

SPECIAL INVESTIGATION

CITY OF WATERTOWN

JANUARY 1, 2011, THROUGH JUNE 30, 2013



State of Tennessee

Comptroller of the Treasury



**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY**

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**Justin P. Wilson
Comptroller of the Treasury**

September 29, 2014

Honorable Mayor and Members of the
Board of Aldermen
City of Watertown
8630 Sparta Pike
Watertown, TN 37184

Ladies and Gentlemen:

The Office of the Comptroller of the Treasury conducted a special investigation of selected records of the City of Watertown which focused on the period January 1, 2011, through June 30, 2013. When warranted, this scope was expanded.

Presented in this report are the findings resulting from this special investigation. Copies of this report are being forwarded to Governor Bill Haslam, 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 and may be viewed at <http://www.comptroller.tn.gov/ia/>.

Sincerely,

Stephanie S. Maxwell, Deputy General Counsel
Office of the Comptroller of the Treasury

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**SPECIAL INVESTIGATION OF SELECTED RECORDS
OF THE CITY OF WATERTOWN
FOR THE PERIOD JANUARY 1, 2011, THROUGH JUNE 30, 2013**

SUMMARY

The Office of the Comptroller of the Treasury performed a special investigation of selected records of the City of Watertown. The investigation focused primarily on the period January 1, 2011, through June 30, 2013, and revealed a misappropriation of at least \$21,773. Two schemes were used to misappropriate the money, as follows:

- At least \$19,023 was misappropriated from utility customer collections. Investigators identified numerous water and sewer payments that had been recorded on customer accounts, but were not deposited into a city bank account. To conceal the misappropriation, a printed record of these collections was either never generated or was generated and discarded.
- At least \$2,750 was misappropriated from collections of meter deposits and connection fees.

Due to the inadequacies of the city's internal controls, we were unable to determine conclusively who was responsible for the misappropriation of city collections.

These matters were referred to the local district attorney general.

INVESTIGATIVE FINDINGS

This section contains a schedule summarizing the misappropriation of city funds, as well as the investigative findings resulting from this special investigation.

Summary Schedule of Amounts Misappropriated

Source	Amount
Customer utility billings	\$19,023
Meter deposits/connection fees	<u>2,750</u>
Total	<u>\$21,773</u>

1. **FINDING: Misappropriation of utility customer collections totaling at least \$19,023**

Our special investigation revealed that at least \$19,023 was misappropriated from water and sewer customer account cash collections during the period January 1, 2011, through June 30, 2013. Investigators identified numerous instances in which payments of customer utility bills were not deposited into a city bank account. Although the payments were appropriately recorded in the individual customer accounts, the city employee(s) responsible for the scheme either failed to generate or failed to retain proper documentation of these recorded collections. Additionally, city officials failed to ensure performance of a detailed monthly bank reconciliation or accounts receivable reconciliation which allowed the scheme to remain undetected for several years.

During the period in question, a part-time city clerk was primarily responsible for receiving, recording, reconciling, and depositing city collections, including collections on water and sewer customer accounts. At times, the city recorder and other employees received collections. Also, the city recorder occasionally recorded water and sewer customer account collections in the city's computerized billing system. All of the employees who received collections on behalf of the city operated out of the same cash drawers. In addition, employees did not properly use identifying usernames and passwords; instead, they entered all daily transactions under the username of the employee who initially accessed the system. These internal control deficiencies prevented any conclusive determination regarding responsibility for the misappropriation of utility collections.

2. **FINDING: Misappropriation of meter deposit and connection fee collections totaling at least \$2,750**

Meter deposit and connection fee cash collections totaling at least \$2,750 were misappropriated during the period January 2011 through June 2013. The part-time clerk primarily responsible for collections stated that when these collections were received, the employee collecting the payment routinely hand-prepared utility billing stubs and water applications and reconciled the amounts on the stubs to the amounts deposited. Sometime after initial preparation of the billing stub, one of the employees prepared a manual prenumbered receipt. Although the investigators located the applications, they noted that the hand-prepared billing stubs for the misappropriated meter deposit and connection fee collections were missing from the applicable billing stub bundles, effectively concealing the misappropriation.

OTHER FINDINGS AND RECOMMENDATIONS

Presented below are the findings and recommendations related to internal control and compliance deficiencies noted during the special investigation. In the accompanying responses, management has indicated they have corrected or intend to correct each of the noted deficiencies. The responses also indicate that management does not concur that city money was misappropriated. At the end of this report, we have included a rebuttal to management's responses to Findings 2, 3, 4, and 5.

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

City officials failed to separate incompatible financial duties. Although both the recorder and a part-time clerk received collections, our special investigation found that the part-time clerk was primarily responsible for all phases of the collections process. The part-time clerk received collections, recorded collections, received and opened mail, prepared and carried deposits to the bank, and had access to make adjustments to utility customer accounts. In addition, both employees used the same cash drawers when receiving collections.

The *Internal Control and Compliance Manual for Tennessee Municipalities*, page 32, states:

Municipal officials should separate duties of employees 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. When possible, different persons should be responsible for the authorization, recordkeeping (posting), custodial (cash and materials handling), and review procedures, to prevent manipulation of records and minimize the possibility of collusion....

Page 49 of the manual states:

Municipal officials should ensure that ... responsibility for each step of cash handling and recording is clearly established. If possible, the employees who receive cash collections (cashiers) should be different from those who maintain the books and records (bookkeepers).

Page 50 of the manual states that "... [e]ach cashier should be assigned a separate cash drawer that is accessible only to that cashier...."

RECOMMENDATION:

To help ensure that all city collections are deposited into a city bank account, and to decrease the risk of undetected errors or irregularities, the mayor and members of the board of aldermen should review employees' responsibilities and ensure that no employee has control over a complete financial transaction. In addition, city officials should require that each employee authorized to receive collections is assigned a separate cash drawer that is accessible only to that employee. Elected officials should exert increased oversight, when necessary.

MANAGEMENT'S RESPONSE:

Mayor and Members of the Board of Aldermen:

We concur. The City of Watertown has employed an additional part-time person in the office of the city recorder so that there are now three employees. The city recorder remains a full-time position; the two part-time positions are designed to work a total of 39 hours per week. Schedules are being established in such a way that there will be two people in the office of the city recorder at all times during regular business hours and no single employee will have control over a complete financial transaction. Reviews of employees' responsibilities will be ongoing and each employee authorized to receive collections is assigned a separate cash drawer that is accessible only to that employee. Only those employees will be authorized to receive collections. Elected officials will exert increased oversight, when necessary.

Recorder:

I concur with the response of the mayor and members of the board of aldermen.

2. **FINDING: Inadequate controls over computer system access**

City officials failed to establish and ensure adequate safeguards for computer data entry access. Although the recorder and clerk both had individual usernames and passwords, they routinely entered all daily financial transactions using the identifying information of the employee who initially accessed the system. This internal control deficiency prevented identification of the employee responsible for recording the stolen customer utility collections in the individual customer accounts.

A good system of internal controls requires limiting access to and identifying users of computer systems and files by requiring proper use of individual usernames and unique passwords.

RECOMMENDATION:

To prevent unauthorized access to computer systems and files and to ensure user identity documentation is correct, the mayor and members of the board of aldermen should require and ensure that city employees access the computer system using only their unique username and password. Employees should log off the computer when they are finished using it, even temporarily.

MANAGEMENT'S RESPONSE:**Mayor and Members of the Board of Aldermen:**

Management concurs with the recommendation. The purchase of new, updated computer equipment has been authorized by the board of mayor and aldermen. Our software will be substantially updated. A meeting has been scheduled with our software supplier to provide what is necessary. Access to the computer system will be limited and city employees with such access will use only their unique username and password.

We do not concur with the last sentence of the first paragraph of this finding referencing "stolen customer utility collections in the individual customer accounts."

Recorder:

I concur with the response of the mayor and members of the board of aldermen.

3. **FINDING: Utility payments not recorded in accounts promptly**

Although utility collections were generally deposited promptly, they were frequently not recorded in customer accounts until several days, or even weeks, had elapsed. Failure to record payments promptly and to establish and ensure adequate safeguards and controls over computer access (as addressed in Finding 2) facilitated the misappropriation of utility collections noted in Investigative Finding 1.

The *Internal Control and Compliance Manual for Tennessee Municipalities*, page 49, 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."

RECOMMENDATION:

To decrease the risk of undetected errors and irregularities, the mayor and members of the board of aldermen should require that all utilities payments be recorded promptly to the proper accounts.

MANAGEMENT’S RESPONSE:

Mayor and Members of the Board of Aldermen:

We concur. Employees’ responsibilities are being revised and reviewed. Additionally, the City of Watertown will continue to employ an outside accounting firm to assist the city recorder and her assistants.

We do not concur that there has been a “misappropriation of utility collections.”

Recorder:

I concur with the response of the mayor and members of the board of aldermen.

4. **FINDING: Accounts receivable and bank reconciliations not performed**

City officials failed to reconcile utility accounts receivable and failed to reconcile cash balances per the city’s general ledger to cash balances per the bank statements. Because these reconciliations were not performed, the discrepancies between the recorded amounts of customer utility payments collected and the amounts deposited were not discovered promptly. As a result, the theft scheme detailed in Investigative Finding 1 continued undetected for at least 2½ years.

The *Internal Control and Compliance Manual for Tennessee Municipalities*, page 58, requires municipal officials periodically to perform an accounts receivable reconciliation.

Page 43 of the manual states,

Municipal officials should ensure that ... bank statements are reconciled with the cash balances presented in the accounting records (general ledger). Bank reconciliations should be prepared within 30 days after the bank statements are received from the bank....

RECOMMENDATION:

To help detect errors, irregularities, or misappropriation of city funds, officials should ensure that accounts receivable reconciliations and bank reconciliations are prepared each month by an employee who does not receive or record collections. The reconciliations should be documented in the city’s records.

MANAGEMENT’S RESPONSE:

Mayor and Members of the Board of Aldermen:

Management concurs. An outside accounting firm will continue to be employed with one of their specific responsibilities being accounts receivable reconciliations and bank reconciliations, to be completed in a timely manner.

We do not agree with the use of the phrase “the theft scheme” contained in paragraph 1 of this finding.

Recorder:

I concur with the response of the mayor and members of the board of aldermen.

5. **FINDING: Prenumbered receipts not used for all applicable collections**

City employees frequently failed to prepare prenumbered receipts for some miscellaneous utility collections, such as meter deposits, connect fees, sales of meters, water pump rentals, etc. Instead, these payments were recorded on hand-prepared stubs. Our investigation revealed that the stubs documenting the misappropriated collections noted in the Investigative Findings were apparently discarded.

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; provided, that this provision for official receipts shall not apply to the payment of funds from one department or division of the state government to another such department or division. Any system now in use shall be acceptable if approved by the comptroller of the treasury.

Section 9-2-104, *Tennessee Code Annotated*, requires that the receipts be prenumbered consecutively and Section 9-2-106 states that failure to abide by the provisions of Sections 9-2-103 – 9-2-105 constitutes a Class C misdemeanor.

The *Internal Control and Compliance Manual for Tennessee Municipalities*, page 49, states:

Municipal officials should ensure that ... prenumbered receipts for each revenue source are issued as required by Sections 9-2-103 and 104, *Tennessee Code Annotated*, and all unused or voided receipts are accounted for. Prenumbered receipts issued should be detailed

to adequately identify and/or document the payment source, payment date, method of payment (cash or check), purpose of payment, if needed, etc....

RECOMMENDATION:

To ensure a complete record of all collections and decrease the risk of undetected errors and irregularities, the mayor and members of the board of aldermen should require that all collections are recorded on prenumbered receipts. City officials should ensure that all amounts on prenumbered receipts are reconciled with amounts deposited into the city's bank account.

MANAGEMENT'S RESPONSE:

Mayor and Members of the Board of Aldermen:

We concur with the recommendation. We do not agree with the last sentence of paragraph 1 of the finding. During this investigation, city records were delivered to the investigating authority, some remained in the possession of the City of Watertown, and some have been in the possession of a previous auditor for the city. This sentence does not say who "apparently discarded" the stubs.

Recorder:

I concur with the response of the mayor and members of the board of aldermen.

REBUTTAL TO MANAGEMENT'S RESPONSES TO FINDINGS 2, 3, 4, AND 5

Even though investigators with the Office of the Comptroller of the Treasury were unable to attribute responsibility for the misappropriation of the City of Watertown's utility collections, the Comptroller's investigation clearly showed that at least \$21,773 was stolen from the City of Watertown.

Additionally, investigators reviewed all records provided by the city, searched city offices, and conferred with the previous auditor for the city in attempts to locate the missing stubs. These missing stubs coincide directly with the misappropriated collections.