




Chesterfield County, Virginia Internal Audit

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GREG L. AKERS
Director

DATE: December 28, 2017

TO: Joseph P. Casey, Ph.D. 

FROM: Greg L. Akers
Director of Internal Audit

SUBJECT: Police Benefit Fund Audit

The Office of Internal Audit completed an audit of the Police Benefit Fund, and the final report is attached.

We would like to thank Dan Kelly and his staff for their cooperation and assistance during this audit.

Attachment

Copy: Daniel W. Kelly, Interim Chief of Police
Theresa Simonson, Chief of Administrative Services
James F. Lane, Ed.D., School Superintendent
Audit and Finance Committee



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Police Benefit Fund

December 28, 2017

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Highlights

Internal Audit Report to the Board of Supervisors/School Board



Police Benefit Fund

What We Found

Background

The Police Benefit Fund (Fund) is a legally separate entity whose monies are not County funds. It is managed by a committee of Police Department employees and was established in 1985 to support and recognize employees during times such as illness, death, or birth. During our audit scope of calendar years (CY) 2013 – 2015, annual receipts ranged from \$670 to \$1,683 and disbursements ranged from \$1,338 to \$1,850. As of December 31, 2015, the Fund's assets totaled \$10,768.

Financial Records and Statements

Internal Audit reviewed and tested the CY 2013 – 2015 financial statements and supporting schedules, checkbook register, receipt and disbursement transactions, bank statements and monthly bank reconciliations. Their current accounting process is very manual and labor intensive. An automated accounting application could simplify reconciliation and financial reporting processes.

Tax Reporting Status and Audit Requirements

The Operations Manual states: "This Benefit Fund is a non-profit organization that is registered with the Federal Government but does not file or pay taxes." However, they have not applied for an IRS ruling or determination letter recognizing their tax exemption, and there is no annual procedure to evaluate IRS filing requirements. As a non-profit organization, we recommend doing both.

The Operations Manual also specifies biennial audit by Internal Audit, which has been included on the County's audit plans as a courtesy to Police. Since Internal Audit's focus is on government operations, we recommend amending the Operations Manual to maintain an independent audit process, but remove reference to performance by Internal Audit.

Drink and Snack Machine Commissions

There are no formal procedures to evaluate and select new vendors. In 2014, the Police Benefit Fund Committee changed drink and snack machine vending companies. During contract negotiations, they evaluated commission percentage, but did not distinguish if it would still be applied to a net sales basis. They anticipated a 21% decrease in commission (from 19% to 15%), but the basis change from net sales to net profit resulted in a 61% decrease (from 19% net sales to 15% net profit). Consequently, declining commission revenues necessitated a \$500 transfer from savings in 2015 to cover expenses.

Additionally, we noted potential concerns/errors with 18 of 22 (92%) of commission statements reviewed during the audit. While underpayments were resolved with the current vendor, we recommend establishing an ongoing procedure to monitor statements for completeness and accuracy.

Management concurred with 12 of 13 recommendations to be implemented from 12/1/2017 to 3/31/2018.

We appreciate the cooperation received from management and staff while conducting this audit.

Why We Did This Review

Internal Audit conducted this review as part of our FY18 audit plan (project carried over from prior plans) approved by the County Administrator, School Superintendent, and the Audit and Finance Committee.

The audit focused on reviewing Police Benefit Fund records for accuracy and compliance. Our objectives were to:

- Test receipts and disbursements for supporting documentation, compliance with policies and procedures, and accurate reporting.
- Review bank reconciliations for accuracy and timely completion.
- Report results to management.

What We Recommend:

Internal control and operational improvements including:

- Consider an automated accounting application.
- Annually verify IRS filing requirements and apply for an IRS ruling or determination letter to clarify tax-exempt category and status.
- Amend the Operations Manual to maintain an independent audit process, but remove reference to performance by Internal Audit.
- Develop review procedures for selecting new vendors and verifying accuracy of vendor commission statements.



INTRODUCTION

BACKGROUND

The Police Benefit Fund audit was a regularly scheduled audit on the FY18 audit plan (project carried over from prior plans) approved by the County Administrator, School Superintendent, and the Audit and Finance Committee. The Police Benefit Fund (Fund) is a legally separate entity whose monies are not County funds. It is managed by a committee consisting of a sworn representative from Uniform and Non-Uniform Departments, a civilian from Police Administration and a member who will serve as the Chair of the Committee from the Police Chief's Executive Staff. The Fund was established in 1985 to support and recognize employees during times such as illness, death, or birth.

During calendar years 2013 – 2015 annual receipts ranged from \$670 to \$1,683 and were primarily from commissions on vending machines at various Police facilities. Annual disbursements ranged from \$1,338 to \$1,850. As of December 31, 2015, the Fund's assets were \$10,768 in two bank accounts (savings and checking).

OBJECTIVES

Objectives of the audit were to:

- Test receipts and disbursements for supporting documentation, compliance with policies and procedures, and accurate reporting.
- Review bank reconciliations for accuracy and timely completion.
- Report results to management.

SCOPE

Our audit work covered all transactions from January 1, 2013 to December 31, 2015.

We considered the following policies and procedures during our audit:

Police Benefit Fund Operations Manual

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Lora Holland, Senior Auditor performed the audit work. Chesterfield County Internal Audit is a department within the organization of Chesterfield County/Schools.

METHODOLOGY

Detailed information regarding the methodology can be found in the individual findings listed in the report. Our methodology included:

- Performing an analytical review of receipts and disbursements.
- Reviewing supporting documentation for all receipts and disbursements to verify compliance with the Operations Manual requirements and accurate reporting.
- Reviewing all bank reconciliations for timely completion, review/approval, and clearing of outstanding items.
- Re-performing a sample of bank reconciliations to verify accuracy.
- Reviewing the vending machine contracts and testing if all commission checks were received, deposited, and for the proper amount.
- Inquiring of management and staff where necessary.

INTERNAL CONTROL CONCLUSION

According to Government Auditing Standards, internal controls, in the broadest sense, encompass the agency's plan, policies, procedures, methods, and processes adopted by management to meet its mission, goals, and objectives. Internal controls include the processes for planning, organizing, directing, and controlling program operations. It also includes systems for measuring, reporting, and monitoring program performance. An effective control structure is one that provides reasonable assurance regarding:

- Efficiency and effectiveness of operations;
- Accurate financial reporting; and
- Compliance with laws and regulations.

Based on the results and findings of the audit test work, auditors concluded there are several opportunities for improvement to internal control procedures to better provide reasonable assurance to assist management in meeting its missions, goals, and objectives. Recommendations specific to improving these controls can be found in detail further in the audit report.

CLOSING

We would like to thank Suzanne Sumner, Administrative Secretary, Theresa Simonson, Chief of Administrative Services, and Dan Kelly, Interim Chief of Police, for their cooperation and assistance during the course of this audit.

FINDINGS, RECOMMENDATIONS, RESPONSES

Financial Records and Statements

(Point Sheet C-1.1A)

CRITERIA:

All organizations should have an accounting system for accurately recording, summarizing, and reporting financial information. Organizations should adopt internal control policies and procedures to maintain accurate information and reliable operations.

CONDITION(S):

The Police Benefit Fund (Fund) is a legally separate entity whose monies are not County funds. It is managed by a committee consisting of a sworn representative from Uniform and Non-Uniform Departments, a civilian from Police Administration and a member who will serve as the Chair of the Committee from the Police Chief's Executive Staff. The Fund was established in 1985 to support and recognize employees during times such as illness, death, or birth.

The Fund's Operations Manual documents policies and procedures, including requirement for preparing an annual report with financial statements. During calendar years (CY) 2013 – 2015 annual receipts ranged from \$670 to \$1,683 and were primarily from commissions on vending machines at various Police facilities. Annual disbursements ranged from \$1,338 to \$1,850. As of December 31, 2015, the Fund's assets were \$10,768 in two bank accounts (savings and checking).

We reviewed and tested the CY 2013 – 2015 financial statements and supporting schedules, checkbook register, receipt and disbursement transactions, bank statements and monthly bank reconciliations, noting the following:

Financial Statements:

- Checks are recorded in a checkbook register which is reconciled to bank statements monthly. A register is not maintained for the savings account. There is no chart of accounts or formal accounting system for recording financial transactions.
- The Committee uses spreadsheets to summarize detail transactions that support financial statements in the annual report.
 - Only 3 of 4 spreadsheets are on-file for CY 2013 and 2014 because the electronic file was inadvertently overwritten in the subsequent year when used as a template.
 - Financial statement spreadsheets are prepared from bank statements rather than the checkbook register. The 2013 financial statement disbursements included a prior year check (\$62) that cleared the bank in January 2013. There were no similar timing differences for 2014 and 2015 financial statements.
- The 2014 Annual Report shows comparative financial data for 2013 and 2014. The 2013 total disbursements listed the 2012 amount (*\$2,311 instead of \$1,338*).

FINDINGS, RECOMMENDATIONS, RESPONSES

Financial Records and Statements

(Point Sheet C-1.1A, Continued)

Receipt and Disbursement Transactions:

- We tested all receipts and disbursements for supporting documentation, compliance with the Operations Manual requirements, and reporting in the financial statements. There were 80 transactions (*excluding interest earned on the savings account*)—22 cash receipts, 57 cash disbursements, and 1 transfer from savings to the checking account. Other than certain minor exceptions, we found:
 - All bank activity was included in the financial statements.
 - Check numbers were sequential with no omissions or voids.
 - Disbursements agreed with supporting documentation, had two authorized signatures on the check, cleared bank statement timely, and were for a legitimate purpose.
 - Cash receipts agreed with support and were deposited timely and intact.

Bank Reconciliations:

- We reviewed all bank reconciliations for timely completion, review/approval, and clearing of outstanding items. An independent person, not on the Committee, performs the monthly reconciliation. The following exceptions were noted:
 - **For 9 of 36 (25%) months**—bank reconciliations were not completed timely.
 - **For 14 of 36 (39%) months**—the official monthly bank statement (E-Statement) was not available to compare with the online banking recent activity report used for reconciliation (April 2013 – May 2014).
 - **For 36 of 36 (100%) months**—there was no documented review/approval of bank reconciliations.
 - **For 36 of 36 (100%) months**—there was no evidence of savings account review/reconciliation.
- Accuracy of bank reconciliations was tested through re-performance of a sample of 9 bank reconciliations (3 per year). We noticed inconsistent documentation format to compare balance per books to the bank.

CAUSE(S):

- The Committee does not have an automated accounting system to aid in accurately recording, summarizing, and reporting financial information. Their current accounting process is very manual and labor intensive.
- In the past, savings account activity normally only consisted of bank dividends/interest earned, so the Committee has relied on bank statements rather than maintaining a register for record of savings transactions. However, in CY 2015 there was a savings withdrawal/transfer transaction in addition to bank interest.
- The April 2013 implementation of online banking resulted in changes to the bank reconciliation process, but new procedures/expectations were not documented in the Operations Manual until April 2016 (*3 years later*). Further, current procedures do not include

FINDINGS, RECOMMENDATIONS, RESPONSES

Financial Records and Statements

(Point Sheet C-1.1A, Continued)

supervisory review/approval nor use of a standard reconciliation form/template (as used prior to online banking).

EFFECT(S):

- Lack of a formal accounting system and outdated procedures results in inefficiencies and an increased risk of error in recording, summarizing, and reporting financial information.
- Annual financial statements may not report all cash receipts and disbursements for a given year, since they are prepared based on bank statements and consequently reflects only transactions that “cleared the bank” during the year.
- Lack of (savings) and untimely (checking) bank account reconciliations increase the risk that errors or irregularities will not be detected within the bank’s statute of limitations.

RECOMMENDATION(S):

We recommend the Police Benefit Fund Committee:

1. Consider automating accounting records, preferably an application such as QuickBooks, to record, summarize, and report on the Police Benefit Fund’s financial activity. Recording financial activity in a system could simplify reconciliation and financial reporting processes.
2. Maintain a savings account register/ledger and reconcile it monthly with the bank statement.
3. Maintain the final schedules produced based on financial records to prepare annual financial statements.
4. Prepare financial statements based on the checking and savings account ledgers, rather than the bank statements, to ensure financial statements include all transactions for a particular year.
5. Implement process improvements to prevent and detect errors in the financial statements.
6. Ensure bank reconciliations are performed timely in accordance with the Operations Manual.
7. Develop a standard form/template to be used for bank reconciliations.
8. Implement a supervisory review/approval process for bank reconciliations.

MANAGEMENT’S RESPONSE(S):

1. *Do not concur. The benefits don’t outweigh the cost both financially and organizationally as the assets of this fund are minimal. By following recommendations outlined in these audit responses, the integrity of the fund will be maintained. An automated accounting system will not be implemented.*
2. *Concur. Theresa Simonson, Chief of Administrative Services is responsible for implementing 12/1/2017. The fund will maintain a savings account register and it will be reconciled monthly against the bank statement.*

FINDINGS, RECOMMENDATIONS, RESPONSES

Financial Records and Statements

(Point Sheet C-1.1A, Continued)

3. *Concur. Theresa Simonson, Chief of Administrative Services is responsible for implementing 3/31/2018. The complete annual report including the final schedules will be scanned and posted on the Finance Unit shared drive.*
4. *Concur. Theresa Simonson, Chief of Administrative Services is responsible for implementing 3/31/2018. The financial statements will now be prepared using the checking and savings ledgers/registers.*
5. *Concur. Theresa Simonson, Chief of Administrative Services is responsible for implementing 3/31/2018. The financial statements will now be reviewed by two departments members (a committee member and a non-committee member).*
6. *Concur. Theresa Simonson, Chief of Administrative Services was responsible for implementing 12/1/2017. The bank reconciliations are performed by a non-committee member. A standard process (form/template) will be used going forward. A member of the committee will review the monthly bank reconciliations.*
7. *Concur. Theresa Simonson, Chief of Administrative Services was responsible for implementing 12/1/2017. The bank reconciliations are performed by a non-committee member. A standard process (form/template) will be used going forward. A member of the committee will review the monthly bank reconciliations.*
8. *Concur. Theresa Simonson, Chief of Administrative Services was responsible for implementing 12/1/2017. The bank reconciliations are performed by a non-committee member. A standard process (form/template) will be used going forward. A member of the committee will review the monthly bank reconciliations.*

FINDINGS, RECOMMENDATIONS, RESPONSES

Tax Reporting Status and Audit Requirements

(Point Sheet C-1.3A)

CRITERIA:

Separate legal entities should have documentation on-file affirming their creation/existence, tax reporting status and audit requirements. They are also responsible for knowing and complying with the annual filing requirements established by the IRS.

Regarding non-profit organizations, the [IRS website](#) states: “Non-profit status may make an organization eligible for certain benefits, such as state sales, property, and income tax exemptions; however, this corporate status does not automatically grant exemption from federal income tax. To be tax exempt, most organizations must apply for recognition of exemption from the Internal Revenue Service to obtain a ruling or determination letter recognizing tax exemption. Although, certain types of organizations are not required to apply for recognition of exemption, many do so in order to clarify their tax status.”

CONDITION(S):

The Police Benefit Fund is a legally separate entity whose monies are not County funds. During our audit scope of calendar years (CY) 2013 – 2015, annual receipts ranged from \$670 to \$1,683 and disbursements ranged from \$1,338 to \$1,850.

Per review of the Police Benefit Fund’s Operations Manual, we made the following observations:

- The Manual states: “This Benefit Fund is a non-profit organization that is registered with the Federal Government but does not file or pay taxes.” However, they have not applied for an IRS ruling or determination letter recognizing their tax exemption. From our inquiries, the Police Benefit Fund Committee is uncertain of their non-profit organization category (*e.g., 501(c)1, 502(c)2, 501(c)3, etc.*).

The Police Benefit Fund began in October 1985 and initially used the County’s employer identification number (EIN). In October 2000, they obtained their own EIN and subsequently asked the IRS if they were listed as non-profit and needed to file a tax return. The November 2000 conversation notes concluded the Police Benefit Fund would not file a return.

- The Manual states: “An independent biennial audit will be conducted by the Chesterfield County Internal Audit Department.” While including audit requirements in the Operations Manual is a good business practice, the County Internal Auditor’s focus should be on government operations.

FINDINGS, RECOMMENDATIONS, RESPONSES

Tax Reporting Status and Audit Requirements

(Point Sheet C-1.3A, Continued)

CAUSE(S):

- There is no annual procedure to evaluate IRS filing requirements, and they have not sought additional guidance since November 2000.
- The Police Benefit Fund has been included on the County's audit plan as a courtesy to the Police Department.

EFFECT(S):

- The Police Benefit Fund may not comply with IRS filing requirements.
- The County's Internal Auditor reports audit results through the County Administrator and School Superintendent to the Audit and Finance Committee. There is not an appropriate structure for the Internal Auditor to audit and report results to a separate entity.

RECOMMENDATION(S):

We recommend the Police Benefit Fund Committee:

9. Consider applying for IRS ruling or determination letter to clarify their tax-exempt category and status.
10. Establish procedure to annually verify IRS filing requirements.
11. Amend the Operations Manual to maintain an independent audit process, but remove reference to performance by Chesterfield County Internal Audit.

MANAGEMENT'S RESPONSE(S):

9. *Concur. Theresa Simonson, Chief of Administrative Services is responsible for implementing 6/30/2018. Staff will evaluate IRS requirements to develop approach and procedures for compliance, with an estimated completion date of 6/30/2018.*
10. *Concur. Theresa Simonson, Chief of Administrative Services is responsible for implementing 6/30/2018. Staff will evaluate IRS requirements to develop approach and procedures for compliance, with an estimated completion date of 6/30/2018.*
11. *Concur. Theresa Simonson, Chief of Administrative Services is responsible for implementing 1/31/2018. An independent audit committee will perform a periodic audit of the financial records for compliance with policies and procedures and the operations manual will be amended accordingly.*

FINDINGS, RECOMMENDATIONS, RESPONSES

Drink and Snack Machine Commissions

(Point Sheet C-1.2A)

CRITERIA:

The Police Benefit Fund's primary revenue stream is commissions on drink and snack vending machines located at various Police Department facilities. There were two vendor contracts in effect during the audit scope of calendar years 2013 – 2015 with different commission payment rates and frequencies, as provided below.

- Canteen Vending Services (*prior to April 2014*): 19% of net sales (gross sales net of tax) commission paid monthly.
- Quick Snack Vending by Diamond Springs (*April 2014 - current*): 15% of net profit commission paid quarterly for all machines except for those at the Whitepine Road location, which yield 10% of gross sales.

CONDITION(S):

Our analytical review noted a significant decrease in receipts during calendar years (CY) 2013 - 2015 compared to prior years, primarily from declining drink and snack machine sales commissions. These revenues were \$664 in 2015 versus \$2,144 in 2012, a \$1,480 or 69% decline.

The decrease in receipts resulted from a much lower commission rate under the new vendor contract starting April 2014. The prior commission rate was 19% of *net sales*, while the new rate is 15% of *net profit*. This change in commission basis significantly reduces commissions received with the new rate equating to 7.5% of net sales.

We tested if all commission checks were received, deposited, and for the proper amount during CY 2013 – 2015. All anticipated monthly and quarterly commission checks were received and deposited. Commission statements report sales and commissions by vending machine locations. **However, there were potential concerns with 18 of 22 (92%) commission statements, as follows.**

Monthly Statements (15 of 16 received in 2013 – 2014)

All vending machine locations were not included on every monthly statement:

- Location 1 (1st Floor Police Admin), 2 statements.
- Location 3 (Providence Rd.), 1 statement. *Police noted contacting the vendor for correction on next statement.*
- Location 5 (Firing Range) and 7 (Driving Range), 14 statements. *One statement noted missing location, but there was no documented resolution.*

FINDINGS, RECOMMENDATIONS, RESPONSES

Drink and Snack Machine Commissions

(Point Sheet C-1.2A, Continued)

Quarterly Statements (3 of 6 received in 2014 – 2015)

- A drink machine was moved from the Woodlake Commons to Whitepine Road location as of CY 2015; however, it was still listed as Woodlake Commons on the commission statements. Consequently, commissions were paid at a lower rate of 15% net profit instead of 10% gross sales applicable to the new location.

CAUSE(S):

- There are no formal procedures to evaluate and select new vendors. In 2014 the Committee changed vending companies to acquire new machines and improve customer service. During contract negotiations, the Committee evaluated commission percentage, but did not distinguish if it would still be applied to net sales. They anticipated commissions decreasing 21% (i.e., from 19% to 15%), but with basis change to net profit it was a 61% decrease (i.e., from 19% to 7.5%).
- There is no procedure for verifying completeness and applicable rate by location on vendor commission statements.

EFFECT(S):

- Decreasing commissions necessitated a transfer of \$500 from savings in CY 2015 to cover expenses. This was the first and only transfer during the five-year period of CY 2011 – 2015.
- Errors on commission statements may not be identified and reported to vendor for correction.

ACTION(S) TAKEN:

The Committee has contacted the current vendor to resolve noted commission discrepancies in the quarterly statements.

RECOMMENDATION(S):

We recommend the Police Benefit Fund Committee:

12. Develop review procedures for selecting new vendors to include obtaining a copy of proposed contract and a sample statement or invoice.
13. Establish procedure for verifying completeness and applicable rate by location on vendor commission statements.

MANAGEMENT'S RESPONSE(S):

12. *Concur. Theresa Simonson, Chief of Administrative Services, is responsible for implementing 1/31/2018. Procedures will be edited to involve all committee members with any proposed contract changes along with one non-committee member and the operations manual will be amended accordingly. NOTE: The vendors were changed to improve better products and better service – not just for the revenue.*
13. *Concur. Theresa Simonson, Chief of Administrative Services is responsible for implementing 1/31/2018. All commission statements will now include a review against current contract rates and this will be reviewed by another committee member.*