

INVESTIGATIVE AUDIT REPORT

**SOUTH EAST TENNESSEE DEVELOPMENT DISTRICT
JULY 1, 2001, THROUGH MARCH 31, 2006**



State of Tennessee



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



STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY

John G. Morgan
Comptroller

STATE CAPITOL
NASHVILLE, TENNESSEE 37243-0260
PHONE (615) 741-2501

September 26, 2006

Board of Directors
South East Tennessee Development District
P. O. Box 4757
Chattanooga, TN 37905-0757

Ladies and Gentlemen:

Presented herewith is the report on our investigative audit of selected records of the South East Tennessee Development District. This investigative audit focused on the period July 1, 2001, through March 31, 2006. However, when warranted, this scope was expanded.

The Comptroller has prescribed a minimum system of recordkeeping for nonprofit agencies, which is detailed in the *Accounting and Financial Reporting for Not-For-Profit Recipients of Grant Funds in Tennessee*. 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 manual.

Our investigative audit revealed that during the period August 1, 2001, through February 28, 2006, the former agency payroll clerk, Stacie Reece, made unapproved and unauthorized payments to herself through the agency's payroll bank account totaling \$218,359. This matter was referred to the local district attorney general. On September 5, 2006, the Hamilton County Grand Jury indicted Stacie Reece on one count of Theft over \$60,000.

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,

John G. Morgan
Comptroller of the Treasury

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

John G. Morgan
Comptroller of the Treasury

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

September 26, 2006

Mr. John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, TN 37243-0260

Dear Mr. Morgan:

As part of our ongoing process of examining the records of nonprofit organizations, we have completed our investigative audit of selected records of the South East Tennessee Development District. This investigative audit focused on the period July 1, 2001, through March 31, 2006. However, when the examination warranted, this scope was expanded.

The Comptroller has prescribed a minimum system of recordkeeping for nonprofit organizations, which is detailed in the *Accounting and Financial Reporting for Not-For-Profit Recipients of Grant Funds in Tennessee*. 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 manual.

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Mr. John G. Morgan
Comptroller of the Treasury
September 26, 2006

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
SOUTH EAST TENNESSEE DEVELOPMENT DISTRICT
FOR THE PERIOD JULY 1, 2001, THROUGH MARCH 31, 2006**

LEGAL ISSUE

1. **ISSUE: Apparent misappropriation of \$219,019**

Our investigative audit revealed that during the period August 1, 2001, through February 28, 2006, the former agency payroll clerk, Stacie Reece, made unapproved and unauthorized payments to herself through the agency's payroll bank account totaling \$218,359.

Our investigative audit determined the following:

- Ms. Reece issued duplicate payroll payments to herself on several occasions.
- Ms. Reece added unauthorized amounts, as much as \$12,000 in one month, to her approved pay. The agency used a direct deposit payroll system, which Ms. Reece administered. When she sent instructions to the agency's bank to make the payroll transfers to employees, she inflated the amount to be sent to her personal bank accounts. (Refer to exhibit.) Auditors were able to document the unauthorized payments deposited directly into Ms. Reece's personal bank account.¹
- Ms. Reece gave herself periodic unapproved salary increases.

Our audit also revealed that Ms. Reece directed contributions to which she was not entitled totaling \$660 into her health savings account.

Ms. Reece was able to conceal her activities from management by altering payroll reports and creating fictitious expenses in the financial records.

Ms. Reece acknowledged to the state auditor that she took agency funds to which she was not entitled for her personal benefit.

Inadequate separation of duties

These schemes were discovered when, due to the temporary absence of Ms. Reece, another employee examined certain payroll records. This other employee uncovered a relatively minor discrepancy in the records and alerted management. Management immediately initiated an investigation. However, during the examination of this minor discrepancy, the agency's contract auditor determined that there had apparently been an

¹The former payroll clerk, Ms. Stacie Reece, voluntarily provided auditors with copies of some of her personal bank records.

ongoing misappropriation scheme for at least the prior 18-month period. Consequently, the agency requested an investigative audit by the Division of Municipal Audit. That audit revealed that the apparent misappropriation had been going on since August 2001.

Prior to the discovery of the unauthorized payments, Ms. Reece had complete control over the payroll function. She authorized payroll transactions, recorded those transactions, and had effective control of the bank account. She set the amounts to be transferred from the operating bank account into the payroll bank account. She also directed the electronic transfers for the direct deposit payroll payments to employees. In addition, she was responsible for reconciling agency bank accounts. As a result of this lack of separation of duties, Ms. Reece was able to direct unauthorized payments to herself over a 55-month period without detection.

Following the discovery of this apparent misappropriation, management installed additional internal controls to reduce the risk of subsequent misappropriations.

This matter was referred to the local district attorney general. On September 5, 2006, the Hamilton County Grand Jury indicted Stacie Reece on one count of Theft over \$60,000.

EXHIBITS

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Direct Deposit Payroll Instructions Sent to Agency Bank for 12/15/2005 Pay Period

exhibit.txt

Ms.
Reece's
personal
bank
account
numbers

\$4,500.00*

62206400005915120313	00004500003100	REECE, STACIE M
0061300410000051		
622064000017530080	00001111753100	REECE, STACIE M
0061300410000052		

\$1,111.75*

62206400005915120313	00004500003100	REECE, STACIE M
0061300410000051		
622064000017530080	00001111753100	REECE, STACIE M
0061300410000052		
0000777514940		BILREY, MYRTLE E
0000002140400		INSON, GWEN
00000964325240		ROBINSON, IVENA F
00001657575250		SEDRICK, MARY
00001677694730		SHAW, ALEETRA
00000987331050		SMITH, ANNA
00001093404860		SMITH, LYNETTE
00000975535230		SMITH, STACIE M
00001766005170		STITT, MICHAEL D

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*Ms. Reece's authorized net pay for this period was \$1,111.75.