



**Auditor of State
Betty Montgomery**

TABLE OF CONTENTS

TITLE	PAGE
Schedule of Relevant Personnel	1
Independent Accountants' Report	3
Supplement to the Special Audit Report	
Background Information	5
Issue No. 1 Utility Revenue Collections and Deposits	6
Issue No. 2 Utility Account Security Deposits	9
Issue No. 3 Collection and Deposit of Other Revenues	11

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**CITY OF FAIRFIELD
BUTLER COUNTY**

SCHEDULE OF RELEVANT PERSONNEL
As of June 30, 2005

City Council Members

Steven Miller, Fourth Ward, Acting Mayor

Mike Snyder, First Ward

Marty Judd, Second Ward

Mitch Rhodus, Third Ward

Howard Dirksen, At-Large

Jill Kinder, At-Large

Mark Scharringhausen, At-Large

Relevant Personnel

Arthur Pizzano, City Manager

James Hanson, Finance Director

Mary Lawson, Utility Division Manager

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Auditor of State Betty Montgomery

INDEPENDENT ACCOUNTANTS' REPORT

Mr. Arthur Pizzano, City Manager
City of Fairfield
5350 Pleasant Avenue
Fairfield, Ohio 45014

We have conducted a special audit of the City of Fairfield's Utility Division by performing the procedures described in the attached Supplement to the Special Audit Report for the period January 1, 2000, through June 30, 2005 ("the Period"). These procedures were performed solely to review the collection of revenue received by the Utility Division and to determine if the funds were deposited into the City's bank accounts.

Although our audit period extended back to January 2000, we were unable to complete an analysis of the records for the years 2000 and 2001 under Issue No. 1, and for the year 2000 under Issue No. 2. Documents for 2000 were destroyed by the City in accordance with its records retention policy. Various other documents could not be located by the City, though the documents had not yet been scheduled for destruction. We issued a noncompliance citation for failure to maintain the records that could not be located.

This engagement was conducted in accordance with Quality Standards for Inspections established by the President's Council on Integrity and Efficiency (March 1993). The procedures and associated findings are detailed in the attached Supplement to the Special Audit Report. A summary of our procedures and significant results is as follows:

1. We reviewed documentation supporting recorded utility receipts to determine whether payments received by the City were deposited intact into an authorized City bank account and accurately posted to the City's accounting records.

Significant Results: We determined that utility receipts of \$334,607 were collected between January 1, 2002 and June 30, 2005, but were unaccounted for or not deposited. We noted that certain records, including account adjustment forms and payment stubs were created or altered to hide the undeposited receipts. We also noted instances where utility payments and other City departments' checks were substituted in utility deposits. In April 2006, former Utility Division Supervisor Mary Lawson provided a written statement to the Fairfield Police Department indicating that she took cash from utility receipts and posted adjustments to customer accounts to cover the missing funds. On May 18, 2006, Ms. Lawson pled guilty to one count of theft in office and one count of tampering with records, both third-degree felonies.

We issued a finding for recovery against Ms. Lawson for receipts collected but unaccounted for in the amount of \$334,607.

We issued two noncompliance citations for failure to make timely deposits and maintain records. We also issued three management comments related to account adjustments, payment processing, and segregation of duties. The City should consider these matters to reduce the risk of fraud and theft, and to ensure that transactions are completely and accurately recorded.

2. We reviewed documentation supporting the City's refunding of utility customer security deposits to determine whether the payments were returned to customers or used in a substitution scheme to divert cash from utility collections.

Significant Results: We identified 22 security deposit refund checks totaling \$907 that were deposited by the City and not applied to customers' outstanding balances indicating the checks were substituted in other deposits for cash that was misappropriated.

We issued a finding for recovery against Mary Lawson for receipts collected but unaccounted for in the amount of \$907.

We issued one management comment related to the implementation of controls over the issuance of security deposit refunds.

3. We reviewed documentation supporting recorded receipts of other revenue sources collected by the Utility Division to determine whether payments received by the City were deposited intact into an authorized City bank account and accurately posted to the City's accounting records.

Significant Results: No discrepancies were determined when we compared the total revenues collected per departmental monthly reports to the amounts deposited. However, we noted that revenue was not deposited daily as the funds were received, often occurring only once or twice a month. Our review of Building Department receipts noted utility payments and other departments' checks in the Building Department deposits. Untimely deposits and the presence of other departments' checks in the Building Department deposits are indications of a substitution scheme by which checks were substituted for cash that was misappropriated. We believe this to be an extension of the adjustment scheme tested in Issue No. 1.

We issued one management comment related to the implementation of controls over the collection of other revenue by the Utility Division.

On June 8, 2006, we held an exit conference with the following individuals:

Arthur Pizzano, City Manager
James Hanson, Finance Director
Dennis Stuckey, Assistant City Manager
Mary Hopton, Tax Administrator / Deputy Finance Director
Michael Dickey, Chief of Police

The attendees were informed that they had until June 15, 2006, to respond to this Special Audit Report. A response was received June 12, 2006 and changes were made to this report as we deemed necessary. In its response, the City asserted that it has made or is in the process of making changes to its policies and procedures to improve internal control in the areas noted in this report.



Betty Montgomery
Auditor of State

March 17, 2006

Supplement to the Special Audit Report

Background Information

The City of Fairfield operates under the council-manager form of government that is composed of a directly elected mayor, seven elected council members and an appointed city manager. Individual City departments are managed by a department director who oversees the department operations and staff. The City's Finance Department is divided into four divisions:

- Accounting & Purchasing Division
- Income Tax Division
- Information Technology Division
- Utility Billing/Collection Division ("Utility Division")

The City provides water and sewer utility services to residents and commercial users. The Utility Division is responsible for processing utility bills and collecting payments from customers. In the past, the Utility Division has also collected and deposited revenue on behalf of other City departments including the Building, Engineering and Fire Departments. During the audit period, Mary Lawson was the Utility Division Supervisor responsible for three full time employees who processed the utility bills and payments and made adjustments to customer accounts. Ms. Lawson also primarily opened all of the City's mail.

In July 2005, Clark, Schaefer & Hackett Co., the independent public accounting firm ("IPA") conducting the financial audit for the City of Fairfield, determined that certain utility collections did not match postings to customer accounts and that cash receipts may not have been deposited in the City's bank account. The IPA firm communicated this information to the City Finance Director and Chief of Police, who opened a criminal investigation into the matter. After an initial review, the City informed Ms. Lawson that she would be put on administrative leave for violating the City's cash handling policies. Ms. Lawson resigned in early July 2005, prior to the administrative action. Shortly after Ms. Lawson's resignation, the IPA notified the Auditor of State of the irregularities.

The Auditor of State's Special Audit Task Force considered the matter and on July 22, 2005, the Auditor of State initiated a Special Audit of the City's Utility Division for revenue collections during the Period. In April 2006, Ms. Lawson provided a written statement to the Fairfield Police Department indicating that she took more than \$330,000 in cash from utility receipts. On May 18, 2006, Ms. Lawson pled guilty to one count of theft in office and one count of tampering with records, both third-degree felonies.

Supplement to the Special Audit Report

Issue No. 1 – Utility Revenue Collections and Deposits

We reviewed available documentation supporting recorded utility receipts to determine whether payments received by the City were deposited intact into an authorized City bank account and accurately posted to the City's accounting records.

Procedures

1. We reviewed documentation supporting adjustments made to customer accounts during the Period to determine their validity.
2. We reviewed deposit documentation to determine if payments were actually received from selected customers whose accounts were adjusted.
3. We compared the amount that should have been deposited to the amount actually deposited and noted any variances.

Results

During the Period, utility charges were calculated by computer, posted to customer accounts and billed monthly. Utility customers were given the option of paying their bills by mail, in person at the Utility Division located in the City's Municipal Building or by logging on to the City's website. When paying by mail or in person, customers were required to return a portion of their bill (the payment stub) with their payment. The payment stubs were used by the Utility Division staff to post the amount paid to the customer accounts.

Adjustments were made to utility accounts for various reasons (e.g. credits for leaks, sewer credits for cooling towers, removal of late penalties, closing final accounts, etc.) and were usually generated by contact from the customer. Each matter was to be investigated by a Utility Division employee who was responsible for completing a Utilities Adjustment Form stating the reason for the adjustment. The form was to be signed by the employee processing the adjustment and a supervisor giving approval. Any supporting documentation for the adjustment was to be attached to the form.

Upon completion of the adjustment form, the adjustment was posted to the customer's account. At the end of each month, a report was generated by Utility Division Supervisor Mary Lawson listing all adjustments posted to the system. The report was submitted to the Finance Director for review and approval. There were no written procedures for processing adjustments to customer accounts.

1. During the Period, 6,058 credit adjustments were made to customer accounts. From this total, we initially selected adjustments for review based on the following criteria: a) all credit adjustments greater than \$200; and b) all credit adjustments of \$5 increments between \$25 and \$200. As we examined documentation throughout the course of the audit, we also selected and reviewed additional adjustments that appeared questionable.

Although our audit period extended back to January 2000, we were unable to complete an analysis of the records for the years 2000 and 2001. Documents for 2000 were destroyed by the City in accordance with its records retention policy. Deposit slips and deposit encoding tapes for 2001 could not be located by the City, though the documents had not yet been scheduled for destruction. The City also could not locate 2002 deposit documentation for the Building and Fire Departments and the July 2003 Utilities Adjustment Forms.

Supplement to the Special Audit Report

In total, 912 adjustments for \$740,147 were selected for review covering the period January 2002 through June 2005. For the selected adjustments, we obtained and reviewed the Utilities Adjustment Forms. Our review of the forms found that 813 did not have supporting documentation attached and none of the forms had been individually initialed by a supervisor as approved. Additionally, Ms. Lawson prepared and/or posted 770 of the 912 adjustments (84 percent).

We also obtained and reviewed the corresponding Customer History Reports for each of the accounts adjusted. The Customer History Reports indicate the amount billed each month, the amount posted as paid and any adjustments made to the account. We used the Customer History Reports to determine the amounts purportedly paid, and then located the corresponding payment stubs. We found that many of the payment stubs had been altered by having the "amount paid" crossed out or covered by white-out. A different paid amount, usually the difference between the amount billed and the adjustment, was handwritten on the stub. In some instances, a new stub was created with the account number and paid amount written-in by hand.

2. Using the Customer History Reports, we traced the billed amounts to deposit slips and deposit encoding tapes to determine the actual amounts paid. We obtained the deposited checks from the City's bank for verification. The checks confirmed that the amount paid was the billed amount and not the amount written on the payment stubs. Additionally, we noted instances when checks had been held for several days before being deposited. Also, we noted checks for utility payments that were substituted in deposits for the Building or Fire Departments and sidewalk assessments.
3. We noted 590 fraudulent adjustments posted between January 2002 and June 2005 totaling \$334,607. Our review of the deposits confirmed that the amounts posted to customer accounts in these instances were not the amounts paid. In April 2006, Ms. Lawson provided a written statement to the Fairfield Police Department indicating that she took cash from utility receipts and posted adjustments to customer accounts to cover the missing funds. In May 2006, Ms. Lawson pled guilty to one count of theft in office and one count of tampering with records, both third-degree felonies.

Finding for Recovery

Former Utility Supervisor Mary Lawson was responsible for the collection and deposit of utility receipts for the City. Ms. Lawson was the primary person within the City's offices who opened the mail and had initial access to utility payments and payment stubs. Ms. Lawson processed these payments by designating the amounts to be posted to customer accounts and the amounts to be deposited daily. In a written statement obtained by the City's police department, Ms. Lawson admitted to posting fraudulent credits to user accounts. In May 2006, Ms. Lawson pled guilty to one count of theft in office and one count of tampering with records, both third-degree felonies.

In accordance to the foregoing facts and pursuant to Ohio Revised Code Section 117.28, a finding for recovery is hereby issued against Mary Lawson, in favor of the City for public monies collected but unaccounted for in the amount of \$334,607.

Noncompliance Citations

Record Retention

Ohio Revised Code Section 149.351 (A) states in part, "(a)ll records are the property of the public office concerned and shall not be removed, destroyed, mutilated, transferred, or otherwise damaged or disposed of, in whole or in part, except as provided by law or under the rules adopted by the records commissions provided for under sections 149.38 to 149.42 of the Revised Code ..." The City did not maintain the following documentation: 2001 deposit slips with encoding tapes, 2002 building and fire deposit slips with encoding tapes, July 2003 utility adjustment sheets, and December 2003 U/B Cycle Receipts Journal.

Failure to maintain accounting records could result in inaccurate financial reporting of activities by the City. Lack of supporting documentation increases the risk that receipts may be diverted for improper uses. We recommend that all records be maintained in accordance with the City's records retention policy.

Supplement to the Special Audit Report

Timely Deposit of Public Funds

Ohio Revised Code Section 9.38 states in part, "...a public official other than a state officer, employee, or agent shall deposit all public moneys received by that person with the treasurer of the public office or properly designated depository on the business day next following the day of receipt, if the total amount of such moneys received exceeds one thousand dollars. If the total amount of the public moneys so received does not exceed one thousand dollars, the person shall deposit the moneys on the business day next following the day of receipt, unless the public office of which that person is a public official adopts a policy permitting a different time period, not to exceed three business days next following the day of receipt, for making such deposits, and the person is able to safeguard the moneys until such time as the moneys are deposited."

We noted 323 checks that were deposited more than three days after the date that the payment was received. Additionally, in Issue No. 3 we found that deposits from other revenue sources were made only once or twice a month.

Infrequent bank deposits allow cash to accumulate. Receipts should be deposited into the bank daily. After hours receipts should be deposited into a bank night depository or collected from the remote lockboxes by the designated individual and deposited with the bank on the next business day.

Management Comments

Account Adjustments

The City did not have written procedures for processing adjustments to customer accounts. Utilities Adjustment Forms did not have supporting documentation attached and were not individually reviewed or approved by a supervisor.

We recommend that the City develop specific, written procedures for making adjustments to customer utility accounts. Proper documentation supporting the reason for the adjustment should be attached to all Utilities Adjustment Forms. When possible, customers should be required to submit signed, written requests for adjustments to their accounts. Lack of supporting documentation increases the risk that improper adjustments may be used to divert receipts. All individual adjustment sheets should be reviewed and approved by a supervisor.

Payment Processing

The City did not reconcile the payment stub batches to the receipts deposited. Checks were substituted in deposits and the corresponding payment stubs were not always in the correct batches. Payment stubs were altered by having the "amount paid" crossed out or covered by white-out. In some instances, new stubs were created with the account number and paid amount written-in by hand.

We recommend that the City implement procedures to reconcile the payment stub batches to the receipts deposited. Additionally, we recommend that the City implement procedures to properly identify the form of all utility payments received (i.e. cash, check or credit card). All reconciliations should be reviewed for completeness and accuracy by a supervisor.

Segregation of Duties

Mary Lawson was the primary person who opened all of the City's mail. Ms. Lawson processed the utility payments, designated the amounts to be posted to customer accounts and prepared the daily deposits. She processed and posted adjustments and prepared the monthly adjustment reports. The inadequate segregation of duties weakened the controls over cash collections.

We recommend that the City implement procedures to adequately segregate duties in the Utility Division. Separate individuals should open the mail, make the deposits, and post payments/adjustments to the utility billing system. Segregation of duties is a key element of any effective internal control system. One employee involved in all functions of the receipt process increases the likelihood that errors or irregularities may occur and not be detected in a timely manner by management.

Supplement to the Special Audit Report

Issue No. 2 – Utility Account Security Deposits

We reviewed documentation supporting the City's refunding of utility customer security deposits to determine whether the payments were returned to customers or used in a substitution scheme to divert cash from utility collections.

Procedures

1. We reviewed documentation supporting the return of customer security deposits issued during the Period.
2. We reviewed deposit documentation to determine if the customer refunds were substituted in the City's deposits.

Results

1. During the Period¹, utility customers who rented or leased housing within the City were required to pay a \$75 security deposit when they opened a utility account. This amount was held by the City until the customer's account was closed. After a final reading of the customer's water meter, a refund of the security deposit, less any outstanding amount due, was requested by the Utility Division. The Accounting Department prepared a refund check for the amount due and turned it over to the Utility Division to mail back to the customer.

The City issued 1,819 security deposit refund checks to customers between January 2001 and June 2005. We inspected the endorsements on the backs of the canceled checks to identify any that had been endorsed and deposited by the City rather than the customer. We identified 28 checks that were not endorsed by the customer, but were marked with the Utility Division's encoding stamp for deposit.

On 13 of the 28 checks, the encoding date stamp was within 1 day of the date of the check, indicating that the checks were not mailed.

2. We reviewed the Customer History Reports for all but 4 of the 28 accounts. The City was unable to locate these 4 accounts on their computer system. Of the 24 examined, two refund checks were applied against the customers' outstanding account balances. The remaining 22 checks totaling \$907 were found to have been deposited by the City, but not applied to the customer's outstanding balance indicating that the checks had been substituted in the deposits for cash. Four of these checks were substituted in Building Department deposits.

Finding for Recovery

Former Utility Supervisor Mary Lawson was responsible for the collection and deposit of utility receipts for the City. Ms. Lawson was the primary person within the City's offices who opened the mail and had access to the customer refund checks received from the Accounting Department and/or returned through the mail without forwarding addresses. Ms. Lawson processed receipts by designating the amounts to be posted to customer accounts and the amounts to be deposited daily. In a written statement obtained by the Fairfield Police Department, Ms. Lawson admitted to taking money from the City.

In accordance to the foregoing facts and pursuant to Ohio Revised Code Section 117.28, a finding for recovery is hereby issued against Mary Lawson, in favor of the City for public monies collected but unaccounted for in the amount of \$907.

¹ Although our audit period extended back to January 2000, we were unable to complete an analysis of the records for the year 2000 because the documents were destroyed by the City in accordance with its records retention policy.

Supplement to the Special Audit Report

Management Comments

Controls over Security Deposit Refunds

Security deposit refund checks were prepared by the Accounting Department and turned over to the Utility Division to be mailed back to the customers. Refund checks were later found to have been deposited by the City and not applied to customer accounts.

We recommend that the Accounting Department mail the deposit refund checks rather than the Utility Division. Prior to mailing, the refund checks should be reconciled to the list of refunds requested by the Utility Division and be reviewed for completeness and accuracy by a supervisor. Returned checks with no forwarding address should be voided and the amount maintained as unclaimed funds. Any refund applied to a customer's ending balance should be evidenced by a written request from the customer and have supervisory approval.

Supplement to the Special Audit Report

Issue No. 3 – Collection and Deposit of Other Revenues

We reviewed documentation supporting recorded receipts of other revenue sources collected by the Utility Division to determine whether payments received by the City were deposited intact into an authorized City bank account and accurately posted to the City's accounting records.

Procedures

1. We determined the amount of other revenue posted by the Utility Division as receipts and deposited into the City's account during the Period.
2. We reviewed documentation from the applicable City departments and compared the amount that should have been deposited to the amount actually deposited and noted any variances.

Results

1. The Utility Division collected and deposited revenues on behalf of the following other City departments during the Period:

Building Department

- Building permits and licenses
- Water taps, meters and expansion fees
- Sewer permits and expansion fees

Fire Department

- Fire inspection permits

Engineering

- Water/sewer licenses
- Damages/vandalism
- Street/water/sewer inspections

Sidewalk Assessments

Other Revenues Collected by Utility Division

	<u>Building¹</u>	<u>Fire</u>	<u>Engineering²</u>	<u>Sidewalk</u>	<u>Total</u>
2000	\$811,177	\$4,918	\$23,046	\$38,354	\$877,495
2001	\$755,140	\$2,429	\$11,875	\$42,973	\$812,417
2002	\$889,370	\$2,510	-	\$96,985	\$988,866
2003	\$891,503	\$3,050	-	\$77,368	\$971,921
2004	\$215,394	\$5,400	-	\$24,690	\$245,484
2005	-	\$5,325	-	\$14,518	\$19,843
	<u>\$3,562,584</u>	<u>\$23,632</u>	<u>\$34,921</u>	<u>\$294,888</u>	<u>\$3,916,026</u>

¹ The Building Department began collecting its own revenues in April 2004.

² The Engineering revenues were included on the monthly utility revenue reports starting in October 2001.

Supplement to the Special Audit Report

2. In her capacity as utility supervisor, Mary Lawson prepared monthly reports for the other revenue received by the Utility Division. The monthly reports were then submitted to the Finance Director and applicable departments. We traced all revenue identified on the monthly reports to the available supporting documentation and validated deposit slips. No discrepancies were noted. The total revenues collected per the monthly reports matched the amount deposited. The Building Department was the only division to reconcile on a monthly basis to the revenue reports received from the Utility Division.

Mary Lawson was also responsible for making the deposits of the revenue collected on behalf of the other departments. We found that Ms. Lawson made deposits only once or twice a month, rather than daily. Our review of the Building Department deposit items found checks from several sources for purposes other than for payments to the Building Department. Included in the Building Department deposits were checks for utility payments, sidewalk assessments, and a fire inspection.

The presence of non-Building Department checks in the Building Department's deposits is an indication of a substitution scheme by which a perpetrator removes cash collected and substitutes the check. As a result, the recorded receipts equaled the deposited amounts. We believe the substitution of other revenue sources into the Building Department's deposits was an extension of Ms. Lawson's adjustment scheme to cover her cash misappropriations as tested and reported on in Issue No. 1.

We also noted that City employees were cashing checks in the 2002 Building Department deposits, including personal checks, payroll and reimbursement checks, and third party checks made payable to employees and their relatives. In 2004, the City implemented a cash handling policy that established procedures for the handling, receiving, transporting and depositing of cash, including currency, checks, money orders and charge card transactions, collected by City personnel. The policy strictly prohibits the cashing of any checks by employees in City collections.

Management Comments

Controls over Collection of Other Revenue

Fire Department

After fire inspections were conducted, invoices for inspection permits were sent out by the Fire Department and the revenues were collected by the Utility Division. As payments were received, the Utility Division highlighted the names on a list prepared by the Fire Department. The Utility Division maintained copies of the checks received or paid invoices as evidence of payment. The Fire Department issued the permits based on monthly revenue reports received from the Utility Division. The permits were not pre-numbered and the Fire Department did not perform reconciliations of the monthly revenue reports to the invoices sent out.

We recommend that the City implement control procedures to issue pre-numbered invoices and permits for fire inspections. The Fire Department should reconcile the invoices and permits issued to the monthly revenue reports received from the Utility Division. These reconciliations should be reviewed for accuracy and completeness by someone in a supervisory capacity and filed with the Finance Department.

Engineering Fees

The Utility Division generated invoices for engineering fees based on memorandums prepared by the Construction Services, Public Utilities and Street Departments. For example, the Construction Services Manager would send a memorandum to the Utility Division requesting that an invoice be prepared and sent out for an inspection. The request would be supported by an inspection report. The Construction Services Department had no further involvement in the revenue collection after the memorandum was sent and was not made aware of when the monies were collected. None of the departments reconciled their memorandums to invoices or monthly revenue reports.

Supplement to the Special Audit Report

We recommend that a duplicate copy of each of the memorandums sent from the various departments to the Utility Division be forwarded to the Finance Department. Additionally, copies of the invoices created should be sent back to both the requesting department and the Finance Department. The individual departments should also obtain monthly revenue reports from the Utility Division. We recommend that the respective departments reconcile their memorandums to the invoices and monthly revenue reports. These reconciliations should be reviewed for accuracy and completeness by someone in a supervisory capacity and filed with the Finance Department.

Sidewalk Assessments

Each year a master list of all sidewalk assessments was generated by the Finance Department and assessment notices were sent to property owners. As payments were received by the Utility Division, Mary Lawson (or an applicable clerk) would mark off the master list. Other than these marks, there was no way to determine the completeness of revenues received. No reconciliation was performed between the sidewalk assessments issued and the subsequent revenues received. Sidewalk assessments were highly variable from year to year, and depended on the City's annual sidewalk improvement programs. Furthermore, assessments were not always collected in the same year as billed as some payments were late and the City offers a 5-year installment payment plan.

We recommend that the City perform reconciliations between the sidewalk assessments issued and the subsequent revenues received. These reconciliations should be reviewed for accuracy and completeness by someone in a supervisory capacity and filed with the Finance Department.



**Auditor of State
Betty Montgomery**

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**CITY OF FAIRFIELD UTILITY DIVISION
BUTLER COUNTY**

CLERK'S CERTIFICATION

This is a true and correct copy of the report which is required to be filed in the Office of the Auditor of State pursuant to Section 117.26, Revised Code, and which is filed in Columbus, Ohio.

Susan Babbitt

CLERK OF THE BUREAU

**CERTIFIED
JUNE 27, 2006**