



Office of the City Auditor

CONSENT CALENDAR
September 11, 2007

To: Honorable Mayor and
Members of the City Council

From: Ann-Marie Hogan, City Auditor

Subject: Audit: Controls and Accountability For Police Asset Forfeiture Deposit
Accounts Need Improvement

RECOMMENDATION

Request the City Manager to report back on or before March 31, 2008, and every three months thereafter, regarding the implementation status of the audit recommendations in the attached audit report until each recommendation is fully implemented.

SUMMARY

The Chief of Police and the Police Review Commission's Evidence Theft Subcommittee (PRC Subcommittee) requested an audit of Police asset forfeiture bank accounts. The Police Chief was concerned that statutory requirements regarding accounting may not be in place, and that there had been no recent audits in this area. The PRC Subcommittee expressed concerns about a former Police employee's access to the accounts. To address these requests, our performance audit was designed to determine if:

- The Police Department obtained the City Manager's and the City Auditor's authorization for withdrawals from the deposit accounts related to currency seizure and asset forfeiture.
- Unauthorized withdrawals, if any, were made for appropriate purposes, and Asset Forfeiture Fund expenditures adhered to City procurement authorization requirements.
- The Finance Department reconciled the quarterly and monthly deposit account statements received from the credit union.

The audit focused on transactions in the seized currency and asset forfeiture deposit accounts for the period July 1, 2003 through April 30, 2007. We reviewed deposits, withdrawals, and account reconciliations, examined relevant documentation, and evaluated applicable laws, policies, and procedures.

Though the audit found no indication that any transactions in asset forfeiture related deposit accounts were for inappropriate purposes, it identified asset accountability and control issues that require management attention. Specifically, we found that:

- Police held \$738 thousand in uninsured, non-collateralized credit union deposits. This amount included seized or surrendered cash that did not belong to the City (\$459 thousand at June 30, 2006).
- The Consolidated Annual Financial Statements (CAFR) understated the amount of uninsured, non-collateralized credit union deposits at June 30, 2006, by about \$211 thousand.
- One police officer had autonomy over withdrawals because the credit union did not enforce the dual signatures requirement.
- Police did not always obtain City Manager or City Auditor approval for withdrawals, as required by the City Charter.
- Finance did not reconcile the monthly or quarterly credit union statements timely.
- Police did not have written procedures to specify requirements for credit union transactions involving seized currency and asset forfeiture.

FISCAL IMPACTS OF RECOMMENDATION

The City may avoid potential liability for non-City funds held on deposit in uninsured, non-collateralized deposit accounts, as well as loss of Asset Forfeiture Fund deposits, should the depository institution fail.

RATIONALE FOR RECOMMENDATION

Implementation of our audit recommendations will decrease risk to the City and result in improved controls over seized currency and Asset Forfeiture Fund deposit accounts.

CONTACT PERSON

Ann-Marie Hogan, City Auditor, 981-6750

Attachment:

1. Controls and Accountability for Police Asset Forfeiture Deposit Accounts Need Improvement

City of Berkeley



Controls and Accountability For Police Asset Forfeiture Deposit Accounts Need Improvement

Prepared by:

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Presented to Council September 11, 2007

**Controls and Accountability for Police Asset
Forfeiture Deposit Accounts Need Improvement**

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I. OBJECTIVES OF AUDIT

The Chief of Police and the Police Review Commission's Evidence Theft Subcommittee (PRC Subcommittee) requested an audit of Police asset forfeiture bank accounts. The Police Chief was concerned that statutory requirements regarding accounting may not be in place, and that there had been no recent audits in this area. The PRC Subcommittee expressed concerns about a former Police employee's access to the accounts. In response to the request of the Police Chief and the PRC Subcommittee, the City Auditor's Office amended our fiscal year 2007 audit plan to include an audit of the Police asset forfeiture deposit accounts. The amended audit plan was presented to the City Council on June 12, 2007.

The objectives of our audit were to determine if:

- 1) The Police Department obtained the City Manager's and the City Auditor's authorization for all withdrawals from the deposit accounts related to currency seizure and asset forfeiture.
- 2) Unauthorized withdrawals, if any, were made for appropriate purposes, and Asset Forfeiture Fund expenditures adhered to City procurement authorization requirements.
- 3) The Finance Department timely and accurately reconciled the quarterly and monthly deposit account statements received from the credit union.

II. RESULTS OF AUDIT

We reconciled all transactions and examined supporting documentation for all withdrawals lacking signatures of either the City Manager or the City Auditor. We found no indication that any transaction in the three asset forfeiture related accounts during the period covered by our review was inappropriate. However, accountability and controls for these deposit accounts need improvement. The following concerns were identified:

- Police held \$738,000 in uninsured, non-collateralized credit union deposits. (Finding 1.1)
- The Comprehensive Annual Financial Report (CAFR) understated the amount at risk at June 30, 2006, by about \$211,000. (Finding 1.2)
- One police officer had autonomy over withdrawals because the credit union did not enforce the dual signatures requirement. (Finding 2)
- Police did not always obtain City Manager or City Auditor approval for withdrawals, as required by the City Charter. (Finding 3)
- Finance did not reconcile the monthly or quarterly credit union statements timely. (Finding 4)
- Police did not have written procedures to specify requirements for credit union transactions

involving seized currency and asset forfeiture. (Finding 5)

III. BACKGROUND

The Asset Forfeiture Fund was established to account for monies received by the City as a result of forfeiture of assets seized during narcotics related law enforcement. The Police Department maintains three credit union deposit accounts that relate to asset forfeiture. The Department uses one of the three accounts to impound cash seized in drug related enforcement (seized cash impound account). These funds are not available for City spending in that they are held for transfer to state or federal authorities, or return to the suspect. Such transfers are made at the direction of the District Attorney's Office, the US Marshal's Office, or the Court. A second account is used to hold funds distributed from completed federal forfeitures (federal account). The third account is used to hold funds distributed from completed state forfeitures (state account).

If seized funds are forfeited through due process, both the federal and state governments share the resultant revenue with the City. Shared revenue is deposited into separate credit union accounts for state and federal cases. The City has authority to spend shared revenue with restrictions. Disbursements from the shared revenue accounts are by cashier's checks. The Asset Forfeiture Fund consists of deposits in the two shared revenue accounts (federal and state), less Fund liabilities and encumbrances.

The Police Department also maintains a fourth deposit account at the same credit union that is not related to drug asset forfeiture. This account, known as the property room account, is used to impound cash surrendered by detainees on non-drug related charges and to store cash seized in other police investigations. According to a Finance representative, the City has been planning for three years to close all accounts at the credit union and transfer the funds to a commercial bank. Finance also drafted an administrative regulation, still to be finalized, which will authorize use of electronic fund transfers for many future City disbursements.

IV. FINDINGS AND RECOMMENDATIONS

Finding 1.1 Funds Held in Credit Union Are In Excess of Insured Amount

Footnotes to the Comprehensive Annual Financial Reports (CAFR) for fiscal years 2003 through 2006 disclosed that the City maintained funds in a depository institution in excess of the amount that was either insured or collateralized. Section 53652 of the California Government Code requires that depository institutions hold securities equal to at least 110 percent of a municipality's deposits.

The uninsured, uncollateralized deposits at June 30, 2006, consisted of funds in the three drug asset forfeiture related accounts (see Background above), plus the fourth property room account in the same credit union. The combined balances of the seized cash impound account and the property room account at June 30, 2006, was over \$559,000, which did not belong to the City¹. Had the credit union failed on that date, the City could have been responsible for replacement of over \$459,000 of lost funds (the account balances less \$100,000 of deposit insurance). In addition, the City would have lost \$279,000 held in the two shared revenue accounts (federal and state). Calculation of these amounts is shown in Table 1.

Table 1
Potential Loss to the City Had Credit Union
Failed on June 30, 2006

Account (Note a)	Amount That Would Require Replacement	Additional Amount That Would Be Lost
Acct 1 Seized Cash Impound Acct	\$386,695	
Acct 2 Federal Acct - Savings		\$76
Acct 2 Federal Acct - Money Market		10,893
Acct 3 State Acct - Savings		164
Acct 3 State Acct Money Market		<u>268,275</u>
Acct 4 Property Room Acct – Savings (b)	25	
Acct 4 Property Room Acct- Money Market (b)	<u>172,296</u>	
Subtotals	\$559,016	\$279,408
Less: Deposit Insurance	<u>100,000</u>	
Total Potential Loss	<u>\$459,016</u>	<u>\$279,408</u>

(a) Accounts 2, 3, and 4 each have savings and money market sub-accounts.

(b) The Property Room Account is the impound account for currency surrendered by detainees on non-drug related charges

Recommendation for Police and Finance

1.1 As soon as practical, but no later than September 30, 2007, move forward with plans to move the uninsured, uncollateralized deposits to a commercial bank.

City Manager’s Response

Police and Finance agree with the finding and recommendation. On July 17 and 19, the four credit union accounts were closed and the funds held therein were transferred to a commercial bank. Recommendation 1.1 has been fully implemented.

¹ These funds were held for transfer to the District Attorney or U.S. Marshall, or return to the detainees/owners.

**Finding 1.2 Comprehensive Annual Financial Report
Understated the Amount at Risk by About \$211,000**

The fiscal year 2006 CAFR reported an uninsured and uncollateralized balance of \$527,267 at June 30, 2006. This amount was premised on \$100,000 of deposit insurance for each of the four accounts. In fact, federal deposit insurance law limits deposit insurance to \$100,000 per depositor for each depository institution. Multiple accounts held by a depositor in one institution are aggregated for deposit insurance purposes². The actual amount at risk was over \$738,000, which consisted of the combined balance of the four accounts, less \$100,000 in deposit insurance. Table 2 shows how the incorrect amount at risk was calculated for the CAFR.

**Table 2
Uninsured and Non-Collateralized Deposits
At June 30, 2006, as Disclosed in CAFR**

	A	B	C
Account	Amount on Deposit	Deposit Insurance Used for CAFR	Amount at Risk Per CAFR (A-B)
Acct 1 Seized Cash Impound Account	\$386,695	\$100,000	\$286,695
Acct 2 Federal Account - Savings	76	100,000	0
Acct 2 Federal Account - Money Market	10,893	100,000	0
Acct 3 State Account - Savings	164	100,000	0
Acct 3 State Account - Money Market	268,275	100,000	168,275
Acct 4 Property Room Account - Savings	25	100,000	0
Acct 4 Property Room Acct - Money Market	<u>172,296</u>	100,000	<u>72,296</u>
Total	<u>\$838,424</u>		<u>\$527,266 (a)</u>

Notes:

- a. This amount is \$1 less than the amount stated above due to rounding.

Table 3 shows the correct calculation of the amount at risk, based on the deposit insurance limit of \$100,000 per depositor per depository institution, as well as the amount by which the CAFR understated the risk.

² 12USC1821 (a) (1) (B) & (C).

Table 3
Uninsured and Non-Collateralized Deposits
Calculation of Risk Understatement

Account	Amount on Deposit
Total Deposits (see Table 1)	\$838,424
Less: Deposit Insurance	<u>100,000</u>
Total amount at Risk	738,424
Amount at Risk Per CAFR	<u>527,267</u>
CAFR Understatement of Risk	<u><u>\$211,157</u></u>

Recommendation for Finance

1.2 Ensure that the fiscal year 2007 CAFR accurately states the amount of deposits at risk.

City Manager's Response

Finance agrees with the finding and recommendation. The recommendation will be implemented with publication of the fiscal year 2007 CAFR.

Finding 2 Dual Signatures Were Not Required For Withdrawals

The credit union did not require dual signatures for withdrawals from the three seized currency and shared revenue accounts. As a result, one police officer acting alone could withdraw funds from the three accounts, which increased the risk of misappropriation of funds. Segregation of duties, where no one person has control over all aspects of a transaction, is a basic tenet of internal control. Segregation of duties facilitates monitoring of transactions and helps prevent improper activities, including theft.

According to our primary Police contact, the credit union strictly enforces a dual signature requirement for the property room account (the fourth account in Table 1). Both the former and current Chiefs of Police sent letters to the credit union requesting that it require dual signatures for all withdrawals. However, neither Chief had signatory authority over the accounts, which might explain why the credit union did not honor their requests. Withdrawals from the credit union accounts were through cashier's check. As stated above, Finance plans to make many future City disbursements by electronic funds transfer. It should be noted that our review of withdrawals from the three accounts during the period July 1, 2003, through April 30, 2007, did not identify any withdrawals that appeared to have been made for inappropriate reasons.

Recommendation for Finance

2.1 As soon as practical, but no later than September 30, 2007, move forward with plans to make disbursements by electronic funds transfer.

Recommendation for Finance and Police

- 2.2 Until such time as funds in the three credit union accounts are transferred to a commercial bank and disbursement are by electronic funds transfer, update authorized signatories and arrange for the credit union to require dual signatures for all withdrawals.

City Manager's Response

Finance and Police agree with the findings and recommendations. Recommendation 2.1 will be implemented by September 30, 2007. A June 26, 2007, letter to the credit union signed by the City Manager, Chief of Police, and City Auditor notified the credit union that the City Manager and the City Auditor must sign withdrawals from any City account. On the same day, the Chief of Police issued a memorandum to applicable staff containing instructions that no withdrawals should be made from Police credit union accounts without approval signed by the City Manager and the City Auditor. Recommendation 2.2 has been fully implemented.

Finding 3 Required Approvals for Withdrawals Were Not Always Obtained

Police did not always obtain approval of the City Manager and the City Auditor for credit union withdrawals, as required by Section 61 of the City Charter, which states in part:

Payment by the City, excepting redemption of bonds and interest coupons, shall be made only upon vouchers certified by the head of the appropriate department and approved by the City Manager, and by means of warrants on the City Treasury, *or by checks drawn upon deposits maintained in a bank or banks, issued by the Auditor and countersigned by the City Manager (Italics ours).*

During the period of our review the City Manager and the City Auditor approved only 2 of 35 transfers from the seized cash impound account. Police staff did not obtain the City Manager's approval for one withdrawal from the state revenue sharing account, and they did not obtain the City Auditor's approval for three withdrawals from the same account. It appears that since Finance was reconciling the accounts and receiving the supporting documentation, Police may no longer have perceived a need for the additional level of control in obtaining the City Manager's or the City Auditor's approval.

Although we found no evidence that any withdrawal was for an inappropriate purpose, failure to obtain required approval, combined with the lack of dual signatures, increased the risk of withdrawals being made for inappropriate or illegal reasons.

Recommendations for Police

- 3.1 Notify the credit union that no Police Department employees are authorized signers on the accounts and both the City Auditor and the City Manager must sign all withdrawal slips.
- 3.2 Follow the requirements of Administrative Regulation 3.18 (Establishing and Closing Bank Accounts) by submitting all future requests for account changes to Accounting.
- 3.3 Until such time as disbursements are by electronic funds transfer, implement procedures to ensure that responsible Police personnel obtain approval from both the City Manager and the

City Auditor for all withdrawals from the credit union accounts.

City Manager's Response

Police agrees with the finding and recommendations (see City Manager's response to Recommendation 2.2). As of June 26, 2007, recommendations 3.1 and 3.3 have been fully implemented. Finance assisted in coordinating the closure of the credit union accounts and the transfer of funds to the commercial bank. Recommendation 3.2 has also been fully implemented.

Finding 4 Deposit Account Statements Were Not Reconciled Timely

The Accounting Division did not reconcile monthly account statements received from depository institutions in the first six months of the fiscal year timely. The Division's annual work plan for fiscal year 2007 calls for statements received in July through December to be reconciled between January 15 and March 31. Therefore, Finance began reconciling July 2006 monthly statements in January 2007. Accounting Division representatives stated that they were not able to reconcile during the first six months because of staffing vacancies, extended sick leave, and the need to prioritize CAFR preparation. Monthly reconciliation of bank account statements is normal business practice considered essential to maintain adequate control over deposits. The Accounting Division's objectives for reconciling bank statements, as stated in its annual work plan for fiscal year 2007, was:

To achieve *timely, up-to-date*, and accurate accounting of City-wide cash balances and provide internal check against embezzlement, misappropriation and other misdeeds related to cash and investments (*Italics ours*).

By not reconciling timely the City was at risk that a misappropriation of funds or a depository institution error would not be discovered timely, which increased the City's risk of loss. Also, Accounting did not achieve the Division's own timeliness objective.

Recommendation for Finance

- 4.1 Establish a formal written policy to require that bank and credit union statements be reconciled within 30 days of receipt. If the workload does not permit monthly reconciliations, the statements should be reconciled no later than quarterly.

City Manager's Response

Finance agrees with the finding and recommendation. The recommendation will be implemented by January 31, 2008.

Finding 5 Lack of Written Procedures for Credit Union Transactions

Police did not have written procedures for transactions in the currency seizure impound and revenue sharing credit union accounts. Written procedures formally convey management’s intent as to uniform application of policy. They are an important management tool to help establish and enforce management’s work expectations, standards, and consistency of performance. The Department had written procedures for asset forfeiture and handling of property and evidence,³ but overlooked including coverage for the drug related deposit accounts. The lack of written procedures resulted in transactions in the three drug related accounts that violated City policies and were inconsistent with management’s intent.

Subsequent to the start of our audit Police developed informal written procedures for the purpose of informing the City Auditor’s staff of actual practices. These informal procedures did not cover withdrawals from the federal forfeiture account. Furthermore, they did not require dual signatures for withdrawals and only required the City Manager’s and the City Auditor’s approval if requested by the Chief.

Recommendation for Police

- 5.1 Develop, finalize, and distribute formal written procedures for all deposits and withdrawals of all Police Department funds.

City Manager’s Response

Police agrees with the finding and recommendation. New written procedures were approved by the Chief of Police and distributed to applicable personnel on August 27, 2007. Recommendation 5.1 has been fully implemented.

VI. CONCLUSION

We did not find that any withdrawals from the seized currency and asset forfeiture deposit accounts were for inappropriate purposes. However, there were accountability and control issues that require management attention. There was increased risk of loss of funds due to maintaining the Police Asset Forfeiture deposits in non-collateralized accounts in excess of insured amounts.

We also found that there was a lack of segregation of duties, a failure to follow City procedures, and untimely monitoring of the assets. Finally, there was a lack of written procedures for credit union transactions. If written procedures had been in place, several of the problems found by our audit might have been avoided. Implementation of our recommendations will improve accountability for the Asset Forfeiture Fund and controls over Fund transactions.

We wish to thank the Chief of Police, the Director of Finance, and their staff for their time,

³ General Orders A-61, entitled “Asset Forfeiture,” and P-65, entitled “Procedures for Care and Handling of Property and Evidence.” Note that these procedures required dual signatures for withdrawals from the account used to impound cash surrendered by detainees on non-drug related charges.

cooperation, and responsiveness extended to us during the audit process.

Appendix A: Audit Scope and Methodology

The audit was limited to reviewing the three deposit accounts related to asset forfeiture. However, since the property room account was also maintained at the credit union there is mention of this fourth account in Findings 1.1, 1.2, and 2. This performance audit covered the period July 1, 2003, through April 30, 2007⁴.

The information used to complete this audit was obtained primarily from:

- Reviewing supporting documentation for unauthorized withdrawals to ensure that they were for appropriate purposes.
- Reviewing Asset Forfeiture Fund expenditures to determine whether the expenditures complied with City approval requirements.
- Reviewing current Police procedures for transactions in the accounts, and current Finance procedures for reconciling the deposit account statements received from the credit union.
- Discussions with staff in the Finance Department and the Police Department.

Our audit was conducted from May 10 through June 26, 2007. Audit work was performed in accordance with Generally Accepted Government Auditing Standards and was limited to those areas specified above.

⁴ The City receives quarterly statements from a seized currency impound account; therefore, we reviewed activity in that account for the period July 1 2003, through March 31, 2007.

Appendix B: Status of Recommendations

Recommendations, Implementation Status, and Dates		
<u>No.</u>	<u>Recommendation</u>	<u>Status/Due Date</u>
1.1	Move forward with plans to move the uninsured, uncollateralized deposits to a commercial bank.	Implemented 7/19/07
1.2	Ensure that the fiscal year 2007 CAFR accurately states the amount of deposits at risk.	To Be Implemented With Publication of CAFR
2.1	Move forward with plans to make disbursements by electronic funds transfer.	To Be Implemented 9/30/07
2.2	Update authorized signatories (on credit card accounts) and arrange for the credit union to require dual signatures for all withdrawals.	Implemented 6/26/07
3.1	Notify the credit union that no Police Department employees are authorized signers on the accounts and both the City Auditor and the City Manager must sign all withdrawal slips.	Implemented 6/26/07
3.2	Follow the requirements of Administrative Regulation 3.18 (Establishing and Closing Bank Accounts) by submitting all future requests for account changes to Accounting.	Implemented 7/19/07
3.3	Implement procedures to ensure that responsible Police personnel obtain approval from both the City Manager and the City Auditor for all withdrawals from the credit union accounts.	Implemented 6/26/07
4.1	Establish a formal written policy to require that bank and credit union statements be reconciled within 30 days of receipt. If the workload does not permit monthly reconciliations, the statements should be reconciled no later than quarterly.	To Be Implemented January 31, 2008
5.1	Develop, finalize, and distribute formal written procedures for all deposits and withdrawals of all Police Department funds.	Implemented 8/27/07

