

KANE COUNTY

Report on Internal Control and Financial Practices

Findings and Recommendations
For the Period January 1, 2013 through March 2, 2016

Report No. 6-KANE-3a



**OFFICE OF THE
UTAH STATE AUDITOR**

KANE COUNTY

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AUDIT LEADERSHIP:

John Dougall, Utah State Auditor
Van Christensen, CPA, CFE, Audit Director
Patricia Nelson, CPA, Audit Supervisor



OFFICE OF THE
UTAH STATE AUDITOR

REPORT NO. 6-KANE-3a

April 27, 2016

Kane County Commission
76 North Main St.
Kanab UT, 84741

Dear Commissioners:

We have completed our investigation of allegations against the Kane County Treasurer (Treasurer) regarding illegally transferring public funds to her personal account. Although this report focuses primarily on actions the Kane County Commission (Commission) can take, the failings identified are first and foremost the failings of the Treasurer to ensure adequate practices in regards to internal controls. Our recommendations regarding the Commission's actions are secondary to the Treasurer's failure to establish internal controls. A separate letter has been provided to the Commission regarding the actions of the Treasurer.

As a result of the investigation identified above, we performed procedures to evaluate certain aspects of Kane County's (County) internal control and financial practices. The Commission has been very cooperative with our investigation and interested in promptly correcting weaknesses that allowed theft and lax oversight to occur. This report is intended to provide the Commission with information that may assist in correcting these weaknesses.

When first becoming aware of the possibility of theft, the Commission's response was swift and deliberate. They immediately worked with banks, IT professionals, and our office to terminate the Treasurer's access to County funds and removed the Treasurer's physical access to her computer and office to preserve records.

Our review of internal control and financial practices has included evaluating bank activity at the County related to concerns identified and reviewed additional areas where the Treasurer had the opportunity to misappropriate funds. Our testwork included reviewing all transfers out of County bank accounts at three separate banks, reviewing certain processed checks, and comparing cash receipt records to actual bank deposits for the period January 1, 2013 through January 31, 2016.

Potential financial irregularities may have occurred prior to the period we reviewed and may have occurred in other areas. However, we evaluated certain risks and focused audit resources in those areas. Therefore, this report should not be interpreted to mean that all potential misuse of funds has been identified. The weaknesses identified primarily deal with the Treasurer's Office and are not a comprehensive review of potential weaknesses countywide.

A county treasurer's responsibilities include 1) receiving, depositing, investing, and maintaining a record of money received by the county, 2) making payments when authorized and managing

bank account balances to ensure funds are available to cover issued checks, 3) working with other county officials to ensure that public funds are properly safeguarded, and 4) providing an accounting of certain financial activity to the county commission.

We noted several areas where the internal controls at the County were weak and allowed for misappropriation of funds to occur as noted in the following findings.

1. COUNTY FUNDS WERE MISUSED WITHOUT DETECTION DUE TO INADEQUATE OVERSIGHT

The Commission, in conjunction with the County Auditor and Treasurer, failed to exercise proper oversight and establish proper internal controls to ensure that County funds were appropriately used. As a result, in addition to mismanaging County funds, the Treasurer was able to make improper transfers and an improper disbursement without detection by the County, as follows:

a. Bank Transfers from County Accounts to Treasurer's Personal Accounts

We reviewed all transfers out of County bank accounts and found 46 transfers, totaling \$34,600, to personal accounts held by the Treasurer. These transfers were made from three separate bank accounts and occurred between February 2014 and January 2016. The signature cards on the County accounts indicate that the Treasurer is the only person authorized to make these transfers.

b. County Funds Used to Pay for Personal Cell Phone Services

We found one online payment for \$1,612.67 from a County bank account for a personal cell phone bill of the Treasurer. The signature card on the County account indicates that the Treasurer is the only person authorized to make payments from this account. We also noted that the Treasurer receives a stipend of \$110 per month for cell phone services.

c. Inappropriate Transfers between County Accounts

- We noted transfers from the County property tax bank account to other County bank accounts (two transfers totaling \$1,700 to the County Justice Court account and another transfer of \$500 to the County health plan account) that corresponded to transfers to the Treasurer's personal bank account (noted in a. above) from the County Justice Court account and County health plan account.
- The Treasurer inappropriately transferred \$27,000 from the property tax bank account to the Justice Court bank account to cover a deficit in the Justice Court account. This deficit occurred when the company that processes the Court's online credit card payments mistakenly deposited the funds into the District Court bank account instead of the Justice Court bank account for the period of about one month. Per the usual practice, the Justice Court clerk prepared checks from the Justice Court account for the amount that had been collected online through credit cards based on the credit card processor's statements for that month. These checks were then properly

deposited into the County's main operating account. However, this created a deficit in the Justice Court account since the credit card company had deposited the money in the District Court account instead of the Justice Court account.

- We further noted additional transfers from the property tax account totaling \$3,000 to the Justice Court due to further deficits in the Justice Court account. We were unable to determine why these additional deficits occurred.

Property taxes are restricted for specific purposes and none of the above property tax account funds totaling \$32,200 were returned to the property tax bank account.

d. Deficit Bank Balances

The County bank accounts had deficits for several of the 37 months we reviewed, as follows: Justice Court account—9 months, property tax account—1 month, and County health plan accounts—3 months. These deficits illustrate a mismanagement of County funds and resulted in unnecessary interest and penalty charges.

e. Missing Signatures on Checks

We noted nine instances where the bank noted and charged fees for missing signatures on checks drawn for the Justice Court account. The checks are required to be signed by both the court judge and the Treasurer. The bank manager indicated that when a signature was missing they contacted the authorized signer and verified his/her authorization before processing the check. These errors illustrate a mismanagement of County funds and resulted in unnecessary penalty charges.

The term “internal controls” is used to describe processes put in place by the governing body, management, or others, to provide reasonable assurance that funds will be properly safeguarded. Proper internal controls include separating certain responsibilities so that no one person has the ability to improperly use money without detection (see Finding No. 2 for more detail), reconciliations of bank statements to the general ledgers, and a review of the County's financial records (disbursements, transfers, adjustments, reconciliations, etc.). The following provisions of *Utah Code* outline who has the responsibility or ability to establish internal controls and provide oversight of the Treasurer's Office:

- *Utah Code* 17-36-45 – “Each county legislative body shall, with the advice and assistance of the county auditor and county treasurer implement an internal control structure to ensure...” that county funds are properly safeguarded.
- *Utah Code* 17-24-11 – “The county treasurer shall reconcile with the county auditor by the last day of each month for the preceding month.”
- *Utah Code* 17-24-12 – “Each county treasurer shall make a detailed report whenever required so to do by the ... legislative body ... of all money received by the treasurer, and of disbursements thereof, and all other proceedings in the treasurer's office so that the receipts into the treasury and the amount of disbursements shall clearly and distinctly appear.”

- *Utah Code 17-24-19* – “The books, accounts, and vouchers of the treasurer are at all times subject to the inspection and examination of the county executive and county legislative body, the county attorney, the district attorney, the county auditor, and the grand jury.”

The Treasurer alone was able to authorize transfers without anyone else’s involvement, including any involvement in the bank reconciliation. As such, improper transfers were made without detection. There are other provisions in the law, as noted above, which allow for greater oversight of the Treasurer’s Office that do not appear to have occurred. Specifically, the County Auditor should have shared access to the bank records in order to perform audits and assist the County in performing or reviewing bank reconciliations.

Because the Commission, County Auditor, and Treasurer did not ensure that internal controls were in place, including exercising proper oversight by performing a monthly review of the County’s financial transactions and separating certain responsibilities within the Treasurer’s Office, County funds have been mismanaged, misappropriated, and misused, including inappropriately transferred to personal accounts without detection by the County.

Recommendation:

We recommend that the Commission:

- **Work in conjunction with the County Auditor and newly appointed Treasurer to establish internal controls that ensure County funds are appropriately used and accounted for.**
- **Provide appropriate oversight of the Treasurer’s Office by reviewing the financial transactions of the County on a monthly basis.**

We recommend that the Treasurer:

- **Work together with the County Auditor to reconcile accounting records to the bank statements on a monthly basis.**
- **Restore funds into the property tax account.**
- **Actively manage accounts to avoid deficit balances and associated charges.**
- **Ensure that all checks have two signatures, in compliance with County policy.**

2. INADEQUATE SEPARATION OF DUTIES ALLOWED CASH TO GO MISSING WITHOUT DETECTION

We compared the cash/check composition of the transactions noted as deposits on the property tax account subledger to the actual bank deposits and noted a difference of \$53,558 (from 63 transactions) that were not deposited into the bank. We also compared the cash/check composition of the transactions noted as deposits on the County’s main operating account ledger to the actual bank deposits and noted a difference of \$2,624 (from 4 transactions) that was not deposited into the bank. These missing receipts were from February 2013 through January 2016. The money, which was nearly all cash, remains unaccounted for.

For these missing cash receipts, the Treasurer had custody of the cash and checks received and was responsible for making the deposits; therefore, at the very least, we consider this improper oversight of County funds by the County Treasurer. However, we believe there is a high likelihood the Treasurer misappropriated these funds.

Not only did the Treasurer have access to the cash/checks, but she had the ability to conceal the missing cash/checks by making adjustments to property tax accounts or the accounting records. From January 1, 2013 through March 2, 2016, the Treasurer's Office made adjustments to property tax accounts, totaling \$648,301, through abatements, write offs, etc. We also noted that the Treasurer's Office voided more than \$1 million of receipts after the tax payments were recorded into the County records and deposited into the bank. Most of these adjustments were likely for legitimate purposes; however, neither the adjustments to the property tax accounts nor the post voided transactions were subject to any secondary review or reconciliation.

In addition, we found that the Treasurer had completed a detailed bank reconciliation which included checkmarks on bank statements and deposit detail that would have identified the discrepancies we noted. If the Treasurer had not misappropriated the funds, she would have followed up with others to resolve these discrepancies; instead it appears that her primary objective in conducting a detailed reconciliation was to conceal misappropriated funds.

During our testwork, we also noted that although the County receipts cash and checks for the Justice and District Courts, as well as various County departments, these original receipt records are not reconciled to the bank records to ensure all receipts received are actually deposited.

Inadequate separation of duties could allow errors and fraud to occur without detection. Separation of duties weaknesses often occur in entities where there are few employees who must perform multiple duties. The ability to authorize transactions, adjust the accounting records, prepare the bank reconciliation, while also maintaining custody of cash/checks, should have been assigned to separate individuals, or if separation of these duties was not feasible, the duties should have been subject to a regular independent reviews or audits.

In situations where it is impractical to separate duties due to the small number of employees, additional controls should be implemented. In this case, adequate compensating controls would include the reviews and reconciliations performed by someone who does not handle cash and checks received.

Recommendation:

We recommend that the Commission ensure that the County has adequate separation of duties, including separating responsibilities for authorizing or approving transactions, accessing cash or checks received, recording transactions in the accounting records or writing off/adjusting accounts receivable, and performing the bank reconciliation. In situations where it is not practical to separate some of these duties, we recommend the Commission ensure that compensating controls are implemented such as independent reviews or audits of these duties.

Our procedures were more limited than would be necessary to express an audit opinion on compliance or on the effectiveness of Kane County's internal control or any part thereof. Accordingly, we do not express such opinions. Alternatively, we have identified the procedures we performed and the findings resulting from those procedures. Had we performed additional procedures or had we made an audit of the effectiveness of Kane County's internal control, other matters might have come to our attention that would have been reported to you.

By its nature, this report focuses on exceptions, weaknesses, and problems. This focus should not be understood to mean there are not also various strengths and accomplishments. We appreciate the courtesy and assistance extended to us by the personnel of Kane County during the course of the investigation, and we look forward to a continuing professional relationship. If you have any questions, please contact the following individuals:

Van Christensen, CPA, CFE, Audit Director, 801-538-1394, vchristensen@utah.gov
Patricia Nelson, Audit Supervisor, at 801-538-1334 or patricianelson@utah.gov

Sincerely,

Office of the Utah State Auditor

Office of the Utah State Auditor

Attachment: Response from Kane County Commission

Kane County Commission

76 N. Main St., Kanab, Utah 84741



April 25, 2016

To: Van Christensen
Audit Director, Office of the Utah State Auditor

From: Dirk Clayson
Kane County Commission Chairman

Re: Audit report 6-KANE-3a

Dear Mr. Christensen,

I appreciate the opportunity to report the changes implemented as a result of the findings from your audit and also appreciate the investigations that your office have conducted regarding this matter. We have felt such a serious impact from the fraudulent transactions identified and realize that these matters extend beyond the individual perpetrating the fraud into the public trust with our entire system. Therefore, we have worked diligently to resolve these issues and strengthen our system and auditing to restore integrity and public trust regarding Kane County finances.

I have responded to the audit below using the same numbering reference system as the audit used. Please see our responses below as follows:

1 Response to Utah State Auditor Control Inadequacies:

A. Bank Transfers from County Accounts to Treasurer's Personal Accounts

Both the Treasurer and the Clerk/Auditor will maintain a list of all outside bank accounts receiving county electronic fund transfers. The Treasurer and/or Clerk/Auditor will bring any unauthorized account reflected on any bank statement to the attention of the commission. The commission must authorize all new accounts. The Clerk/Auditor will audit all bank reconciliations performed by the Treasurer's office within the statutory time requirement, usually monthly.

B. County Funds Used to Pay for Personal Cell Phone Services

A list of automatic bank debits for county related charges must go through the same approval process as check disbursements. This will help insure there is separation from the department requesting payment and the office issuing the check. The Clerk/Auditor for periodic review will keep a summary record of all electronic payments by the commission.

C. Inappropriate Transfers between County Accounts

The Treasurer will maintain a record of all departmental bank transfers, which will be reviewed and approved monthly by the Clerk/Auditor. Transfers due to cash shortfalls will not come from the property tax bank account. The Clerk/Auditor will use an authorized sweep account to help maximize interest earnings while covering all withdrawals. The Clerk/Auditor, with commission approval, will set the sweep account limits.

D. Deficit Bank Balances

Setting up a sweep account with reasonable limits should help eliminate unnecessary interest/penalty bank charges due to bank balance deficits. The Clerk/Auditor will be responsible to monitor agency bank balances and recommend appropriate funding to cover operations as needed. The county now requires that two individuals take deposits to the bank.

E. Missing Signatures on Checks

The county has instituted a new policy to have two authorized individuals sign checks. A verbal bank authorization to process a check will no longer be allowed. The Clerk/Auditor will review bank charges, voided transactions, and missing signatures on checks and, if significant, report them to the commission.

2 Other Items – Inadequate Separation of Duties

The Clerk/Auditor will insure that the daily receipts journal (listing report) coincides with daily bank deposit. The Clerk/Auditor will review the two reports monthly and initial them if completed properly. The county will implement better separation of duties within county departments to insure that different individuals are assigned to receive, record, and reconcile financial information.

2 Other Items

The commission will insure that all funds improperly transferred from the property tax bank account to other county departments, including the Justice and District Courts, will be returned. County agencies shorted because of the misappropriation of funds will be compensated from insurance proceeds.

Electronic online bank transfers from the treasurer's office will be limited to authorized bank accounts only, as approved by the commission. The Treasurer will maintain an adjustment file, including supporting journal entries, for all customer abatements or credits and for clerical/recording errors, which will be reviewed by the Clerk/Auditor, and if significant, reported to the commission.

County agencies will be required to keep a separate cash receipts logbook to record all cash transactions, which will be audited periodically. County departments receiving funds from the public will prepare a daily batch receipt report that will be submitted to the treasurer's office. An appointee from the Treasurer's office will sign for each batch, keep a record, and make the bank deposit according to county policy, which will help insure a separation of duties.

Summary:

A review by county commissioners of internal controls is currently in process (see attached list of review questions). This review will help them better understand their fiduciary responsibility to the citizens of Kane County. The commissioners are committed to institute proper internal controls to provide reasonable assurance that funds will be properly safeguarded. As provided by Utah Code 17-24-11, 12, 19, the treasurer and clerk will regularly reconcile all county receipts and disbursements. The commissioners and/or attorney will plan to periodically audit county records. The commission will review its process for selecting outside auditors in an effort to provide better scrutiny of county procedures related to internal controls, including changing auditors periodically.

The commission will also implement a tracking procedure for all general ledger journal entries to transfer or reconcile funds. This will ensure that reconciliation of accounts maintains integrity and that amounts can't simply be added back into the system to make up for lost funds.

The commission has implemented a corrective action plan to continue to refine the financial procedures associated with county funds to ensure improved tracking, efficiencies and auditing of all accounts. This process will include a 6-month follow up on corrective actions to ensure that the process changes are working effectively.

We have also replaced the Treasurer's position through the GOP replacement process and the new treasurer has started working half time last week and will be full time next week. Please let me know if there are any other items that I can answer regarding this audit. Again, thanks for your help regarding this matter.

Sincerely,



Dirk Clayson
Kane County Commission Chairman