employees, responsibility for collecting, recordkeeping, and other financial duties were separated. Observation of the collection process and conversation with responsible employees revealed that when necessary, general government employees would accept collections for the utility department and vice-versa. At the end of the workday, collections received by clerks on behalf of one another were exchanged. However, prenumbered receipts were not prepared and issued when money was transferred between clerks. Therefore, no record existed of collections received by one clerk and transferred to another clerk, making it impossible to determine responsibility for such collections.

In addition, although prenumbered receipts were prepared by city hall personnel, they were not issued to parks and recreation department employees or airport employees when applicable collections were delivered to city hall for deposit. Therefore, there was no indication of agreement as to collection amounts transferred to city hall for deposit.

The *Internal Control and Compliance Manual for Tennessee Municipalities*, Title 3, Chapter 1, Section 2, states:

. . . Anytime custody of money changes from one employee to another, the money should be counted by both employees, a receipt should be issued by the recipient of the funds, and BOTH EMPLOYEES SHOULD SIGN THE DOCUMENT

INDICATING CONCURRENCE WITH THE AMOUNT TRANSFERRED.

RECOMMENDATION:

To provide greater accountability and responsibility for city collections and to better account for all revenue, city officials should require a duplicate, prenumbered receipt be issued when custody of money changes from one employee to another. Both employees should count the money and sign the receipt to indicate agreement with the amount transferred.

MANAGEMENT'S RESPONSE:

Mayor and Members of the City Council:

Management concurs with the finding and has implemented corrective actions. All revenues delivered to the finance department are receipted whether by customer or other city employee. The receipts are signed and dated. In addition, the clerks no longer trade collections. Each clerk's workstation is now designed to handle any type of payment and deposit to the bank whether the collection is for city property tax or utility bills.

Finance Director:

Response is the same as that of the mayor and council.

8. **FINDING: Collections not deposited intact and promptly**

City officials did not require and ensure that city collections were deposited intact (i.e., in the form and amount in which they were collected) and promptly. We noted the following deficiencies regarding intact and prompt deposit of city collections:

- a) Many of the unauthorized checks noted in Legal Issue 1 and some checks paid to the city, noted in Legal Issue 2, were apparently improperly exchanged for cash collections. As a result, deposits were not made intact.
- b) City personnel apparently used cash collections for unallowable purposes, such as cashing petty cash and third-party checks, purchasing money orders, and making loans to city employees. As a result, deposits were not made intact.
- c) Parks and recreation department cash collections were sometimes used to pay lifeguards and purchase concessions and other supplies. Therefore, intact collections were not turned over for deposit.

- d) Golf course collections were not always deposited within three working days of being received.
- e) Airport collections often were not turned over to city hall employees for deposit until weeks after being received.

Failure to require and ensure intact deposits, in conjunction with the failure to properly complete and/or retain deposit slips as noted in Finding 9, allowed the misappropriations noted in Legal Issues 1 and 2 to occur without timely detection.

The *Internal Control and Compliance Manual for Tennessee Municipalities*, Title 3, Chapter 1, Section 5, states:

Collections should be deposited promptly and intact and only in designated depositories. The bank's night depository should be used, if necessary, to avoid large accumulations of currency overnight. . . . The municipality should make daily deposits when large amounts of money are involved.

Section 6-56-111, *Tennessee Code Annotated*, states:

- (a) Every municipal official handling public funds shall be required to, as soon as practical, but no later than three (3) working days after the receipt by such municipal official of any public funds, deposit the funds to the credit of such municipality's official bank account, or bank accounts.
- (d) A violation of this section is a Class C misdemeanor.

Section 40-35-111(e), *Tennessee Code Annotated*, states, "The authorized terms of imprisonment and fines for misdemeanors are: . . . (3) Class C misdemeanor, not greater than thirty (30) days or a fine not to exceed fifty dollars (\$50.00), or both, unless otherwise provided by statute."

RECOMMENDATION:

To help prevent the misuse or loss of collections and to increase the probability that errors or irregularities are detected timely, city officials should ensure that all collections are deposited intact within three working days into an official city bank account. Collections should not be used to cash petty cash or third-party checks, purchase money orders or supplies, make loans to city employees, or pay lifeguards. All collections should be deposited within three working days of being received by the city.

MANAGEMENT'S RESPONSE:

Mayor and Members of the City Council:

Management concurs with the finding and has implemented corrective actions. Collections are no longer used to cash petty cash or third-party checks or for any other such purpose. In addition, deposits to the bank are made on a daily basis. Further, deposit amounts are verified with daily cash reports each day.

Finance Director:

Response is the same as that of the mayor and council.

9. **FINDING: Deposit slips not properly completed and some deposit slips not retained**

Municipal officials did not require and ensure that checks were individually listed on deposit slips. Also, some deposit slips did not separately indicate the total amounts of cash and checks being deposited. Further, for some deposits, the former recorder retained only the deposit receipt received from the bank. Duplicate deposit slips for these deposits could not be located. The failure to require proper completion and retention of deposit slips, in conjunction with the failure to require and ensure intact deposits as noted in Finding 8, allowed the misappropriations noted in Legal Issues 1 and 2 to occur without timely detection. The *Internal Control and Compliance Manual for Tennessee Municipalities*, Title 3, Chapter 1, Section 4, requires that each check deposited be listed separately on an itemized deposit slip.

RECOMMENDATION:

To better account for collections and document that all collections are deposited intact, city officials should require that all checks be listed individually on deposit slips. Deposit slips should also indicate total cash and total checks being deposited. All duplicate deposits slips should be retained.

MANAGEMENT'S RESPONSE:

Mayor and Members of the City Council:

Management concurs with the finding and has implemented corrective actions. Specifically, each clerk is responsible for preparing a daily check listing of all checks received. The daily cash reports prepared by each clerk contain total checks and cash received. The daily cash reports are verified to daily deposit slips. Also, deposit slips are maintained with the daily cash reports and are traced to bank statements.

Finance Director:

Response is the same as that of the mayor and council.

10. **FINDING: Inadequate controls over traffic citations and court docket**

City officials did not require that adequate controls over traffic citations and the city court docket were implemented. We noted the following deficiencies in internal controls over traffic citations and the city court docket:

- a) The former city judge, who was also the former city recorder, was responsible for hearing traffic court cases, posting dispositions to the city court docket, collecting fines, posting court collections to the city's records, and preparing court collections for deposit.
- b) Traffic citations were not properly accounted for and postings to the city's court docket did not include applicable ticket numbers.
- c) Receipts for court collections did not include applicable ticket numbers.
- d) The former city judge did not sign the record of all dispositions.

Because Rockwood officials failed to properly separate the duties of the city court judge and failed to ensure that adequate court records were maintained, we could not determine whether the city received all court-related revenue due, or if all city court collections received were recorded in the city's records and deposited into a city bank account.

The *Internal Control and Compliance Manual for Tennessee Municipalities*, Title 3, Chapter 5, describes the proper procedures for traffic citations and court collections. Those procedures include physically controlling unissued citations, accounting for all issued and voided citations, filing citations numerically, issuing prenumbered receipts for fines, posting ticket numbers to the court docket, posting receipt numbers for fines to the court docket, recording dispositions of all citations in the court docket, and establishing efforts to collect all outstanding fines.

The *Internal Control and Compliance Manual for Tennessee Municipalities*, Title 1, Chapter 2, Section 2, states:

Municipal officials should enforce division of duties to provide a system of checks and balances so that no one person has control over a complete transaction from beginning to end. Work flow should be established so that one employee's work is automatically verified by another employee working independently. . . .

Title 1, Chapter 2, Section 4, of the manual states:

Municipal officials should ensure that automatic proof techniques are applied whenever possible. These techniques include the use of an employee without prior access to the records to . . . reconcile bank accounts . . . periodically test . . . daily balancing of cash receipts . . . open mail and prelist mail receipts . . . perform routine duties of other employees . . . for at least one vacation period per year.

RECOMMENDATION:

To help ensure that all court-related revenue is collected, recorded in the city's records, and deposited into a city bank account, city officials should establish and require strict adherence to internal control policies over traffic citations and the court docket as set forth in the *Internal Control and Compliance Manual for Tennessee Municipalities*, Title 3, Chapter 5. Officials should ensure that all citations are accounted for, a complete court docket is maintained, and the court clerk's copies of citations are marked to indicate disposition and are signed by the judge. In addition, officials should ensure that receipts are written for all collections and that those collections are promptly deposited into a city bank account. Ticket numbers should be recorded on related receipts. City officials should review employees' responsibilities to ensure that no employee has control over a complete transaction. Under no circumstances should the city court judge be allowed to receive collections.

MANAGEMENT'S RESPONSE:

Mayor and Members of the City Council:

Management concurs with the finding and has implemented corrective actions. Specifically, a new city judge has been appointed. A new city court computerized data base has been completed and is in use for tracking and managing traffic citations. The clerk marks all citations to indicate status and the city judge signs the citations. The judge does not receive any collections. All collections are taken by the finance department cashier clerks and receipts for these transactions are properly prepared and maintained. Further, the police use consecutively prenumbered citations and each citation is accounted for.

Finance Director:

Response is the same as that of the mayor and council.

Police Chief:

Response is the same as that of the mayor and council.

11. **FINDING: Inadequate controls over parks and recreation department collections**

City officials did not ensure adequate controls over parks and recreation department collections were established and followed. We noted the following deficiencies in internal controls over parks and recreation department collections:

- a) Parks and recreation department personnel did not issue duplicate, prenumbered receipts for all applicable collections.
- b) The parks and recreation department director did not keep accurate and separate records of collections received for sports programs.
- c) Accurate and separate collection records, such as prenumbered receipts or cash register Z-tapes, were not maintained for concession sales or for city pool admissions and basketball game admissions. Therefore, expected and actual collections could not be determined or compared.
- d) Parks and recreation department personnel used cash collections to purchase concessions supplies and pay lifeguards. Therefore, actual collections and disbursements were not properly reflected in the city's accounting records.

As a result of the deficiencies in internal controls over parks and recreation department collections, we could not determine whether the department received all revenue due it, or that all department collections were recorded in the city's records and deposited into a city bank account.

Section 9-2-103, *Tennessee Code Annotated*, states:

Each state, county and municipal official who receives any sum or sums in such official's capacity shall issue to the payer thereof a receipt and shall retain a duplicate thereof in the office of such official . . .

Section 9-2-106, *Tennessee Code Annotated*, states, "Any person violating any of the provisions of §§ 9-2-103 - 9-2-105 commits a Class C misdemeanor." Section 40-35-111(e), *Tennessee Code Annotated*, states, "The authorized terms of imprisonment and fines for misdemeanors are: . . . (3) Class C misdemeanor, not greater than thirty (30) days or a fine not to exceed fifty dollars (\$50.00), or both, unless otherwise provided by statute.

The *Internal Control and Compliance Manual for Tennessee Municipalities*, Title 3, Chapter 1, Section 6, states:

Municipal officials should ensure that . . . each day the cashier summarizes all cash collections by source on a daily collection report, clearly indicating the amount to be deposited, the amount

retained for change, and the amount of cash over or short. Each report should be dated, and the date should be recorded on the corresponding deposit slips. The total on the daily collection report should agree with the total of the corresponding deposit slips as well as with the total of all applicable receipts. The cashier should sign the daily collection report. Each cashier should be assigned a separate cash drawer that is accessible only to that cashier.

Title 1, Chapter 2, Section 1, of the manual states, “Municipal officials should establish a simple and flexible organizational plan which clearly places responsibility for specific activities upon specified individuals. . . .” Section 3 of the manual states that municipal officials should provide constant, close supervision to ensure that adequate information is being furnished promptly.

Section 6-56-111, *Tennessee Code Annotated*, states:

- (c) Every municipal official authorized to disburse public funds shall be required to make disbursements of such public funds by consecutively prenumbered checks, warrants or other generally accepted negotiable instruments drawn on the municipality’s official bank account or accounts. Disbursements may also be made by electronic transfer, if such transfer is properly documented and recorded.
- (d) A violation of this section is a Class C misdemeanor.

RECOMMENDATION:

To help ensure that all revenue due the city is collected, recorded in the accounting records, and deposited into a city bank account, and to help prevent possible loss due to misappropriations, city officials should require adequate supporting documentation, such as prenumbered receipts or cash register tapes, for all collections received by the parks and recreation department. Officials should provide constant and close supervision to ensure that parks and recreation department records are adequate for promptly providing financial information as needed, including lists of teams and players and amounts charged to and collected from each individual. City officials should assign specific recordkeeping duties to individual employees and hold those employees accountable for performing their assigned duties. In addition, officials should require a designated employee not involved in collections or recordkeeping of these activities to analyze the records, perform a reconciliation of expected collections to actual collections, and prepare a profit analysis in order to evaluate operations. Any variance from expected collections should be investigated.

MANAGEMENT'S RESPONSE:

Mayor and Members of the City Council:

Management concurs with the finding and has implemented and planned corrective actions. Specifically, the parks and recreation department now keeps accurate and separate records of collections for sports programs and issues duplicate and prenumbered receipts for all applicable collections. In addition, cash registers will be used for concession sales and accurate and separate collection records maintained for sales with the register Z tape. The city is considering not charging admission fees. However, current admission fees are reported and deposits are prepared and made daily. Further, the finance department will provide profit and loss analysis for parks and recreation activities.

Finance Director:

Response is the same as that of the mayor and council.

12. **FINDING: Proper procedures not followed for solid waste and sanitation collections**

City officials did not ensure that proper procedures were followed and adequate records maintained for solid waste and sanitation collections. Several deficiencies in procedures and recordkeeping precluded the required reconciliation of individual accounts receivable with the applicable general ledger account. These deficiencies were as follows:

- a) Monthly billings included amounts due for past-due accounts. No separate record was prepared or maintained of current billings due. Instead, only the aggregate billing amount of current and past-due accounts was retained.
- b) Penalties for late payment were not assessed until the end of the month, when the following month's bills were computed. Therefore, collections for penalties received prior to the end of the month were often not posted to customer accounts, since to post the payments would result in negative accounts receivable for those customers.
- c) Adjustments were often recorded as payments. No accurate record of adjustments was maintained.
- d) Some billing stubs were unavailable for auditor review.
- e) Some collections for special solid waste and sanitation pick ups were not posted to any customer account.

- f) In many instances, calculated totals of solid waste and sanitation billing stubs did not match the attached adding machine tapes, the amount of solid waste and sanitation collections recorded in the records, or the amount shown as deposited in the city's bank account.

The *Internal Control and Compliance Manual for Tennessee Municipalities*, Title 3, Chapter 3, Section 10, states, "Municipal officials should ensure that . . . the total amount of the unpaid individual accounts on the utility billing sheet is reconciled to the applicable general ledger control account total at the end of each month."

Title 3, Chapter 3, Sections 4 and 5, of the manual state:

Municipal officials should ensure that . . . documentation of each adjustment is required and retained. Adjustments to billings for meter reading and other errors should be recorded in the billing register. All adjustments to customers' bills should be approved by the governing body or its designee.

Municipal officials should ensure that . . . all applicable late payment charges are recorded. A listing of the amounts of accounts receivable from the prior month's utility billing sheets should be prepared.

Title 3, Chapter 1, Section 6, of the manual states, ". . . The total on the daily collection report should agree with . . . the total of all applicable receipts. . . ."

RECOMMENDATION:

To detect errors or irregularities promptly, city officials should require a designated city employee to prepare a monthly reconciliation of individual accounts receivable to the applicable general ledger account. Monthly billings should distinguish between the current balance due and past-due balances. Penalties for late payment should be assessed as they are incurred and collections for penalties should be posted to customer accounts. Adjustments should be recorded as adjustments, not as payments, and an accurate record of adjustments should be maintained. Strict care should be exercised regarding the retention of billing stubs. Charges for special solid waste and sanitation pick ups should be billed to customer accounts and collections for special solid waste and sanitation pick ups should be posted to customer accounts. The total calculated amount of solid waste and sanitation billing stubs should match the attached adding machine tapes. Both totals should match the amount of solid waste and sanitation collections recorded in the city's records and deposited into a city bank account.

MANAGEMENT'S RESPONSE:

Mayor and Members of the City Council:

Management concurs with the finding and has implemented corrective actions. Specifically, monthly billings distinguish between current balances and past-due amounts. Penalties are assessed as soon as is possible with the current computer system. The daily collections are balanced with the daily cash report process. In addition, billing stubs are retained and balanced with collections each day. Further, the solid waste billing capability will be greatly enhanced with the Local Government Data Processing System. Solid waste billing will then be included on the customers' utility billing. In addition, a more accurate accounting of accounts receivable and delinquent accounts can be accomplished with the new system.

Finance Director:

Response is the same as that of the mayor and council.

13. **FINDING: Failure to follow up on unpaid business license fees and taxes or ensure that all sales tax due was received**

City officials failed to ensure that the city received all sales tax due from the state or that collection of unpaid business license fees and taxes was continuously and systematically enforced. Our comparison of recorded business license and tax collections with state sales tax department data revealed that during the period July 1, 1999, through December 31, 2000, the city did not receive business license fees and taxes from many applicable businesses. This analysis also revealed that the city was not receiving all applicable sales tax due. We noted that business license forms, which served as the city receipt, were not prenumbered. In at least three instances, business license numbers were duplicated, apparently in an attempt to conceal part of the misappropriation noted in Legal Issue 1. An additional \$819.56 in recorded business license fees and tax collections could not be traced to deposit into a city bank account. This missing amount is included in Legal Issue 2.

The *Internal Control and Compliance Manual for Tennessee Municipalities*, Title 3, Chapter 2, Section 2, states:

Municipal officials should ensure that . . . business tax and business license enforcement procedures are established. Information on new businesses and on business ownership changes should be obtained from observations of police officers and building inspectors, utility billing changes, newspaper and telephone advertising, and state sales tax department data.

Title 3, Chapter 2, Section 4 of the manual states, “Municipal officials should ensure that . . . collection of business tax and regulatory license and permit fees is continuously and systematically enforced out of fairness to the reputable business operators who pay willingly.”

Section 9-2-103, *Tennessee Code Annotated*, states:

Each state, county and municipal official who receives any sum or sums in such official’s capacity shall issue to the payer thereof a receipt and shall retain a duplicate thereof in the office of such official . . .

Section 9-2-106, *Tennessee Code Annotated*, states, “Any person violating any of the provisions of §§ 9-2-103 - 9-2-105 commits a Class C misdemeanor.” Section 40-35-111(e), *Tennessee Code Annotated*, states, “The authorized terms of imprisonment and fines for misdemeanors are: . . . (3) Class C misdemeanor, not greater than thirty (30) days or a fine not to exceed fifty dollars (\$50.00), or both, unless otherwise provided by statute.”

The *Internal Control and Compliance Manual for Tennessee Municipalities*, Title 3, Chapter 2, Section 3, states, “Municipal officials should ensure that . . . collections of the business tax, regulatory license fees, and permit fees are recorded on prenumbered forms designed for the specific purpose, using similar internal control procedures as for other cash receipts.”

RECOMMENDATION:

To ensure that the city receives all applicable revenue and to decrease the risk of undetected fraudulent transactions or other irregularities or errors, city officials should designate responsibility for, and ensure follow up on, all unpaid business license fees and taxes that are past due. A designated official should also ensure that the city receives all applicable sales tax revenue. Business license forms should be prenumbered.

MANAGEMENT’S RESPONSE:

Mayor and Members of the City Council:

Management concurs with the finding and has implemented corrective actions. Specifically, the finance department is in the process of verifying all business license fees and taxes. It has obtained a master list from the State of Tennessee and has matched this to the city’s business license files. The department is identifying unpaid business license fees and taxes and will follow through with the collection and recording processes. Further, business licenses will be maintained on the Local Government Data Processing System allowing for automation, accurate recordkeeping, and prompt billing and collecting of business license and sales taxes due.

Finance Director:

Response is the same as that of the mayor and council.

14. **FINDING:** **Unnecessary bank accounts and checks issued with only one signature**

During the period July 1, 1998, through December 31, 2000, the city maintained over 20 separate bank accounts. Two of the bank accounts, held by the municipal golf course and municipal library, required only one signature. Our examination revealed that fraudulent transactions accounted for a significant portion of the activity in several bank accounts. It appears that the excessive number of bank accounts aided the former recorder in committing the misappropriation noted in Legal Issue 1.

The *Internal Control and Compliance Manual for Tennessee Municipalities*, Title 2, Chapter 2, Section 2, states, "Municipal officials should require two signatures on all checks." The *Internal Control and Compliance Manual for Tennessee Municipalities*, Title 1, Chapter 3, Section 2, states, "Municipal officials should ensure that . . . any dormant bank accounts are closed as soon as they become unneeded."

State law requires separate accounting for certain sources of revenue, including drug fines and state street aid. However, in most instances, state statutes do not require the use of separate bank accounts. There appears to be no valid reason for the use of an excessive number of bank accounts.

RECOMMENDATION:

To help prevent loss or misappropriation of funds, city officials should close all unnecessary bank accounts unless the account is legally mandated. For all municipal accounts, two signatures should be required to authorize all withdrawals.

MANAGEMENT'S RESPONSE:

Mayor and Members of the City Council:

Management concurs with the finding and has implemented and planned corrective actions. Specifically, some separate and unnecessary bank accounts have been identified and closed. The city's accounting records have been placed on Quick Books software for the time being and have been brought up to date. Additional accounts are determined and scheduled for closing. In addition, the Local Government Data Processing System will enable the city to maintain adequate separation of different revenues with no need for separate bank accounts.

Finance Director:

Response is the same as that of the mayor and council.

15. **FINDING: Accurate and complete property tax records not maintained**

City officials did not ensure that personnel maintained accurate and complete property tax records. Several property tax payments were not posted to the city's property tax roll. In addition, the calculated total of related property tax receipts did not always equal the amount recorded in the city's records or the amount shown as deposited in the city's bank account. Also, no property tax receipts or related deposits of property tax collections could be located for over \$900 of property tax recorded as paid in the property tax roll. We were unable to determine the cause of these discrepancies.

The *Internal Control and Compliance Manual for Tennessee Municipalities*, Title 3, Chapter 1, Section 3, states, "Municipal officials should ensure that . . . the payment date and amount is recorded for each individual account in the property tax roll or utility billing register on a timely basis." Title 3, Chapter 4, of the manual states:

Municipal officials should ensure . . . that the property tax receivable balance per the general ledger is periodically reconciled to the total amount of unpaid accounts per the tax roll and to the total amount of the unpaid tax receipts . . . each individual taxpayers' payment is promptly posted on the applicable tax roll.

The *Internal Control and Compliance Manual for Tennessee Municipalities*, Title 3, Chapter 1, Section 6, states, ". . . The total on the daily collection report should agree with . . . the total of all applicable receipts. . . ."

RECOMMENDATION:

To help ensure that all collections are recorded in the city's accounting records and deposited into a city bank account, city officials should ensure that accurate and complete property tax records are maintained. Property tax payments should be recorded promptly to the property tax roll. Payments recorded in the property tax roll should be supported by property tax receipts and corresponding deposits. Property tax receipt totals should match property tax postings and deposits of property tax collections. The property tax receivable balance per the general ledger should be periodically reconciled to the total amount of unpaid accounts per the tax roll and to the total amount of the unpaid tax receipts.

MANAGEMENT'S RESPONSE:

Mayor and Members of the City Council:

Management concurs with the finding and has implemented corrective actions. Specifically, proper collection procedures, receipting and recordkeeping have been established in the finance department. In addition, old tax records are being reviewed and accounts receivable amounts determined. The city has established an interim data base for delinquent taxes and the data base will be updated daily. Further, the Local Government Data Processing System will provide computerized tax rolls and accurate accounting of collections, delinquent taxes, receipting and balancing of accounts receivable and bank deposits when fully operational.

Finance Director:

Response is the same as that of the mayor and council.

16. **FINDING: Inadequate controls over vending operations**

City officials failed to require and implement adequate controls over vending machines. Vending machines stocked by city employees were located in the parks and recreation department building and the golf course clubhouse. However, complete records of inventory purchased and collections received were not available. Therefore, records were inadequate to perform a profit analysis of vending operations or to reconcile expected collections with actual collections. In addition, although vending machines were operated by outside vendors on city property, revenue related to these machines was not recorded in the city's records. Commission checks from a snack machine located in the police department were apparently sent directly to and retained by a city employee. Drink machine vendors claimed that profits were insufficient to warrant a profit-sharing arrangement with the city. However, the city did not verify in any manner the amount of profit received by vendors.

Attorney General's Opinion Number U89-134 states:

It is the opinion of this Office that . . . revenues derived from such operations [vending] are public funds and revenues of the local governmental entity which owns and operates the building in which such operations are conducted. Such revenues should be handled in the same manner as other revenues of the local governmental entity.

RECOMMENDATION:

To ensure that all public funds are handled properly, city officials should require city personnel to maintain complete and accurate records of vending inventory purchases and collections. A designated employee not involved in receiving collections or maintaining records of vending activities should analyze the records, perform a reconciliation of expected collections to actual collections, and prepare a profit analysis in order to evaluate operations. Any variance from expected collections should be investigated. City officials should ensure that the city receives appropriate vending commission payments for vending machines stocked and operated by outside vendors on city property.

MANAGEMENT'S RESPONSE:

Mayor and Members of the City Council:

Management concurs with the finding and has implemented corrective actions. Specifically, departments with vending operations are maintaining accurate records of sales and inventory. Further, the finance department will provide profit and loss analysis on vending operations as well as accounts receivable information and records from outside vendors.

Finance Director:

Response is the same as that of the mayor and council.

17. **FINDING: Inadequate accounting records**

The former recorder's accounting records did not include a cash receipts journal or a cash disbursements journal. The *Internal Control and Compliance Manual for Tennessee Municipalities*, Title 1, Chapter 1, Section 2, states:

Municipal officials should ensure that . . . a complete, self-balancing account group is established and maintained for each fund. This group should include all general ledger accounts and subsidiary records necessary to comply with legal provisions and generally accepted accounting principles and to present the financial position and the results of financial operations of the fund.

RECOMMENDATION:

So that the city's financial condition can be readily and accurately determined, city officials should require the recorder, or other designated official, to maintain all

necessary books and records, including a cash receipts journal and a cash disbursements journal, as well as other necessary subsidiary ledgers.

MANAGEMENT'S RESPONSE:

Mayor and Members of the City Council:

Management concurs with the finding and has implemented and planned corrective actions. Specifically, on an interim basis and to develop auditable financial data and statements, the new finance director has placed the city's accounting on Quick Books Pro software and posted all accounting data not previously recorded in order to get the city's books up to date. A private CPA firm is currently conducting the FY 1999 and FY 2000 year-end audits. In addition, the city's accounting will be placed on the Local Government Data Processing System within the next two months. This system will provide general ledger as well as the cash receipts and disbursements journals and subsidiary capabilities.

Finance Director:

Response is the same as that of the mayor and council.

18. **FINDING: Unconstitutional lending of city's credit**

City money was loaned to some employees. Some loans were made by prenumbered check and others were made out of the general fund collections drawer. Article II, Section 29, of the *Constitution of the State of Tennessee*, provides:

But the credit of no County, City or Town shall be given or loaned to or in aid of any person, company, association or corporation, except upon an election to be first held by the qualified voters of such county, city or town, and the assent of three-fourths of the votes cast at said election.

Without the above election, the *Constitution of the State of Tennessee* does not provide for the lending or giving of a municipality's credit to individuals. Also, regarding the use of city collections to make personal loans, Section 6-56-111, *Tennessee Code Annotated*, states:

- (c) Every municipal official authorized to disburse public funds shall be required to make disbursements of such public funds by consecutively prenumbered checks, warrants or other generally accepted negotiable instruments drawn on the municipality's official bank account or accounts. Disbursements may also be made by electronic

transfer, if such transfer is properly documented and recorded.

- (d) A violation of this section is a Class C misdemeanor.

Section 40-35-111(e), *Tennessee Code Annotated*, states, “The authorized terms of imprisonment and fines for misdemeanors are: . . . (3) Class C misdemeanor, not greater than thirty (30) days or a fine not to exceed fifty dollars (\$50.00), or both, unless otherwise provided by statute.”

RECOMMENDATION:

To avoid an unconstitutional giving or lending of the city’s credit, city officials should ensure that municipal funds are not used to make personal loans without the assent of three-fourths of the votes cast at an election of qualified voters in the city. No disbursements, for loans or other purposes, should be made using city collections.

MANAGEMENT’S RESPONSE:

Mayor and Members of the City Council:

Management concurs with the finding and has implemented corrective actions. Specifically, no disbursements for employee loans or other such purposes are made with city funds and/or collections. Internal controls have been implemented to ensure that this practice is no longer followed. The finance department now has designated accounts payable personnel and accounts payable policies and procedures. In addition, dual signatures and approvals of payments are required.

Finance Director:

Response is the same as that of the mayor and council.

19. **FINDING: Required procedures for confidential funds transactions not followed**

The police department failed to maintain a separate bank account for confidential funds. Also, confidential funds were disbursed to officers in cash. “Procedures for Handling Cash Transactions Related to Undercover Investigative Operations of County and Municipal Drug Enforcement Programs” developed pursuant to Section 39-17-420(f), *Tennessee Code Annotated*, requires that a separate bank account be maintained for confidential funds and that all confidential funds be disbursed by prenumbered check payable to the applicable officer. Section 6-56-111, *Tennessee Code Annotated*, states:

- (c) Every municipal official authorized to disburse public funds shall be required to make disbursements of such

public funds by consecutively prenumbered checks, warrants or other generally accepted negotiable instruments drawn on the municipality's official bank account or accounts. Disbursements may also be made by electronic transfer, if such transfer is properly documented and recorded.

(d) A violation of this section is a Class C misdemeanor.

Section 40-35-111(e), *Tennessee Code Annotated*, states, "The authorized terms of imprisonment and fines for misdemeanors are: . . . (3) Class C misdemeanor, not greater than thirty (30) days or a fine not to exceed fifty dollars (\$50.00), or both, unless otherwise provided by statute."

RECOMMENDATION:

To properly account for confidential funds, a separate bank account for confidential funds should be maintained in accordance with the "Procedures for Handling Cash Transactions Related to Undercover Investigative Operations of County and Municipal Drug Enforcement Programs." Disbursements to officers from the confidential fund bank account should be made by prenumbered check.

MANAGEMENT'S RESPONSE:

Mayor and Members of the City Council:

Management concurs with the finding and has implemented corrective actions. Specifically, a separate confidential fund bank account has been established. In addition, the city has established proper procedures for accounting for confidential funds including prenumbered checks for disbursements to officers.

Finance Director:

Response is the same as that of the mayor and council.

Police Chief:

Response is the same as that of the mayor and council.

20. **FINDING: Time records not signed by supervisor**

City employees, including department heads, were paid hourly wages and received overtime payment for additional hours worked. However, city employees often did not sign their time records. In addition, the time records of a substantial number of

employees, including department heads, were not signed by supervisors to indicate concurrence with the number of hours worked, including overtime.

The Internal Control and Compliance Manual for Tennessee Municipalities, Title 2, Chapter 3, Section 7, states, “. . . NOTE: Time cards or honor system time sheets (approved by department heads) should be maintained for all employees in order to eliminate unauthorized pay and repeated tardiness.”

RECOMMENDATION:

To decrease the risk of improper payroll payments and to ensure compliance with state regulations, city officials should require city employees to sign respective time records. Supervisors should review employee time records for reasonableness and accuracy and sign the records to indicate concurrence with the number of hours worked. Time records for department heads should be reviewed for reasonableness and accuracy by the mayor, or other designated official, and signed to indicate concurrence with the number of hours worked. All overtime should be approved prior to being earned.

MANAGEMENT’S RESPONSE:

Mayor and Members of the City Council:

Management concurs with the finding and has implemented corrective actions. Specifically, employees and supervisors are required to sign time records. In addition, the payroll clerk is required to double check for all required signatures. Further, supervisors are required to sign for payroll checks picked up to disburse to employees in their respective departments and are required to review and sign employee vacation and sick leave verification reports.

Finance Director:

Response is the same as that of the mayor and council.

21. **FINDING:** No verification of payment of building permit fees

Controls over building permits were inadequate to ensure that all applicable permit fees were collected by the city. The city’s building inspector issued building permits to city residents and businesses for new construction, renovations, and so forth. Permit holders were instructed to pay building permit fees to city cashiers after building permits were issued. However, the building inspector failed to verify that building permit fees were actually received by the city.

The *Internal Control and Compliance Manual for Tennessee Municipalities*, Title 1, Chapter 2, Section 2, states, “. . . Work flow should be established so that one employee’s work is automatically verified by another employee working independently. . . .” Title 1, Chapter 2, Section 4, of the manual states, “Municipal officials should ensure that automatic proof techniques are applied whenever possible. . . .” Further, Title 3, Chapter 2, Section 4, of the manual states, “Municipal officials should ensure that . . . collection of . . . permit fees is continuously and systematically enforced . . .”

RECOMMENDATION:

To help prevent the loss of collections, city officials should require the building inspector to verify payment of building permit fees with city cashiers.

MANAGEMENT’S RESPONSE:

Mayor and Members of the City Council:

Management concurs with the finding and has implemented corrective actions. Specifically, the building inspector verifies payment of building permit fees with city clerks. In addition, building permits are prenumbered.

Finance Director:

Response is the same as that of the mayor and council.

22. **FINDING: Excess cash in noninterest-bearing account**

One of the city’s bank accounts had a balance of over \$1.1 million as of December 29, 2000. However, the city did not earn interest on this account. The *Internal Control and Compliance Manual for Tennessee Municipalities*, Title 1, Chapter 3, Section 7, states, “Municipal officials should ensure that . . . investment program(s) yields a maximum return considering all available legal investments with adequate liquidity and security.”

RECOMMENDATION:

To achieve a maximum return on the city’s money, city officials should seek the highest possible yield for idle cash within the guidelines of authorized investments.

MANAGEMENT’S RESPONSE:

Mayor and Members of the City Council:

Management concurs with the finding and has implemented corrective actions. Specifically, the city utilizes an overnight interest-bearing account. This account provides

access to funds as well as good interest earning capability. In addition, the city utilizes certificate of deposit accounts. Further, better cash management and cash flow analysis can be achieved with the completion of placing the city's accounting on the Local Government Data Processing System.

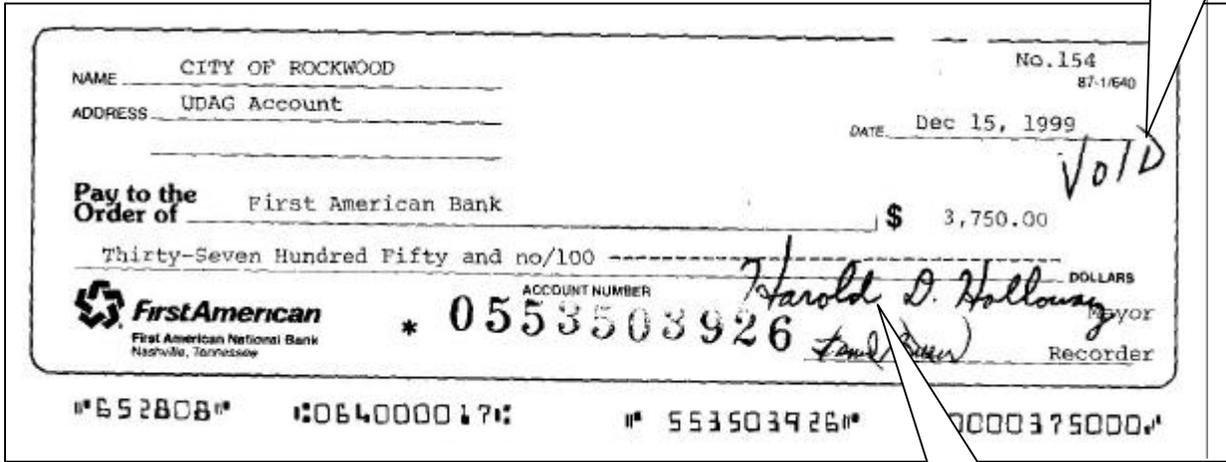
Finance Director:

Response is the same as that of the mayor and council.

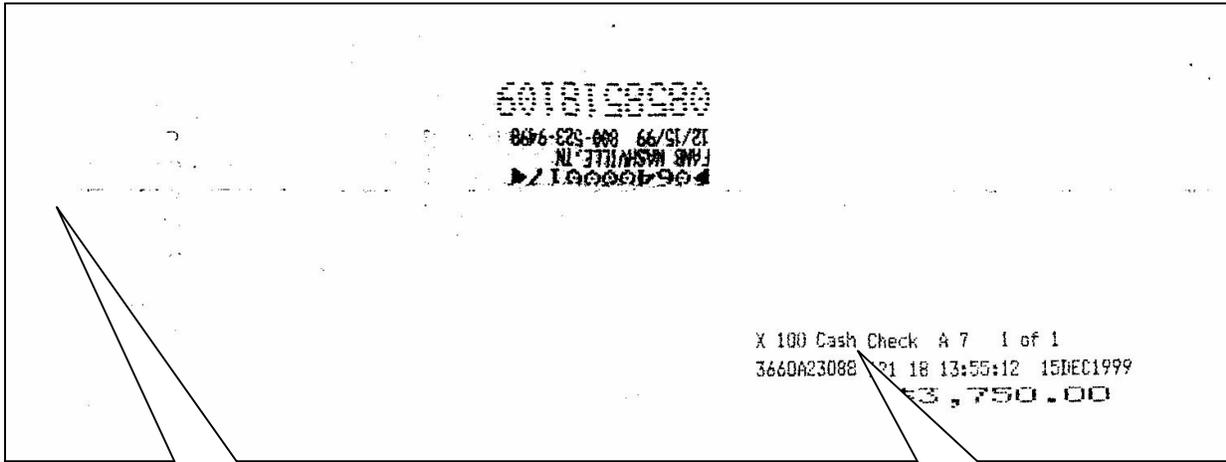
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EXHIBITS

The former recorder apparently marked this check as "VOID," after the canceled check was received from the bank.



According to former mayor Holloway, unauthorized use of mayor's signature stamp maintained by former recorder.



Endorsement apparently not required by bank teller for this check.

Bank marking indicates check was cashed.

December 15, 1999, UDAG Fund checks 153 (on opposite page) and 154 totaling \$10,737 were not recorded in the City of Rockwood's accounting records. Bank processing stamps indicate the checks were cashed by the same bank teller on the same date in consecutive transactions. Apparently the bank teller did not require any endorsement in order for this check to be cashed.

The former recorder apparently marked this check as "VOID," after the canceled check was received from the bank.

NAME CITY OF ROCKWOOD No. 153 87-1
 ADDRESS UDAG Account DATE Dec 15, 1999

Pay to the Order of First American Bank \$ 6,987.00

Six Thousand Nine Hundred-Eighty-Seven and no/100 Harold D. Holloway DOLLARS
 Recorder

ACCOUNT NUMBER *0553503926

First American National Bank
 Nashville, Tennessee

⑈652809⑈ ⑆064000017⑆ ⑆~~0553503926~~⑆ 000698700⑆
 ⑆064000017⑆ ⑆0553503926⑆ 000698700⑆

According to former mayor Holloway, unauthorized use of mayor's signature stamp maintained by former recorder.

00937

0651701680

0558518108
 12/15/99 09:52:37
 FBI/MSM/TLE, TN
 406900017

X 100 Cash Check A 7 1 of 1
 3660A23088 122 18 13:56:37 15DEC1999
 \$6,987.00

Endorsement apparently not required by bank teller for this check.

Bank marking indicates check was cashed.

December 15, 1999, UDAG Fund check nos. 153 and 154 (on opposite page) totaling \$10,737 were not recorded in the City of Rockwood's accounting records. Bank processing stamps indicate the checks were cashed by the same bank teller on the same date in consecutive transactions. Apparently the bank teller did not require any endorsement in order for this check to be cashed.

The former recorder apparently marked this check as "VOID," after the canceled check was received from the bank.

NAME City of Rockwood No. 153
 ADDRESS UDAG Fund DATE Sept 21, 1999
 Pay to the Order of Howard Butler \$ 10,000.00
 Ten Thousand and no/100 -----
 First American ACCOUNT NUMBER 0553503926 *Harold D. Holloway* Mayor
 Recorder
 MICR: ⑈ 652806 ⑈ ⑆064000017⑆ ⑆001000000⑆

According to former mayor Holloway, unauthorized use of mayor's signature stamp maintained by former recorder.

121005002655 06 052199 06 0000000010212
 SEP 22 1999
 955048 09/22/99 00088
 FANB NASHVILLE
 06400017
 PROCESSED 09/22/99
 0547703529 064207195
 11743325
 041 FBT 924 921990005 \$10000.0000
 3804 63241
Harold Butler

Bank marking indicates check was cashed.

Apparently endorsed by the former recorder.

September 21, 1999, UDAG Fund check No. 153 was not recorded in the City of Rockwood's accounting records. Bank processing stamps indicate the check was cashed.

FIRST AMERICAN NATIONAL BANK
ROCKWOOD, TN 87-789642 366 010285

City of Rockwood
GENERAL FUND
 110 NORTH CHAMBERLAIN AVE.
 ROCKWOOD, TN 37854

\$2,800.00

DATE	CHECK NO.	CHECK AMOUNT
Nov 22, 2000	010285	\$ 2,800.00

PAY TO THE ORDER OF
 City of Rockwood

RECORDER - TREASURER
[Signature]
 MAYOR
 Harold D. Holloway
 AUTHORIZED SIGNATURE

⑆0⑆0285⑆ ⑆064207894⑆ ⑆052000480⑆ ⑆000280000⑆

According to former mayor Holloway, unauthorized use of mayor's signature stamp maintained by former recorder.

ENDORSE HEREIN

X City of Rockwood
 Pay *[Signature]* Recorder

DO NOT WRITE, STAMP OR SIGN BELOW THIS LINE
 RESERVED FOR FINANCIAL INSTITUTION USE *

6006 94517

NOV 22 00

FIRST AMERICAN BANK
 11/22/00 064207894 5
 ⑆064⑆000⑆17⑆
 7821620009

FEDERAL RESERVE BOARD OF GOVERNORS REG. DC

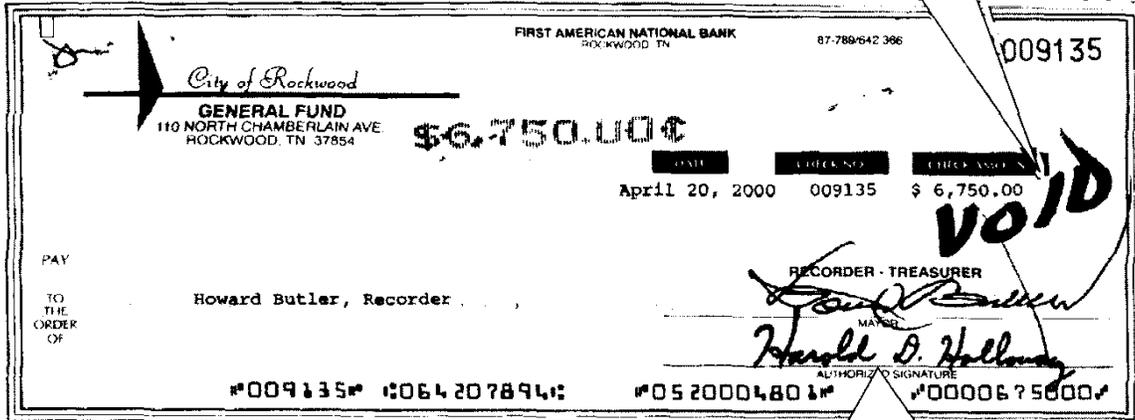
P011-22-2000 01:35P W00152 TH05345 W04
 Known Customer
 040520004801 OR AM CAMILE'S
 CSH CHK \$2,800.00

Apparently endorsed by former recorder.

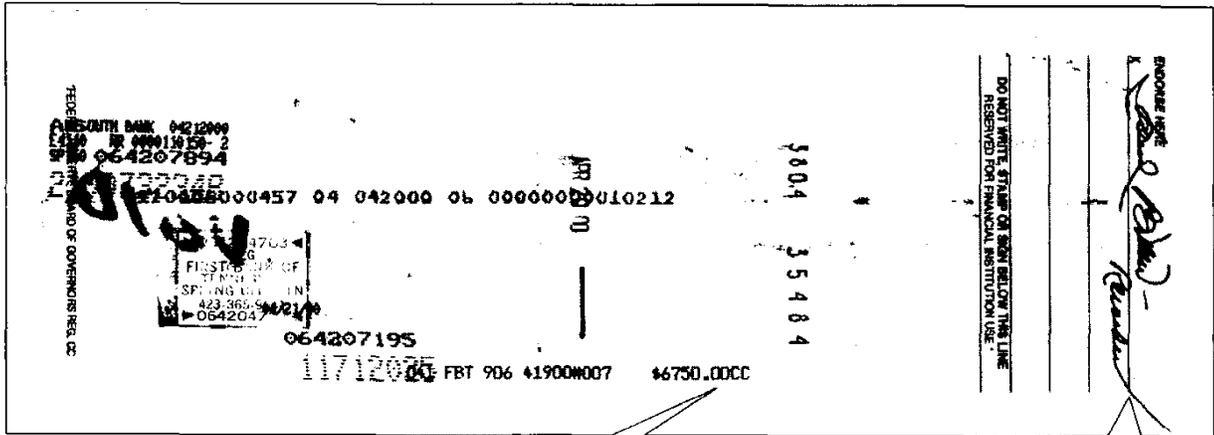
Bank marking indicates check was cashed.

This check was not recorded in the City of Rockwood's accounting records. Bank processing stamps indicate the check was cashed. This original canceled check was returned with the November 30, 2000, bank statement which arrived at city hall after Mr. Butler was placed on administrative leave.

The former recorder apparently marked this check as "VOID," after the canceled check was received from the bank.



According to former mayor Holloway, unauthorized use of mayor's signature stamp maintained by former recorder.

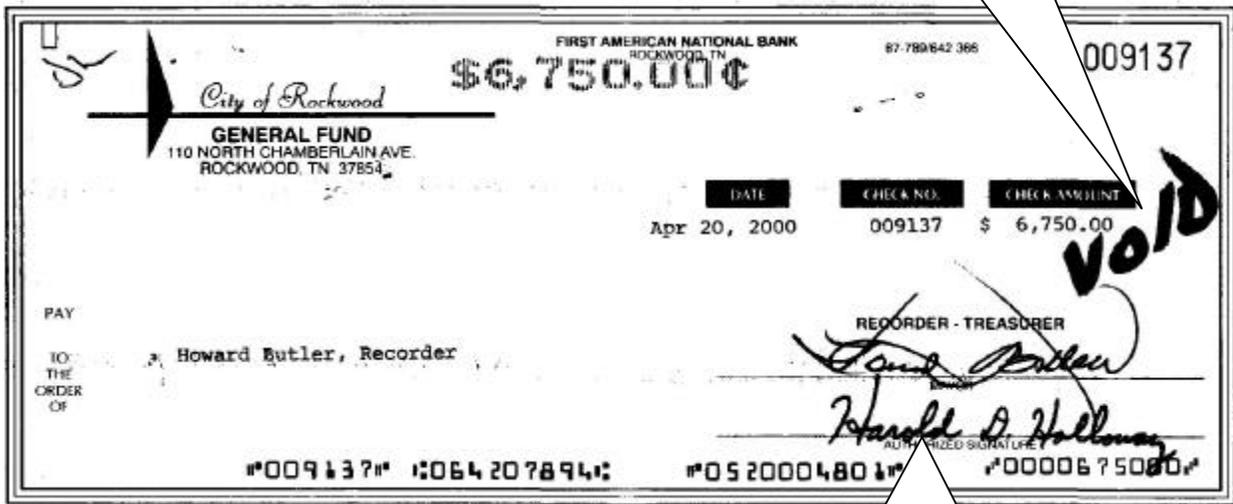


Bank marking indicates check was cashed.

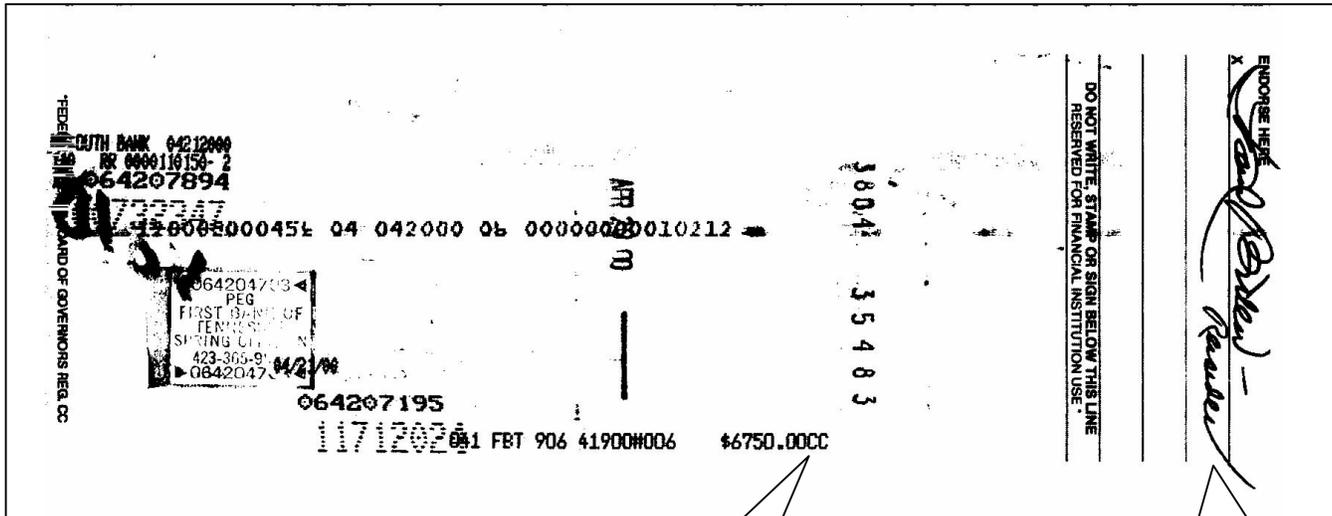
Apparently endorsed by former recorder.

General Fund check nos. 9135 and 9137 (on opposite page) totaling \$13,500 were not recorded in the City of Rockwood's accounting records. Bank processing stamps indicate the checks were cashed the same date in consecutive transactions.

The former recorder apparently marked this check as "VOID," after the canceled check was received from the bank.



According to former mayor Holloway, unauthorized use of mayor's signature stamp maintained by former recorder.

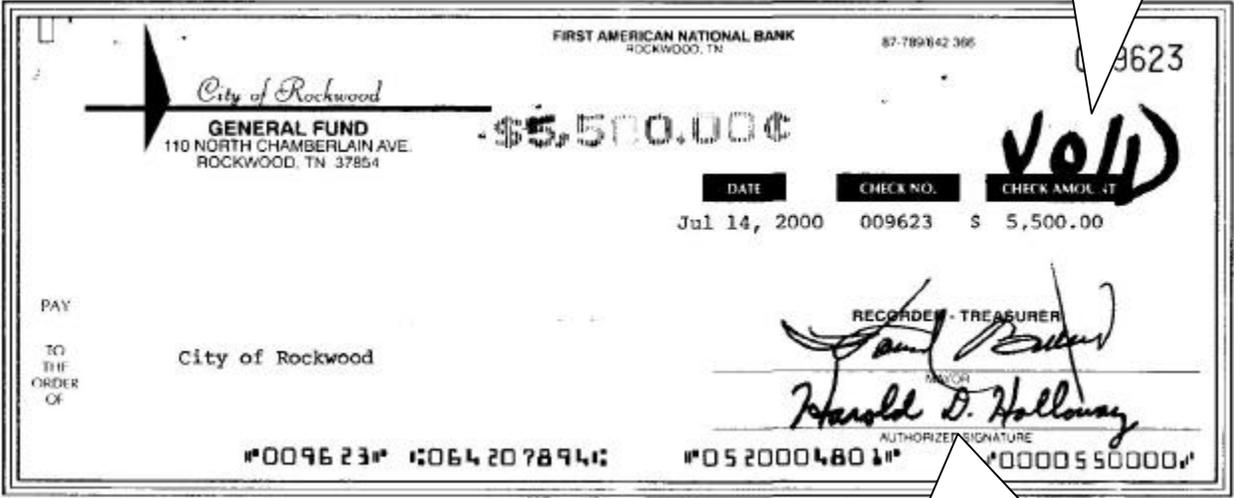


Bank marking indicates check was cashed.

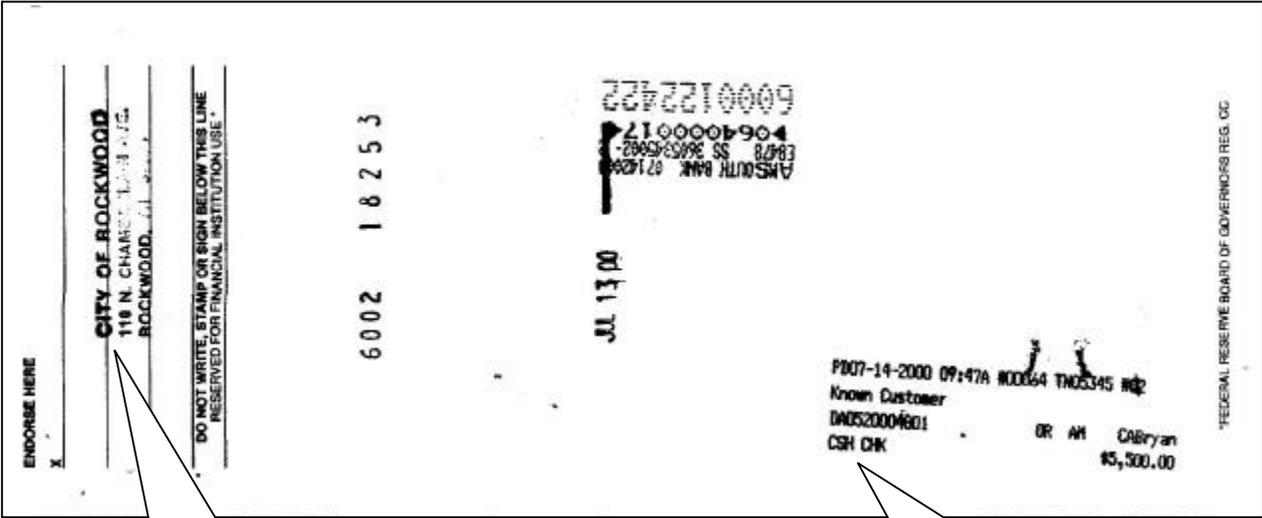
Apparently endorsed by former recorder.

General Fund check nos. 9135 (on opposite page) and 9137 totaling \$13,500 were not recorded in the City of Rockwood's accounting records. Bank processing stamps indicate the checks were cashed on the same date in consecutive transactions.

The former recorder apparently marked this check as "VOID," after the canceled check was received from the bank.



According to former mayor Holloway, unauthorized use of mayor's signature stamp maintained by former recorder.



Stamped endorsement apparently accepted by bank teller even though check was cashed.

Bank marking indicates this check was cashed.

General Fund check no. 009623 was not recorded in the City of Rockwood's accounting records. Bank processing stamps indicate the check was cashed.