

INVESTIGATIVE AUDIT REPORT

SEWANEE UTILITY DISTRICT
JANUARY 1, 2006, THROUGH OCTOBER 31, 2008



State of Tennessee



**Comptroller of the Treasury
Department of Audit
Division of Municipal Audit**



STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY

Justin P. Wilson

Comptroller

STATE CAPITOL

NASHVILLE, TENNESSEE 37243-9034

PHONE (615) 741-2501

July 16, 2009

Members of the Board of Commissioners
Sewanee Utility District
P.O. Box 3211
Sewanee, TN 37375

Commissioners:

Presented herewith is the report on our investigative audit of selected records of the Sewanee Utility District. This investigative audit focused on the period January 1, 2006, through October 31, 2008. However, when warranted, this scope was expanded. The audit was conducted in cooperation with the Tennessee Bureau of Investigation.

Section 9-2-102, *Tennessee Code Annotated*, requires that the Comptroller of the Treasury prescribe a uniform system of bookkeeping designating the character of books, reports, receipts and records, and the method of keeping same, in all state, county and municipal offices, including utility districts, which handle public funds. This code section also requires that all officials adopt and use the prescribed system. The Comptroller has prescribed a minimum system of recordkeeping for utility districts, which is detailed in the *Uniform Accounting Manual for Tennessee Utility Districts* combined with Chapter 6 of *Governmental Accounting, Auditing and Financial Reporting*. The purpose of our audit was to determine the extent of the entity's compliance with certain laws and regulations, including those in the above-mentioned manuals.

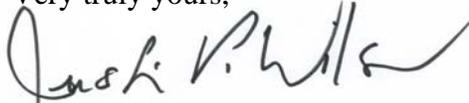
This matter was referred to the local district attorney general. In July 2009, the Franklin County Grand Jury indicted Theresa Patton, former district office manager, on 11 counts including theft over \$60,000, forgery, passing forged instruments, official misconduct, and destruction or tampering with government records.

The findings and recommendations in this report also relate to those conditions that we believe warrant your attention. All responses to each of the findings and recommendations are included in the report.

Members of the Board of Commissioners
Sewanee Utility District
July 16, 2009

Copies of this report are being forwarded to Governor Phil Bredesen, the State Attorney General, the District Attorney General, certain state legislators, and various other interested parties. A copy is available for public inspection in our office.

Very truly yours,

A handwritten signature in black ink, appearing to read "Justin P. Wilson". The signature is written in a cursive style with a large initial "J" and a long horizontal stroke at the end.

Justin P. Wilson
Comptroller of the Treasury



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF MUNICIPAL AUDIT

Justin P. Wilson
Comptroller of the Treasury

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Dennis F. Dycus, CPA, CFE, Director
Division of Municipal Audit

July 16, 2009

Mr. Justin P. Wilson
Comptroller of the Treasury
State Capitol
Nashville, TN 37243-9034

Dear Mr. Wilson:

As part of our ongoing process of examining the records of utility districts, we have completed our investigative audit of selected records of the Sewanee Utility District. This investigative audit focused on the period January 1, 2006, through October 31, 2008. However, when the audit warranted, this scope was expanded. The audit was conducted in cooperation with the Tennessee Bureau of Investigation.

Section 9-2-102, *Tennessee Code Annotated*, requires that the Comptroller of the Treasury prescribe a uniform system of bookkeeping designating the character of books, reports, receipts and records, and the method of keeping same, in all state, county and municipal offices, including utility districts, which handle public funds. This code section also requires that all officials adopt and use the prescribed system. The Comptroller has prescribed a minimum system of recordkeeping for utility districts, which is detailed in the *Uniform Accounting Manual for Tennessee Utility Districts* combined with Chapter 6 of *Governmental Accounting, Auditing, and Financial Reporting*. The purpose of our audit was to determine the extent of the entity's compliance with certain laws and regulations, including those in the above-mentioned manuals.

This matter was referred to the local district attorney general. In July 2009, the Franklin County Grand Jury indicted Theresa Patton, former district office manager, on 11 counts including theft over \$60,000, forgery, passing forged instruments, official misconduct, and destruction or tampering with government records.

Our investigative audit also resulted in findings and recommendations related to the following:

1. Inadequate separation of duties
2. Failure to establish and follow policies regarding credit cards
3. Premiums received from district vendor
4. Inadequate petty cash records

Mr. Justin P. Wilson
Comptroller of the Treasury
July 16, 2009

5. Inadequate supporting documentation
6. Deposits not made promptly
7. Failure to properly pay payroll taxes

In addition to our findings and recommendations, we are also providing management's response. If after your review, you have any questions, I will be happy to supply any additional information which you may request.

Sincerely,

A handwritten signature in black ink, appearing to read "Dennis F. Dycus". The signature is fluid and cursive, with a large initial "D" and "F".

Dennis F. Dycus, CPA, CFE, Director
Division of Municipal Audit

**INVESTIGATIVE AUDIT OF SELECTED RECORDS
OF THE SEWANEE UTILITY DISTRICT
FOR THE PERIOD JANUARY 1, 2006, THROUGH OCTOBER 31, 2008**

LEGAL ISSUES

1. **ISSUE:** **Former office manager made personal charges totaling \$58,849 on district credit card paid with district funds**

Our investigative audit revealed that the former office manager, Theresa Patton, apparently charged personal purchases to a credit card issued in the name of the utility district. The former office manager prepared and issued district checks, or made payment by telephone from district bank accounts, totaling at least \$58,849 to pay her personal charges. Some of those charges were made from vendors which clearly were not justifiable for lawful district purposes, such as Victoria's Secret, Old Navy, DirecTV and Rooms to Go. In addition, Ms. Patton apparently obtained several cash advances using the district card which she then repaid with district funds. Auditors noted that most of the related credit card charge slips and invoices and many of the credit card statements were not on file in district records.

2. **ISSUE:** **Unauthorized payments totaling \$6,166 to former office manager**

Our investigative audit noted that, in June 2006, Ms. Patton, the former office manager, prepared and issued a check payable to "DT Services" totaling \$2,997. However, Ms. Patton recorded this check in the district's accounting records as a payment to another legitimate district vendor. She endorsed the back of the check, took it to her personal credit union, and deposited it into her personal bank account. Ms. Patton was not authorized to receive this payment.

Our investigative audit noted that, in June 2008, Ms. Patton, the former office manager, prepared and issued a check payable to herself totaling \$3,169. Ms. Patton was not authorized to receive this payment. She took this check to her personal credit union, where she deposited a portion of it into her personal bank account. The balance was apparently given to her in cash. The former office manager was responsible for issuing all district checks, recording the accounting data, and reconciling all district bank accounts.

3. **ISSUE:** **Apparent forgery**

Our investigative audit found that the \$3,169 check noted above contained on its face an apparent forged signature. The commissioner whose name appeared as one of the

signatures on that check told state auditors that it was not her authentic signature, and had been used without her consent or authority. District checks required two authorized signatures. One of those signatures was typically the former office manager, while the second signature was usually the general manager or a commissioner. In this case, the former office manager's signature appeared to be authentic while the commissioner's signature was apparently forged.

4. **ISSUE: Apparently fraudulent petty cash expenses**

Our investigative audit identified apparently fraudulent petty cash expenses. Auditors noted several fuel invoices dated on weekends and many other alleged reimbursements for fuel with no invoice at all. The district used a fuel service for their district vehicles, and therefore, there was no legitimate need for these petty cash payments. In another instance, petty cash was allegedly used to buy lunch for a district crew. However, the lunch had already been charged to Ms. Patton's district credit card. Ms. Patton was responsible for maintaining the petty cash fund, including reconciling the petty cash invoices and preparing the district checks to replenish the petty cash fund.

5. **ISSUE: Falsification of government records**

Our investigative audit revealed that the former office manager created fictitious entries in the district's accounting records in an apparent attempt to conceal her scheme from management. For instance, she recorded a \$3,169 check payable to herself as payment for an electric expense. When she was initially questioned about this check, she apparently attempted to void the check from the accounting system. In addition, she recorded the previously noted personal charges on the district credit card as legitimate district expenses.

Summary of Loss	
Method	Amount
Personal credit card charges paid for with district funds	\$58,849
Unauthorized checks payable to Theresa Patton	6,166
Fraudulent petty cash expenses	<u>781</u>
Total	<u>\$65,796</u>

FINDINGS AND RECOMMENDATIONS

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

Management failed to adequately separate employees' responsibilities. One employee had been issued a district credit card and was also responsible for reconciling monthly credit card statements, paying credit card bills and filing credit card statements, invoices and other documentation. The *Uniform Accounting Manual for Tennessee Utility Districts*, Section 2-6, states:

Ideally, the same individual should not be responsible for authorizing transactions, recording transactions, and maintaining custody of assets. Establish work flow so that an employee's work is automatically verified by another employee working independently. Such procedures will help to eliminate errors in accounting records and limit the possibility of fraud.

RECOMMENDATION:

To decrease the risk of undetected errors and irregularities, management should review employees' responsibilities to ensure that no employee has control over a complete transaction. When necessary, management should assume additional oversight duties.

MANAGEMENT'S RESPONSE:

Members of the Board of Commissioners:

We concur. The district will implement accounting controls that require an original receipt for every transaction be attached to the request for payment, and that the payment instrument, request for payment, and receipt be reviewed by a designated employee who did not generate the payment. The reviewer will initial the payment request indicating that it has been reviewed prior to authorization of payment.

Manager:

Response is the same as that of the board of commissioners.

2. **FINDING:** **Failure to establish and follow policies regarding credit cards**

The board of commissioners failed to establish policies related to credit cards issued in the district's name. The *Uniform Accounting Manual for Tennessee Utility Districts*, Section 2-6, states:

Written guidelines should include instructions to personnel for authorizing, reviewing, and record keeping as a means of providing control and protecting the district's assets. Such guidelines should be readily available/accessible to all personnel.

We noted numerous deficiencies in internal controls and procedures related to district credit cards:

- a) District officials had not adopted guidelines on what type of transactions were permissible for charge on the district credit card. Cash advances should be prohibited.
- b) There was no thorough oversight or review of credit card charges to substantiate the appropriateness of purchases by any official other than the former office manager. As noted in Legal Issue 1, there were numerous credit card charges that were clearly not for a valid district purpose and would have been regarded as suspicious even after a cursory review.
- c) There was no effort by district officials to ensure that they monitored all credit cards issued in the name of the district. Our investigative audit revealed that a majority of charges for one of the district's credit cards had no invoices on file at the district's office. As a result, records were insufficient to determine if the district received the benefit of numerous purchases.
- e) Officials had not addressed custody and safekeeping of the physical credit cards. The authorized district credit cards may have been given to other district officials from time to time. However, if this happened, there was no log or other record to document that some other user made a particular charge.

RECOMMENDATION:

To ensure only authorized, permissible charges are made on district credit cards, district officials should formulate clear, comprehensive credit card policies and procedures.

MANAGEMENT'S RESPONSE:

Members of the Board of Commissioners:

We concur. The district will adopt a credit card usage policy that will:

- a) Prohibit cash advances
- b) Establish a monthly review of all charges, comparing receipts to the statement and establishing the appropriateness of each charge
- c) Hold the cardholder personally liable for purchases charged for which there are no receipts

- d) Establish a log book for company credit cards to document the chain of custody for purchases made by an employee other than the card holder.

Manager:

Response is the same as that of the board of commissioners.

3. **FINDING: Premiums received from district vendor**

Documentation in district files indicated district personnel received premiums from one vendor. The district earned points apparently based on the volume of the district's purchases from that vendor. Although district personnel redeemed a portion of those points for property apparently put into use by the district, auditors were unable to determine any district purpose for the use of approximately six \$100 gift cards. When employees or officials receive gifts from vendors, it increases the risk that purchasing decisions will not be made based on the district's needs and interest.

Section 8-17-103, *Tennessee Code Annotated*, requires that utility districts adopt ethical standards before July 2007. In compliance with that statute, the board of commissioners of the Sewanee Utility District adopted the ethics policy of Franklin County.

Section 4 of the *Code of Ethics, Franklin County, Tennessee*, states:

An official and employee ... may not accept, directly or indirectly, any gift, money, gratuity, or other consideration or favor of any kind from anyone other than the [utility]:

- (1) For the performance of any act, or refraining from performance of an act, that he would be expected to perform, or refrain from performing, in the regular course of his duties.

In addition, Sewanee Utility District prohibits any member of the board of commissioners or any employee from accepting any gift from any vendor who supplies or may supply goods or services to the district.

RECOMMENDATION:

To avoid the possibility of actual or apparent undue influence, the board should make its employees aware of the provisions of the district's code of ethics. This includes prohibiting employees from accepting gifts from vendors.

MANAGEMENT’S RESPONSE:

Members of the Board of Commissioners:

We concur. The district will review the adopted code of ethics with all district personnel, especially established policies on not accepting vendor gifts.

Manager:

Response is the same as that of the board of commissioners.

4. **FINDING: Inadequate petty cash records**

Utility district files did not contain adequate supporting documentation for all district petty cash purchases. As noted in the Legal Section of the report, certain petty cash disbursements were inappropriate. In addition, our investigative audit also revealed that there was no documentation in district files for at least \$600 in petty cash funds. The *Uniform Accounting Manual for Tennessee Utility Districts*, Section 5-3, outlines procedures for a petty cash fund. These procedures include requiring someone other than the petty cash custodian to inspect and approve each petty cash invoice, and having employees sign for any money received.

RECOMMENDATION:

To ensure appropriate, legitimate petty cash disbursements that benefit the district’s customers, members of the board of commissioners should require adequate supporting documentation. Someone other than the petty cash custodian should inspect and approve the invoice or receipt for each disbursement. Employees should sign for any money obtained from the petty cash fund.

MANAGEMENT’S RESPONSE:

Members of the Board of Commissioners:

We concur. The district has eliminated our petty cash account.

Manager:

Response is the same as that of the board of commissioners.

5. **FINDING: Inadequate supporting documentation**

Utility district files did not contain adequate supporting documentation for all district purchases. The *Uniform Accounting Manual for Tennessee Utility Districts*, Section 5-2, outlines procedures for an adequate cash disbursements system. These procedures include approving invoices for payment, dating and canceling invoices to avoid duplicate payment, and filing invoices and other supporting documentation numerically by check number.

RECOMMENDATION:

To ensure valid disbursements that benefit the district's customers, members of the board of commissioners should require adequate supporting documentation. These documents should be retained as set forth in the manual.

MANAGEMENT'S RESPONSE:

Members of the Board of Commissioners:

We concur. In addition to the changes to be made under Finding 1, the district will establish a uniform filing system for financial documentation. Receipts, invoices, and check stubs will be filed together to make independent review of disbursements easier.

Manager:

Response is the same as that of the board of commissioners.

6. **FINDING: Deposits not made promptly**

Utility district personnel sold scrap material for cash in October 2007. However, the proceeds were never deposited. The cash was apparently kept in the same location as the petty cash. According to district personnel, these funds were to be used for an employee picnic. As our investigative audit was underway, district personnel attempted to account for these funds and found that, of the \$510 collected, only \$10 remained. The other \$500 was unaccounted for. The *Uniform Accounting Manual for Tennessee Utility Districts*, Section 3-1, requires prompt and intact deposits of collections.

RECOMMENDATION:

To minimize the risk of loss or misuse of district funds, all collections should be deposited promptly.

MANAGEMENT’S RESPONSE:

Members of the Board of Commissioners:

We concur. The district will ensure that all collections will be deposited promptly.

Manager:

Response is the same as that of the board of commissioners.

7. **FINDING:** **Failure to properly pay payroll taxes**

Our review revealed that the former office manager underpaid payroll taxes for the first quarter of 2008, resulting in a penalty of \$1,088. The *Uniform Accounting Manual for Tennessee Utility Districts*, Section 5-2, requires that management pay bills in a timely manner to take advantage of all possible discounts and avoid additional costs.

RECOMMENDATION:

To ensure that public funds are used wisely, members of the board of commissioners should hire competent and capable employees who are conscientious in their management of district money. District personnel should pay debts to take advantage of all discounts and avoid any penalties

MANAGEMENT’S RESPONSE:

Members of the Board of Commissioners:

We concur. The district will ensure debts are paid in a manner that will take advantage of possible discounts and avoid any penalties. We will establish checklists for recurring payments to ensure payments are made promptly.

Manager:

Response is the same as that of the board of commissioners.