

INVESTIGATIVE REPORT

CITY OF OKMULGEE

April 1, 2010 through September 30, 2011



*Independently serving the citizens of
Oklahoma by promoting the
accountability and fiscal integrity of
governmental funds.*



Oklahoma State
Auditor & Inspector
Gary A. Jones, CPA, CFE

CITY OF OKMULGEE
INVESTIGATIVE REPORT
APRIL 1, 2010 THROUGH SEPTEMBER 30, 2011

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Oklahoma State Auditor & Inspector

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March 26, 2012

O. R. Barris III, District Attorney
D. A. District #25
314 W. 7th
Okmulgee, Oklahoma 74447

Transmitted herewith is our Investigative Report for the City of Okmulgee. Pursuant to **74 O.S. 2011 § 212(H)**, the District Attorney may request audit services from the Oklahoma State Auditor and Inspector to examine the books and accounts of any officer of any public entity.

In accordance with the requirements of **74 O.S. 2011 § 212(H)**, we performed an investigation for the period April 1, 2010 through September 30, 2011.

The objectives of our investigation included, and were primarily limited to, the areas noted in your request. Our findings related to these objectives are presented in the accompanying report.

Because our investigative procedures do not constitute an audit conducted in accordance with generally accepted auditing standards, we do not express an opinion on the account balances or financial statements of the City of Okmulgee, Oklahoma for the period April 1, 2010 through September 30, 2011.

The goal of the State Auditor and Inspector is to promote accountability and fiscal integrity in state and local government. Maintaining our independence as we provide this service to the taxpayers of Oklahoma is of utmost importance.

We wish to take this opportunity to express our appreciation for the assistance and cooperation extended to our office during the course of our investigation.

This report is addressed to and intended solely for the information and use of the District Attorney, District #25, and should not be used for any other purpose. Consequently, this document is *not* a public document, but is part of the investigation and/or litigation files of the District Attorney. Until its release by the District Attorney's office, it may be kept confidential pursuant to the **Oklahoma Open Records Act**, in accordance with **51 O.S. 2011, § 24A.12**. This document has been released for publication by the District Attorney, District #25.

Sincerely,

A handwritten signature in blue ink, appearing to read "Gary A. Jones", is written over a horizontal line.

GARY A. JONES, CPA, CFE
OKLAHOMA STATE AUDITOR & INSPECTOR

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CITY COUNCIL MEMBERS

Brian Priegel Mayor, Council Member at Large
Steven Baldrige Vice Mayor, Council Member Ward II
Everett Horn Council Member Ward I
Terry Bemis Council Member Ward III
Robert Robertson Council Member Ward IV

City Manager

Bob Baxter

Introduction

The City of Okmulgee, Oklahoma is organized as a “council-manager form of government,” as outlined in **11 O.S. § 10-101, et seq.** and *The Charter of the City of Okmulgee, Oklahoma.*

11 O.S. § 10-101, states:

The form of government provided by Sections 11-10-101 through 11-10-121 of this title shall be known as the statutory council-manager form of city government. Cities governed under the statutory council-manager form shall have all the powers, functions, rights, privileges, franchises and immunities granted, or which may be granted, to cities. Such powers shall be exercised as provided by law applicable to cities under the statutory council-manager form, or if the manner is not thus prescribed, then in such manner as the council may prescribe.

In addition, the City of Okmulgee (City) and its public trust authority are subject to the provisions of some other sections in Title 11 (Cities and Towns), as well as other statutes found in various titles including, but not limited to, Title 25 (Definitions and General Provisions), Title 51 (Officers), Title 60 (Property, Chapter 4 Uses and Trusts), Title 61 (Public Buildings and Public Works), Title 62 (Public Finance) and Title 68 (Revenue and Taxation).

The Okmulgee Municipal Authority (OMA or Authority) is a public trust established under **60 O.S. § 176 et seq.** The Authority operates utility services providing water, sewer, sanitation, and airport services to the residents of the City. The City Council members serve *ex officio* as the Board of Trustees for the Authority.

A private, independent audit firm audits the City and the Authority. Audit reports were made available for our review.

Any references to the “City” should be assumed to also apply to the Okmulgee Municipal Authority, unless otherwise specified.

All dollar amounts in this report are rounded to the nearest dollar, unless otherwise indicated.

The City/Authority’s fiscal year starts July 1 and ends June 30. In this report, fiscal years are abbreviated by using the ending calendar year. For example, the fiscal year of July 1, 2010, to June 30, 2011, will be identified as “FY11.”

The Office of the State Auditor and Inspector (OSAI) conducted an investigation of the Treasurer’s office of the City of Okmulgee, primarily

those accounting records relating to concerns expressed by the District Attorney in his request.

The objectives as expressed by the District Attorney were specifically related to certain delays and omissions of the payment of “dues” to the Fraternal Order of Police Lodge #96 and the International Association of Firefighters Local 2839.

The results of our investigation are in the following report.

OBJECTIVE I. Determine the explanation(s) for delayed deposits of Fire and Police union dues.

Background

The Treasurer for the City of Okmulgee (City) is responsible for withholding union dues from the paychecks of the members of the Fraternal Order of Police Lodge #96 (FOP) and the International Association of Firefighters Local 2839 (IAFF), and for remitting those dues to each union.

According to union agreements, the withholdings for union dues should be submitted to the treasurers of the respective unions "...no later than fifteen (15) calendar days after the deduction is made."

Prior to 2006, the City used checks to pay the FOP and IAFF the union dues that were withheld. Beginning in 2006, the City continued to write checks to the FOP but began "direct deposit" of union dues to the IAFF's bank account. In April of 2010, the City discontinued issuing checks to the FOP and began direct depositing the withholdings for both unions.

In late summer 2011, FOP union officials noticed that some of their withholdings had not been deposited in a timely manner and alerted IAFF officials who confirmed the same circumstance in reviewing their bank account activity. In September 2011, the FOP drafted a letter to the City Manager. The letter reads, in relevant part:

Upon reviewing the FOP's bank account, it was determined during the eighteen months since the direct deposit was put into place, the City of Okmulgee has failed to make full or partial deposits into the account. The City of Okmulgee is deducting the monthly membership dues from the employee's bi-weekly payroll check but is not depositing the funds into the FOP's account.

After the letter was provided to the City Manager, the City made additional deposits totaling \$9,175 on the dates of September 8, 12, and 13, to "catch-up" on union dues withheld for both unions. The dues withholdings for the month of September 2011, totaling \$1,810 for both unions, were deposited in a timely manner that month.

While the "catch-up" deposits were being calculated and deposited by the City administration, the union officials notified the District Attorney of the matter on September 13, 2011, expressing their concern that the union

withholdings were not deposited timely by the City Treasurer and requesting an investigation.

Also, in September 2011, the City discontinued direct deposit of withholdings for both unions and instead began mailing checks by “certified” mail in order to address the issue, provide the unions their dues in timely manner, and obtain evidence and assurance that the unions were receiving those dues.

According to the City Manager, since the implementation of the new “checks issued/sent by certified mail” procedure, there have been no further concerns expressed by the IAFF and FOP officials.

Findings

OSAI confirmed there were errors made in the membership dues deposited for the unions. Based on interviews conducted and records reviewed, we concluded the failure to timely deposit union dues withheld resulted from a combination of factors, but was not a potential misappropriation.

Errors were made in the membership dues deposited for the unions.

With bank statements provided by the two unions, OSAI prepared a schedule of union dues withheld from union members’ paychecks that had been deposited into the unions’ bank accounts. Those deposits were then compared to payroll withholdings records for the two city departments for the investigative audit period. Since the original allegation more or less assumed the late deposit problem began with the start of “direct deposit” for the FOP in April 2010, that month was selected for the start of the period reviewed.

Our detailed schedule (on the following page) of withholdings versus deposits was then summarized to show the monthly amounts deducted for the union dues, the amounts remitted by the City, and the outstanding balances, if any, at the end of each month.

Month	Amounts Withheld IAFF	Amounts Withheld FOP	Total Amount Owed	Total Remitted	Outstanding Balance
Apr-10	1,200.00	800.00	2,000.00	2,000.00	0.00
May-10	1,200.00	780.00	1,980.00	2,000.00	-20.00
Jun-10	1,200.00	760.00	1,960.00	1,940.00	0.00
Jul-10	1,150.00	840.00	1,990.00	980.00	1,010.00
Aug-10	1,230.00	840.00	2,070.00	3,050.00	30.00
Sep-10	1,220.00	840.00	2,060.00	2,040.00	50.00
Oct-10	1,200.00	840.00	2,040.00	2,040.00	50.00
Nov-10	1,225.00	840.00	2,065.00	1,020.00	1,095.00
Dec-10	1,250.00	920.00	2,170.00	0.00	3,265.00
Jan-11	1,250.00	920.00	2,170.00	2,170.00	3,265.00
Feb-11	1,250.00	920.00	2,170.00	1,085.00	4,350.00
Mar-11	1,250.00	940.00	2,190.00	2,190.00	4,350.00
Apr-11	1,250.00	860.00	2,110.00	2,110.00	4,350.00
May-11	1,200.00	820.00	2,020.00	2,020.00	4,350.00
Jun-11	1,100.00	760.00	1,860.00	950.00	5,260.00
Jul-11	1,100.00	760.00	1,860.00	0.00	7,120.00
Aug-11	1,050.00	780.00	1,830.00	0.00	8,950.00
Sep-11	1,050.00	760.00	1,810.00	10,635.00	125.00
Totals	21,375.00	14,980.00	36,355.00	36,230.00	

The above schedule reviewed withholdings and deposits for the 18 month period of April 2010 through September 2011. It does ***NOT*** include any review of potential errors and/or omissions prior to April 2010. Had we performed additional procedures for the prior periods, the \$125 balance due at the end of September 2011, may have been found to be a different amount.

As noted in the schedule above, the City had made timely remittances to the unions from April 2010 through October 2010, with the exception of one untimely payment in July 2010. Beginning in November 2010, however, the City’s remittances were consistently late and by the end of June 2011, the City had stopped remitting union dues completely. Finally, in the month of September 2011, “catch-up” remittances were made to make up for late and omitted payments.

Our review also noted that the \$125 outstanding balance due for September 2011, appeared to be a combination of a \$675 *overpayment* to the IAFF and an \$800 *underpayment* to the FOP for the time period reviewed, with the *net* difference of \$125 still owed at the end of September.

Based on interviews conducted and records reviewed, it appeared that several factors contributed the failure to timely deposit union dues withheld. One of those factors was a poorly designed implementation of the accounting software.

Interviews with city officials, including the Treasurer, indicated:

- The move to “direct deposit” for the unions was an effort to streamline the payment process;
- In past years there had been recurring issues of failure by previous or earlier union officials to timely deposit *physical* checks issued for union dues withheld, leaving outstanding checks to be reconciled at the end of the month, or sometimes months;
- It was thought that the direct deposit method of payment would simplify the payment of union dues for both the City and the unions.

Additional information provided through these interviews included:

1. The City had purchased new accounting software in February 2007, from a Colorado company that specializes in municipal and county government applications, Computer Information Concepts, Inc., out of Greeley, CO.
2. The software was tested for two months (by running the old and new software concurrently or “parallel” to be sure that the transactions and reports processed and compiled by the new system would match the system being replaced).
3. After City officials concluded the new system was functioning and producing reliable records and reports, the new system was fully implemented as of July 1, 2007, to begin FY08.
4. The old general ledger chart of accounts was “outdated” but continued to be used on the new computer system.
5. The new software system was “interactive” or “integrated,” meaning that transactions that were produced in one module or application (i.e. general ledger, payroll, utility billing, accounts payable, etc.) would flow from one group of records and accounts to the other, without having to manually enter or re-enter the transactions into the records and accounts of the other accounting applications involved or affected by the transactions.
6. One feature of the new software that facilitates the “integration” is an “automatic” posting option that can be set or not set, depending

on the specific situation, account or transaction. For example, the amounts of withholdings for payroll taxes, health insurance, union dues, garnishments, etc. generated by the payroll system *automatically* posted credits *and* debits to the corresponding liability accounts in the general ledger and subsequently to the accounts payable account in the accounts payable software module.

7. The eighteen (18) departments of both the City General Fund and the OMA operating account/fund are processed as a single payroll to avoid having to process two separate payrolls each pay period.
8. The City pays its employees bi-weekly (every two weeks, 26 pay periods per year).
9. Payroll transactions are *partially* handled through a separate “payroll” bank account within the General Fund “cash” balance on the general ledger. The “net” payroll checks (i.e. “gross” pay less deductions for payroll taxes, insurance, union dues, etc.) are issued to the City’s employees through its payroll system and this “payroll” bank account.

Cash is used from the City’s two main *operating* bank accounts, the “#10” General Fund bank account and the “#60” Okmulgee Municipal Authority (OMA) operating account, to fund each regular payroll. *However, the process in place for charging these two funds and their primary bank accounts for the payroll expenditures has been somewhat convoluted under the “new” CIC software system.*

Different software systems may process transactions and operate in somewhat different ways even though the ordinary payroll, utility billing, general ledger, or accounts payable transactions are similar from an accounting standpoint. The “new” system was set up to process ALL of the City’s regular payroll, including the OMA’s eight (8) departments, through the City’s *General Fund* bank account(s).

This method of payroll software implementation forced a “commingling” of the City’s and the OMA’s operating funds and transactions with regard to the OMA payroll and related liability transactions. This is not a preferred circumstance since the Okmulgee Municipal Authority is technically a *separate legal entity* from the City of Okmulgee.

Based on our interviews, the “commingling” of the OMA payroll transactions with the City’s General Fund payroll transactions resulted in the necessity to manually enter and post a number of debits and credits each payroll period, or as the Treasurer referred to them, “due to’s” and

“due from’s.” These manually entered transactions were part of the final steps in processing each biweekly payroll.

In addition, using the General Fund general ledger cash account for the entire municipal payroll, including the OMA departments, necessitated the periodic transfer of actual cash from the OMA operating bank account to the General Fund operating bank account and/or the “payroll” bank account, which is included and reported in the City General Fund. This was/is necessary in order to reimburse the City General Fund for the OMA’s share of “net” paychecks and its related payroll liabilities.

The design of the payroll system *does* successfully process the payroll and charge the appropriate departmental expenditure accounts, liability accounts, etc., but the entire process appeared unnecessarily complicated.

Too much “automation” in the posting of the payroll transactions resulted in the potential for errors and omissions.

In addition, the “automatic posting” feature mentioned in *bullet #6* above was originally set up in such a way that the automation went perhaps a step too far.

Concurrent with the processing of paychecks to the municipal employees, credits for the payroll related liability accounts (taxes withheld, other withholdings, etc.) *automatically* posted in the general ledger, followed by *automatic* debits to those same liability accounts (leaving \$-0- balances). Those initial automatic postings shifted the credit balances of those payroll liabilities to the “accounts payable” module and the “accounts payable” *general ledger* account.

If the automation had stopped at that point, most likely there would not have been a problem. However, when we asked for “transaction histories” for IAFF and FOP “vendor” accounts in the accounts payable module, it became clear that once again when the “credit” balances for payroll related liabilities were *automatically* shifted from the general ledger accounts to the accounts payable, these credit transactions were immediately followed by *automatic* “debit” transactions that “zeroed out” the amounts owed to the IAFF and FOP in the accounts payable module *also*.

In other words, the accounts payable system had been set up to *automatically* show the withholdings, such as the Fire and Police union dues, *were paid* (the debit entries), in effect *assuming* that the payment of

those liabilities would be completed on the same day as the payroll was processed. After the system *automatically* posted the *debits* in accounts payable, the amount owed to the unions would show \$-0-, even though no payments had actually been disbursed.

Payroll is done on a “biweekly” basis with 26 pay periods per year. If the payroll process, particularly the final steps and manual debit and credit postings are not completed, it is only a short time before the next pay period is due for processing. It could be relatively easy to get behind and forget some of the steps not completed on the *prior* payroll.

The “direct deposit” process was a separate method of payment that was one of the those final steps involved in completing the typical pay period processing, but that step required a finance staff member to physically initiate the payments after the other payroll *check* disbursements had been issued.

Both the general ledger payroll liability accounts and the “vendor” accounts for the IAFF and the FOP in the accounts payable system would already be displaying \$-0- balances due to the automated posting of transactions, as described above. If the “direct deposit” payments were not processed promptly, there was no visual “clue” to alert the Treasurer that that step in the payroll process had been overlooked since those liability and/or vendor accounts would show nothing “due” or owed.

The failure to create additional “cash” and investment accounts for the City’s various funds resulted in “off-books” efforts to track the City’s cash and investment bank deposits, wasted time, and contributed an unnecessary complication to the present software system.

Another issue in the implementation of the CIC software likely resulted from a miscommunication, a misunderstanding, or confusion of terminology between city finance staff and the software company programmers and customer service rep. During the implementation of the 2007 software system, it became “understood” by the City finance staff that the new software “would not allow” more than one cash/bank account “per fund.”

Consequently, ALL the bank and investment accounts (multiple banks and multiple accounts) for the City’s General Fund and for the OMA operating fund/account were combined into *two* cash balances, one for the General Fund and one for the OMA in the accounts payable module and the general ledger.

For nearly five years, this misunderstanding or miscommunication required the Treasurer to keep spreadsheet records separate from the “system” in order to reconcile the various bank accounts and investments to the single “cash” computer balance set up for the General Fund and the single “cash” balance set up for the OMA operating fund/account.

Recently, the City sold some property for a significant amount that the administration wanted to make a separate accounting for. The Treasurer discovered that, in fact, additional “cash” accounts *can* be set up in the City’s *general ledger*. The limitation of just one “cash” account per fund was apparently applicable to the *accounts payable* module only.

This new piece of information now permits the various cash and investment deposits at any and all of the City’s depository banks to be separately maintained and accounted for within each City fund, *without the necessity of keeping off-books spreadsheet records*. This change should greatly simplify and aid in the monthly reconciliations of the City’s various bank account balances.

Additional duties in the second quarter of 2011 possibly contributed to the clerical errors and failures to timely pay the union dues in the last several months of the time period reviewed.

In the fall of 2010, a new employee was hired to begin taking over some of the payroll duties of the Treasurer. In the second quarter (April-June) of 2011, additional training of the new employee was begun in earnest in preparation for assigning that employee to become the “payroll clerk,” a position held by the Treasurer for eight years prior to also being appointed to the Treasurer’s office and given those duties. The training of the new employee (although beneficial in the long run) was an added responsibility that occurred during approximately the same time frame as the *beginning* of the complete omission or failure to pay the union dues during the three summer months (June-August) of 2011.

In addition, according to our interviews with the Treasurer, she was in the middle of revising the old “chart of accounts” carried over from the prior computer system, which may have been even *older* than that earlier software system. The old *accounting* system was significantly outdated and was not consistent with recommendations made by the Government Finance Officers Association (GFOA) in its “Blue Book” publication.

With the assistance of the City’s financial consulting firm, the Treasurer was working on the new chart of accounts project during the same time

frame (April-June) as the training of the new payroll clerk was occurring. The “hard deadline” for implementing the updated chart of accounts was the start of the new fiscal year on July 1, 2011. The new chart of accounts was implemented and is in place for FY12, which is the current fiscal year.

We observed these additional duties likely contributed to time pressures and could have “distracted” the Treasurer from performing appropriate review procedures to verify the completion of payroll processing for the pay periods during those summer months, including remembering to initiate the direct deposits to the union bank accounts.

Our review of the City’s bank records indicated that there was no deficiency in City funds that would account for any possible need to “delay” payment of union dues withheld.

We reviewed the possibility of another reason or circumstance that might be a cause for delaying the payment of the union dues, as well as other City obligations.

The police and fire union membership dues are remitted from the City’s General Fund. We obtained the General Fund bank statements from March 2010 through October 2011. While reviewing the General Fund bank statements, we noted transfers to and from the “Super Now-Publ Fund Account 201XXXX.”

According to the Treasurer, this is an investment account that the City utilizes to earn interest. We created a schedule of account balances for both bank accounts for the period June 2010 through September 2011. The purpose of this schedule was to determine if the City had adequate funds to pay the union membership dues during the time period under investigation.

Bank statement balances indicate there were *more than adequate* funds to pay the membership dues, as well as other obligations of the City for the period reviewed. Because there were adequate funds, we concluded a “lack of funds” was not a potential explanation for the delayed payment of union dues.

Conclusion

Based on our interviews conducted and the records we reviewed, we concluded that there had not been a potential misappropriation or “diversion” of funds.

Based on our investigation, we concluded the errors made first in the “falling behind” and then in the subsequent complete failure to deposit the union dues in the summer of 2011, were attributable to:

1. A poor design and implementation of the “relatively new” software system dating back to 2007;
2. Too much “automation” in the integration of the payroll system with the general ledger and the accounts payable system that left no visual “clues,” i.e. union dues related *balances* in the accounts payable system to alert the Treasurer or anyone else that the union dues withheld had not been paid;
3. A miscommunication and/or misunderstanding concerning the general ledger versus the accounts payable system that added unnecessary bookkeeping and reconciliation duties to the Treasurer for the past five years;
4. Additional duties during the spring of 2011, combined with a “hard deadline” to implement an overhaul of the out-of-date chart of accounts by July 1;
5. All contributed to the failure to keep up with and timely pay the union dues withheld from IAFF and FOP members’ paychecks.

In our interviews with the Treasurer, she acknowledged that remitting the union dues to the unions’ bank accounts was solely her responsibility and that she had failed to process the “direct deposits” in a timely manner. She said that her failure to do so was “no one’s fault but her own.” She indicated she had gotten behind due to her other duties and had not been diligent in “catching the City up” to where it needed to be.

Only through additional interview questions and subsequent clarifications were we able to determine the “other duties” were the various issues described above and their probable contribution(s) to the clerical errors and omissions that resulted in the delays in paying the union dues owed to the local IAFF and FOP.

Recommendations We have prepared a separate letter addressed to the City administration making several recommendations that we believe would simplify and thereby improve the payroll system for the City.

II. OBJECTIVE Review internal controls over the payroll process and other areas of finance.

Background

The City of Okmulgee uses Crawford & Associates as their accounting consultant on a fee-for-service basis and for the preparation of their annual financial statements. The City also hires Arledge & Associates (Arledge) as their independent auditors. As part of their annual audit procedures, Arledge documents the City's internal controls for processing and reporting financial transactions.

Since the allegations made by the fire and police union officials suggested the possibility of a misappropriation, we reviewed the "internal controls" of the City's financial recording and reporting to determine if they were adequate to mitigate the risk of a misappropriation.

One extremely important internal control is the "segregation of duties" in relation to a complete financial transaction. In a small municipality, the segregation of duties, or lack thereof, is often the key underlying issue in the ability of an employee to perpetrate a fraud or misappropriation that may go undetected.

There are four general categories of duties or responsibilities that are necessary for an adequate segregation of duties: *authorization, custody, record keeping, and reconciliation*. Ideally, three or four separate individuals should perform the work related to those four duties.

Segregation of duties provides two benefits: first, a deliberate fraud is more difficult, because it requires collusion of two or more persons; and second, with multiple employees involved, it is more likely that ordinary human errors will be identified in a timely fashion.

Findings

Arledge provided us with their internal control memos for the City for the year ended June 30, 2010. We reviewed these memos to gain an understanding of the City's internal controls. We developed a list of questions from these memos and other sources to further corroborate the information and to determine what internal controls were in place during the period of April 1, 2010 through September 30, 2011.

We then interviewed the Treasurer regarding both her and our understanding of the historical internal controls. We corroborated the

pertinent responses made by the Treasurer during our interview with the City Clerk.

We concluded the controls were adequate to mitigate the risk of a *material* fraud or misappropriation or error. Specifically, the City's segregation of duties appeared to be adequate in relation to the receiving, handling and depositing of the various revenue collections of the City, such as utility billing and municipal court. Those two areas of finance are of particular concern and "risk" for many smaller municipalities.

With regard to the failure to timely process the "direct deposit" of union member dues withheld, there were the computer system issues described in Objective I, and apparently some *less than adequate* (or not designed or implemented) "reconciliation" procedures that did not detect those errors. It should be noted that the amounts of union dues withheld were relatively small per pay period in comparison with the City's total payroll, payroll taxes, medical insurance, and other withholdings.

Overall, the reasonably adequate segregation of duties for the City's revenue collections supported our conclusion that a "misappropriation" was an improbable explanation for the delayed payment of union dues withheld.

Recommendations Some recommendations related to payroll reconciliations were included in our letter addressed to the City administration.

DISCLAIMER The State Auditor and Inspector has no jurisdiction, authority, purpose or intent by the issuance of this report to determine the guilt, innocence, culpability or liability, if any, of any person or entity for any act, omission, or transaction reviewed and such determinations are within the exclusive jurisdiction of regulatory, law enforcement, and judicial authorities designated by law.



Oklahoma State Auditor & Inspector

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March 26, 2012

Mr. Brian Priegel, Mayor
Mr. Bob Baxter, City Manager
City Hall
111 East 4th Street
Okmulgee, Oklahoma 74447

Dear Sirs:

We have completed the investigation requested by the District Attorney and have issued our report on the results of our investigation. We were not engaged by the City, and we are not providing any opinion on the City's account balances, financial statements, or the effectiveness of the City's internal control over financial reporting.

During the course of our investigation, we observed some issues for which we have prepared some recommendations for your evaluation and consideration. We would advise you to consult with your financial consultants and/or your financial statement auditors as part of your evaluation and consideration of these recommendations.

Our report found that the "automation" of *certain* payroll related transactions contributed to the errors and omissions related to delays in paying the police and fire union dues withheld from union members. Accordingly, we recommend that any automatic transactions of specifically the *accounts payable* system be reviewed and carefully evaluated for the potential to create other errors and/or omissions. We recommend that accounts payable *debit* entries in particular should result from actual transactions and disbursements and not be "automatically" posted to *vendor account* balances, such as the IAFF and FOP.

We noted that the payroll of the Okmulgee Municipal Authority is currently being processed through bank account(s) of the City General Fund. We understand that this has been the process for approximately five years and that the OMA's payroll charges are eventually "sorted out" with correcting entries made in the general ledgers of both the City General Fund and the OMA operating fund/account **and** with cash transfers to reimburse the City General Fund bank account or accounts.

Instead of commingling the OMA's payroll transactions with the City General Fund's bank account(s), we recommend the City *consider* the use of a "Payroll internal service fund." *Internal service funds* are often used to account for services provided to other sections or divisions *or Funds* within a governmental entity.

The current "payroll" bank account reported in the City General Fund could be transferred to this internal service fund and ALL payroll transactions would then be processed through that "Payroll" internal service fund and its "payroll" bank account. The suggested "Payroll" internal service fund could "charge" or "bill" the *gross payroll* and related *employer paid* fringe benefits (such as FICA matching, matching pension, and OMRF retirement benefits, etc.) to the OMA *and* to the City General Fund.

The advantages to implementing a "Payroll" internal service fund would be:

1. The finance staff can continue to process only one payroll for the whole municipality;
2. The payroll of the Okmulgee Municipal Authority could be allocated and charged more directly without the necessity of the "due to's" and "due from's" following each pay period.
3. The commingling of OMA payroll transactions with the City General Fund bank account(s) could be avoided completely.
4. The process and procedures would be in place to accommodate "payrolls" from *other* Funds or revenue sources, such as a federal grant or any other special purpose revenue fund.

The *disadvantage* to implementing a "Payroll" internal service fund would be the Treasurer would need to make *two* cash transfers, one from the OMA operating account and one from the City General Fund operating bank account, instead of the current single cash transfer from the OMA to the City General Fund.

Whether or not the current "payroll" bank account is moved from the City General Fund to an internal service fund, we recommend that the "payroll" bank account be operated as an "imprest balance" account. "Imprest balance" simply means that there is a *specific* cash balance (i.e. \$10,000.00) for the payroll bank account which can be reconciled monthly.

Our investigative team noted that the current payroll account had some "carryover" in it. The Treasurer acknowledged the carryover, indicated that she knew the probable reason(s) for some of the carryover balance, but also indicated she was not sure about how some of the other carryover had accumulated in that bank account.

Establishing a *specific* "imprest balance," and then reconciling the monthly payroll account bank statement to the established imprest balance, will provide another point of reconciliation that could reveal if some paycheck, garnishment, union dues check, etc., had not cleared the bank, or

if a “direct deposit” had not been processed. Promptly addressing any outstanding balances identified in the monthly reconciliation would be a valuable internal control. The “imprest balance” would be more effective if ALL payroll and payroll related transactions flow through the single bank account.

As reported in our investigative report, the issue of only “one bank account” per fund was found to be a misunderstanding or miscommunication. The Treasurer is planning to establish general ledger cash and investment accounts to show in detail where the City and OMA have their funds deposited, to begin with FY13, starting July 1, 2012. This should be a considerable improvement over the “off-books” spreadsheet procedures used since the new software system was implemented in 2007. We concur with her efforts and believe that issue has already been addressed or is in the process of being addressed.

Sincerely,

A handwritten signature in blue ink, appearing to read "Gary A. Jones", with a long horizontal flourish extending to the right.

GARY A. JONES, CPA, CFE
OKLAHOMA STATE AUDITOR & INSPECTOR



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