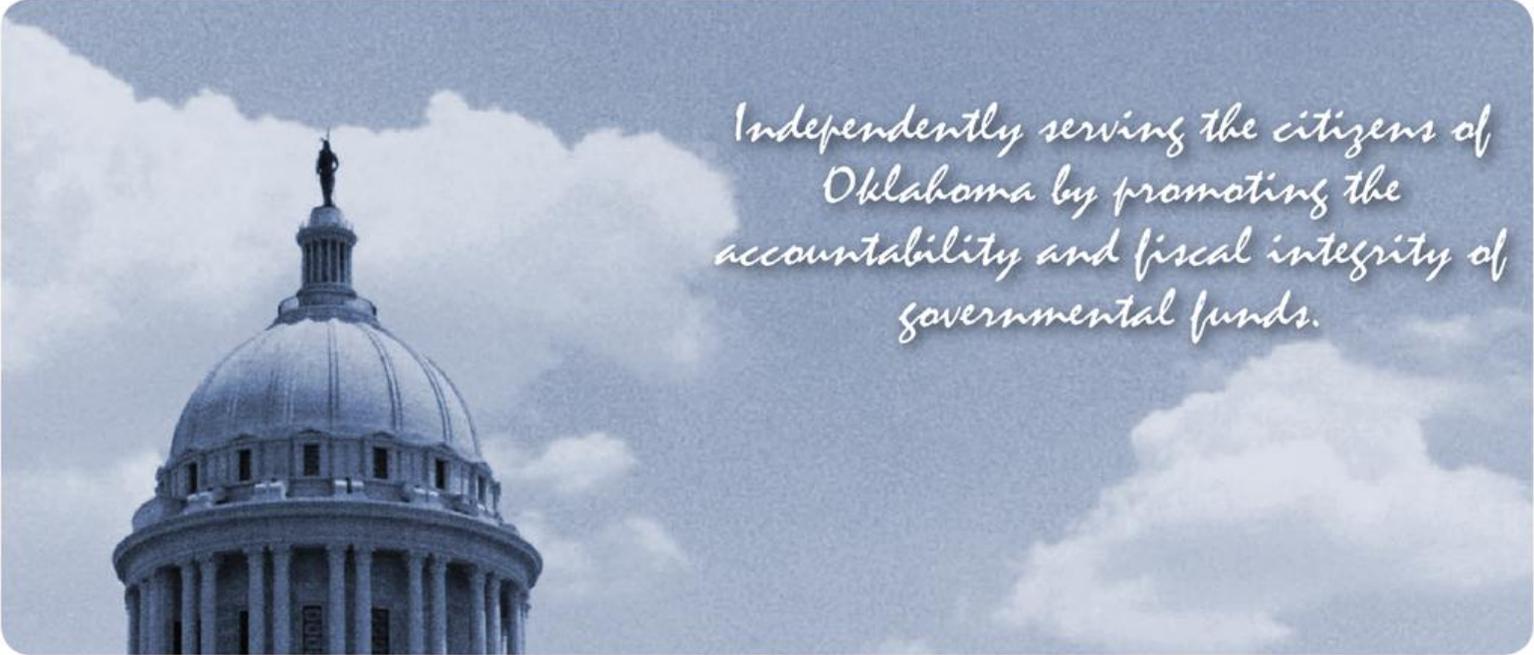


INVESTIGATIVE REPORT

CITY OF HEALDTON

July 1, 2009 through June 30, 2012



*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 HEALDTON
INVESTIGATIVE REPORT
JULY 1, 2009 THROUGH JUNE 30, 2012



Oklahoma State Auditor & Inspector

2300 N. Lincoln Blvd. • State Capitol, Room 100 • Oklahoma City, OK 73105 • Phone: 405.521.3495 • Fax: 405.521.3426

January 22, 2014

Mayor David Smith
City of Healdton
P. O. Box 926
167 Franklin Street
Healdton, Oklahoma 73438

Transmitted herewith is our Investigative Report of the City of Healdton.

Pursuant to your request and in accordance with the requirements of **74 O.S. 2011, § 227.8**, we performed an investigation of the City of Healdton for the period July 1, 2009 through June 30, 2012.

The objectives of our investigation primarily included, but were not limited to, the areas noted in your request. Our findings related to those objectives are presented in the accompanying report.

Because 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 Healdton.

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

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 document is a matter of public record pursuant to **51 O.S. 2011, § 24A.12**, the Oklahoma Open Records Act.

Sincerely,

A handwritten signature in blue ink that reads "Gary A. Jones".

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

TABLE OF CONTENTS

	Page
CITY OFFICIALS	ii
INTRODUCTION	1
OBJECTIVES AND FINDINGS.....	2

OBJECTIVES

Objective I. Determine if a misappropriation of funds occurred in utility billing.....	2
Objective II. Review bank records provided by the District Attorney’s office	13
Objective III. Review prior audit reports and related findings.....	14
Objective IV. Other concerns or issues were identified	19

CITY OFFICIALS

City Council
(as of January 22, 2014)

David SmithMayor
D.J. Brown Member
Rick Pender Member
Danny Veal Member
Randy Welch Member

Vivian Glenn
Former City Clerk

Karen Kardaleff
Former City Treasurer

Introduction

The City of Healdton (City) operates under the council-manager form of government provided for by **11 O.S. § 10-101, et seq.:**

The form of government provided by Sections 11-10-101 through 11-20-121 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.

The City of Healdton also operates under a “city charter” similar to a local “constitution.” The city charter governs in local affairs, addresses issues that may not be covered by statute and may supersede statute, if more restrictive or dealing with an issue that is strictly local in nature.

On July 11, 2012, the Healdton City Council and the Healdton Public Works Authority (“Authority”) Board of Trustees voted to request the State Auditor and Inspector to conduct an investigative audit in order to determine if City or Authority funds had been misappropriated.

As a result of the request by the City and Authority, OSAI performed the investigative audit. The results are contained in the following report.

Objective I: Determine if a misappropriation of funds occurred in utility billing.

- Findings:**
- A method often used to misappropriate funds was identified. This method is usually referred to as a *check-for-cash substitution scheme*. The amount of alleged misappropriation identified was \$42,704.57.
 - A second method of misappropriation was identified. The second method was a simple *cash larceny scheme*. Cash, which had been receipted, was apparently taken and not deposited. The amount of alleged misappropriation identified was \$37,053.39.
 - Some daily receipt *reports* were missing.
 - Out of 214 receipt *numbers* that were missing from the daily receipt reports reviewed, we could account for only twenty.
 - We found a printed receipt that conflicts with the amounts recorded on the computer system, indicating the potential for additional unreliable records.
-

Background

Karen Kardaleff became city treasurer October 1, 2000. The city treasurer also functions as treasurer for the Healdton Utilities Authority. According to the City Charter, Article IV, Sec 4-1:

“...the city treasurer or personnel under his supervision and control shall collect or receive revenue and other money for the city; shall be responsible for its custody, safekeeping, deposit, and disbursement; shall maintain a general accounting system for the city government; and shall have such other powers and duties consistent with this charter...”

The Healdton Utility Authority (HUA) issues a two-part bill to its utility service customers. When a customer pays their bill, one part of the two part bill serves as the receipt for the payment and the other part is retained by HUA.

According to Marcia Schoonover, a part-time utility clerk from April 2009 through May 2011, and Liz Hanna, presently employed with the City since May 2010, the following procedures were followed in relation to the daily collections and reports:

- At the end of the day a receipts journal, reflecting the day's collections, is printed and reconciled with the on-hand cash and checks.
- Once the on-hand cash and checks are reconciled to the receipts journal, the cash, checks, and receipt journals are placed in a file drawer in a vault in city hall.
- The next business day, the vault is opened by the city clerk.
- The city treasurer removes funds from the vault, prepares a deposit ticket corresponding to the collections and receipts journal, and deposits these funds at a local bank.

The "receipts journal and budget receipts transfer journal" that is prepared includes funds from utility billing, municipal court, meter deposits, licenses, permits, or other sources of revenue. This document is used to reconcile the funds collected to the bank deposits.

On January 19, 2011, a memorandum reflecting changes to the end-of-the-day reconciliation procedures was signed by City Clerk Vivian Glenn and City Treasurer Karen Kardaleff. The memorandum included the following procedures:

1. Marcia [Schoonover] will leave for the day.
2. Vivian will count and balance out the [cash] drawer.
3. Karen will update the accounts and deposit money to the bank.

Kardaleff's duty of preparing the bank deposits was suspended on March 7, 2012. At this time, City Clerk Vivian Glenn assumed the duties of preparing and making the deposits. Kardaleff was suspended from *all* duties, as of July 3, 2012, and eventually terminated August 28, 2012.

We reviewed the receipt journals and bank statements for the period July 1, 2009, through June 30, 2012, comparing the total amounts deposited as well as the relative portion of checks and cash that comprised the deposits.

Finding:

A method often used to misappropriate funds was identified. This method is usually referred to as a *check-for-cash substitution* scheme.

A primary purpose of performing a receipt-to-deposit test is to determine if all funds received and receipted are being deposited. This test is conducted in order to determine if a misappropriation of receipted money is occurring. One common means of misappropriating cash is to substitute checks that are not receipted to replace a corresponding amount of cash

that was receipted. This method is commonly referred to as a *check-for-cash substitution* scheme.

The following scenario is an example of a check-for-cash substitution scheme:

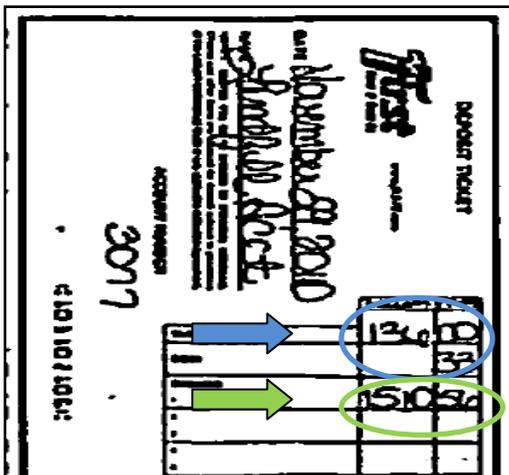
One person comes to city hall and pays \$100 cash for a utility payment. Because the person is actually present when making the payment, a receipt for \$100 cash is written. A second person also pays a \$100 utility bill by mailing a check to city hall. Because the check arrived in the mail, the clerk chooses not to issue a receipt. The clerk can now remove the \$100 cash and replace it with the unreceipted check. The total deposit amount remains \$100.

In this case, the corresponding report would reflect a \$100 shortage in the cash composition and \$100 overage in the check composition, although the actual deposit amount would reconcile to the daily report.

A commonly used procedure to recognize a check-for-cash substitution scheme is to identify checks inserted into a deposit that have not been receipted. By comparing the cash to check “composition” of the daily receipt journals to the daily deposits, we determined that a check-for-cash substitution scheme had been occurring.

A review of the daily receipts journals showed days when the total collections and the amount deposited for the day agreed, but the composition of cash and check amounts did not agree. For example, the November 29, 2010, receipts journal showed the collection of \$883.93 in cash, \$762.96 in checks, and \$143.00 in credit card payments, totaling \$1,789.89:

	TOTL DUE	CODE	AMOUNT X	CHK AMT/NUMBER T	CASH AMT	CC AMT	CHNG
TOTALS: CNT = 23	1789.89		1789.89	762.96	883.93	143.00	0.00



The actual amount that should have been deposited for November 29th was \$1,646.89 (cash and checks excluding the \$143.00 credit card payment). A review of the deposit corresponding to this daily receipts journal revealed a deposit of \$1,646.89, but the composition of the cash and checks deposited was different.

The cash amount deposited was \$747.60 *less* than the amount of cash reflected on the receipts journal and the amount of checks deposited was \$747.60 *more* than reflected on the receipts report.

We obtained the deposit sources from the bank to determine the item or items deposited that had caused the \$747.60 variance in the cash and check amounts. A check from Mitchell Tank Truck Service, Inc., in the amount of \$747.60, was included in the deposit, although it was not receipted or listed on the November 29th receipts journal.

MITCHELL TANK TRUCK SERVICE, INC.
PO BOX 101 20000
HEALDTON ALBERTA T4R 1A4

11/29/11

1111

City of Healdton

City of Healdton

747.60

We found other instances in which checks were inserted and the corresponding amounts of cash were removed. For example:

- The July 7, 2011, receipts journal reflected \$1,227.86 in cash and \$1,933.31 in checks were receipted, totaling \$3,161.17. The bank deposit slip reflected \$734.67 in cash and \$2,426.50 in checks were deposited, a difference of \$493.19. From the deposit sources, we found a check in the amount of \$493.19 in payment of the July COBRA health insurance for a former city manager. The \$493.19 check was neither receipted nor listed in the receipts journal.
- The January 6, 2012, receipts journal reflected \$1,218.88 in cash and \$1,962.23 in checks were receipted, totaling \$3,181.11. The bank deposit slip reflected \$1,091.38 in cash and \$2,089.73 in checks were deposited, a difference of \$127.50. From the deposit sources, we found checks in the amounts of \$27.50 and \$100.00 from Carter County. These checks were neither receipted nor included in the receipts journal.

Between July 1, 2009 and March 7, 2012, we found a total of \$42,704.57 in cash that was removed from deposits and replaced with unreceipted checks, as shown in the table below:

FY 11-12	TOTAL SHORTAGE	CHECKS INSERTED	FY 10-11	TOTAL SHORTAGE	CHECKS INSERTED	FY 09-10	TOTAL SHORTAGE	CHECKS INSERTED
07/2011	\$2,369.24	\$2,349.24	07/2010	\$2,219.99	\$1,898.99	07/2009	\$3,414.58	\$1,224.05
08/2011	\$3,936.84	\$1,660.98	08/2010	\$682.07	\$482.07	08/2009	\$4,364.70	\$457.68
09/2011	\$2,095.00	\$1,545.00	09/2010	\$2,937.98	\$1,937.98	09/2009	\$1,151.35	\$1,094.42
10/2011	\$2,337.48	\$2,035.80	10/2010	\$5,419.26	\$4,963.02	10/2009	\$3,869.83	\$1,862.60
11/2011	\$713.00	\$688.00	11/2010	\$1,732.93	\$1,732.93	11/2009	\$2,596.18	\$1,277.56
12/2011	\$3,106.19	\$1,953.00	12/2010	\$6,095.09	\$1,515.09	12/2009	\$2,732.40	\$1,332.40
01/2012	\$1,112.50	\$277.50	01/2011	\$1,673.87	\$1,573.87	01/2010	\$1,470.99	\$837.99
02/2012	\$893.00	\$158.00	02/2011	\$1,472.51	\$1,472.51	02/2010	\$3,618.52	\$885.52
03/2012	\$150.00	\$100.00	03/2011	\$1,595.48	\$1,110.55	03/2010	\$1,859.63	\$779.55
04/2012	\$0.00	\$0.00	04/2011	\$2,773.08	\$1,838.58	04/2010	\$3,075.59	\$275.59
05/2012	\$0.00	\$0.00	05/2011	\$1,877.25	\$1,005.89	05/2010	\$3,205.82	\$278.56
06/2012	\$0.00	\$0.00	06/2011	\$1,444.57	\$1,424.82	06/2010	\$1,767.89	\$674.83
FY Total	\$16,713.25	\$10,767.52	FY Total	\$ 29,924.08	\$20,956.30	FY Total	\$ 33,127.48	\$10,980.75
							Total	\$42,704.57

We noted that the check-for-cash substitutions appeared to stop, following the suspension of the bank deposit duty of Kardaleff in March 2012.

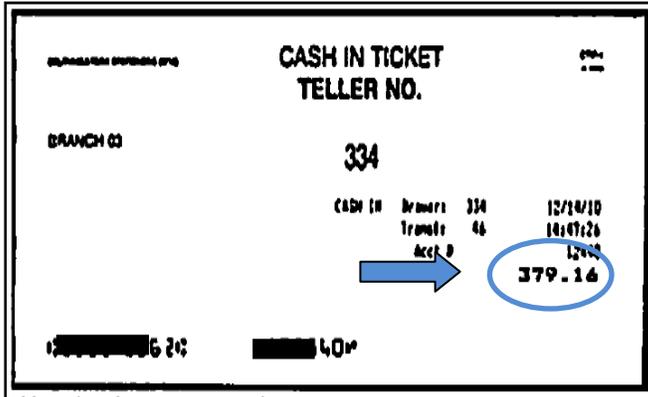
Finding: **A second method of misappropriation was identified. The second method was a simple *cash larceny scheme*. Cash, which had been receipted, was apparently taken and not deposited.**

As previously noted, the daily collections were placed in a drawer in a vault located at city hall at the end of each business day. The next morning, the vault was opened by City Clerk Glenn and remained open and unlocked for the remainder of the day.

In addition to the check-for-cash substitution scheme, we noted instances in which the amount of cash deposited was significantly less than the amount of cash receipted. For example, the receipts journal for December 13, 2010, reflected the collection of \$1,379.16 in cash, as shown in the image below:

TOTALS: CNT =	TOTL DUE	CODE	AMOUNT X	CHK AMT/NUMBER T	CASH AMT	CC AMT	CHNG
95	8330.26		8330.26	6561.52	1379.16	389.58	0.00

The report reflected the total collection amount of \$8,330.26 including \$389.58 in credit card payments. The total of the collections that should have been deposited was \$7,940.68 (the \$8,330.26 amount minus the \$389.58 credit card payments).



However, our review of the bank deposit records revealed that the actual amount deposited was \$6,940.68. The deposit source information from the bank included “cash in” tickets reflecting the total amount of cash being deposited. In this instance, the “cash in” ticket reflected the deposit of only \$379.16, and a shortage of \$1,000 in cash.

In reviewing the receipt journals and the corresponding deposits, we identified other instances in which the amount of cash deposited was less than the amount of cash collected.

- The December 2, 2010, the receipts report showed \$1,310.84 in cash and \$4,628.69 in checks collected. The corresponding bank deposit reflected \$310.84 in cash and \$4,628.69 in checks for a cash shortage of \$1000.
- On August 28, 2010, the receipts journal reflected \$1,670.47 in cash and \$543.45 in checks collected. The corresponding bank deposit reflected the deposit of \$543.45 in checks but only \$29.05 in cash for a cash shortage of \$1,641.42.

Between July 1, 2009 and March 7, 2012, we found a total of \$37,053.39 in cash that was received, but not deposited, as shown in the table below:

FY 11-12	TOTAL SHORTAGE	CASH SHORTAGE	FY 10-11	TOTAL SHORTAGE	CASH SHORTAGE	FY 09-10	TOTAL SHORTAGE	CASH SHORTAGE
07/2011	\$2,369.24	\$20.00	07/2010	\$2,219.99	\$321.00	7/2009	\$3,414.58	\$2,190.53
08/2011	\$3,936.84	\$2,275.86	08/2010	\$682.07	\$200.00	8/2009	\$4,364.70	\$3,907.02
09/2011	\$2,095.00	\$550.00	09/2010	\$2,937.98	\$1,000.00	9/2009	\$1,151.35	\$56.93
10/2011	\$2,337.48	\$301.68	10/2010	\$5,419.26	\$419.81	10/2009	\$3,869.83	\$2,007.20
11/2011	\$713.00	\$25.00	11/2010	\$1,732.93	\$0.00	11/2009	\$2,596.18	\$1,318.62
12/2011	\$3,106.19	\$1,153.19	12/2010	\$6,095.09	\$4,580.00	12/2009	\$2,732.40	\$1,400.00
1/2012	\$1,112.50	\$835.00	1/2011	\$1,673.87	\$100.00	1/2010	\$1,470.99	\$633.00
2/2012	\$893.00	\$735.00	2/2011	\$1,472.51	\$0.00	2/2010	\$3,618.52	\$2,733.00
3/2012	\$150.00	\$50.00	3/2011	\$1,595.48	\$484.93	3/2010	\$1,859.63	\$1,080.08
4/2012	\$0.00	\$0.00	4/2011	\$2,773.08	\$934.50	4/2010	\$3,075.59	\$2,800.00
5/2012	\$0.00	\$0.00	5/2011	\$1,877.25	\$870.97	5/2010	\$3,205.82	\$2,927.26
6/2012	\$0.00	\$0.00	6/2011	\$1,444.57	\$19.75	6/2010	\$1,767.89	\$1,123.06
FY Total	\$16,713.25	\$5,945.73	FY Total	\$ 29,924.08	\$8,930.96	FY Total	\$ 33,127.48	\$22,176.70
							Total	\$37,053.39

We noted that the cash larceny transactions also appeared to stop, following the suspension of the bank deposit duty of Kardaleff in March 2012.

Finding: Some daily receipt reports were missing.

For the period July 1, 2009 through June 30, 2012, the City was unable to provide the receipts journals that were printed contemporaneous with the daily collections and deposits. The number of missing reports was twenty-six.

We asked the officials to reprint these reports from the City's computer system. Nine of the twenty-six reports were incomplete, allegedly due to some data loss from a software conversion, but the City was able to provide seventeen "history" reports of the twenty-six missing reports.

These reprinted history reports reflected the total amounts collected, but the amounts were not listed by individual receipt numbers and, as such, were of questionable value. In order to determine the total collections for the day, the reprinted history report, containing utility collections, must be combined with a reprinted receipt register. However, these reprinted receipt registers did not always include the actual receipt numbers.

If a receipt was issued for any payment *other than a utility payment*, then a receipt number was reflected on the reprinted report. However, if the payment was made *for a utility payment*, the reprinted reports did *not* show the receipt numbers.

For example, using the reprinted history reports we reconciled a \$118.28 variance in the total collection amounts. Later, while reviewing records, we located a receipt, number 3971, in the amount of \$118.28 that should have been included in the reprinted reports. The source of this variance was identifiable *only* because the receipt was printed and maintained among other miscellaneous records.

We note next in this report that the software used by the City allowed receipts and corresponding reports to be altered or deleted *after* receipts and reports were printed.

Because the reprinted reports do not include the receipt numbers for utility collections and the software used by the City allows for receipt alteration or removal, the reliability of the information contained in the seventeen reprinted reports is uncertain.

Although we identified an *additional* \$7,006.66 that appeared to be unaccounted for from both schemes previously reported, this amount is reported separately due to the potential unreliability of the information contained in the seventeen reports.

Finding: Out of 214 receipt numbers that were missing from the daily receipt reports reviewed, we could account for only twenty.

A fundamental test in determining if funds are missing is to perform a comparison of receipts issued to deposits made. As part of this test, receipt numbers are reviewed to ensure that receipt books are not missing or that copies have not been removed from receipt books.

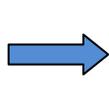
As noted earlier, the City used a two-part utility bill. When a customer paid their utility bill, one part of the bill, a payment stub, served as the only receipt retained by the HUA. The billing stubs were not pre-numbered as in the case of a receipt book.

As these billing stubs are not pre-numbered, it is imperative that the associated receipts journal include an accurate, sequential numbering of receipts in order to determine if receipts are missing.

From our prior experience with the billing and receipting software used by the City, we were aware that receipts can be altered or entirely removed from the computer system after issuance. City officials stated that one reason for this allowance was that in case of an error being made on a receipt, the receipt could be deleted and a new receipt issued.

When a receipt is deleted, gaps in the numbering exist. In order to determine if all the receipts were accounted for, we reviewed each day's daily receipts journal containing receipt numbers, and determined that gaps existed in the receipt journals, indicating receipts were deleted from the computer system.

For example, the receipts journal for October 10, 2011 included receipts ranging from 16554 through 16727. However, we noted a gap between receipts 16699 and 16701:



RCPT#	ID	DATE	ACCOUNT #	NAME/REMARKS	TOTL DUE	CODE
016699	.H	10/10/11	05-0049.00	JUBB, PATRICIA	56.45	U
016701	.H	10/10/11	08-0080.02	WRIGHT, STEVE & AMANDA	76.83	U

Searching miscellaneous records, we located the missing receipt, number 16700, showing a collection of \$100 in cash. We found no indication that the receipt was voided or that the receipt was issued in error.

**** RECEIPT ****					
ACCOUNT:	DATE: 10/10/11 TIME: 12:03:40 PM USER ID: LH	RECEIPT #: 016700			
CITY OF HEALDTON 310 FRANKLIN PO BOX 926 HEALDTON OK 73438 580-229-1283					
<i>deposited to Cemetery Caw Fund</i>					
REMARKS: JERROD COFFMAN					
CHECK 0.00	CASH 100.00	CR CARD 0.00	AMT PAID 100.00	TOTAL DUE 100.00	CHANGE 0.00
RENT	RENTS			100.00	

11-00-1283

We reviewed and reconciled the daily receipts journal with the day's deposits and found no variance between the report and the deposit since the \$100 receipt was not included in the report. It appeared that the \$100 receipt was deleted from the computer system, and the cash recorded with receipt #16700 was not included in the corresponding deposit.

In addition to gaps in the receipt numbers *within* a report, we also identified gaps in the receipt numbers *between* the daily reports. For example, the daily receipts journal for September 16, 2010 ended with receipt number 12597. The September 17, 2010 receipts journal started with receipt number 12630. Receipt numbers 12598 – 12629 were unaccounted for.

During the audit period, we found the 214 missing receipt numbers on 143 separate reports. In an attempt to locate the missing receipts, we searched

**** RECEIPT ****					
ACCOUNT:	DATE: 01/17/12 TIME: 3:21:50 PM	RECEIPT #: 001108			
CITY OF HEALDTON 310 FRANKLIN PO BOX 926 HEALDTON OK 73438 580-229-1283					
REMARKS: BLUE STEWART					
CHECK 0.00	CASH 425.00	CR CARD 0.00	AMT PAID 425.00	TOTAL DUE 425.00	CHANGE 0.00
FINE	FINES			425.00	

through the boxes of billing stubs and printed receipts, locating 13 of the 214 missing receipts. These receipts, representing \$1,679.15 in collections, gave no indication of having been voided or reprinted. An example of one of the 13 receipts is shown on the left.

We also found seven other receipts that appeared to have been actual corrected duplicate receipts issued for seven erroneous receipts that had been deleted. We had no means to determine the amount that may have

been collected, but was unaccounted for in relation to the other 194 (214 – 13 – 7) missing receipts.

Finding: **A printed receipt that conflicted with the amounts recorded on the computer system was identified, indicating the potential for additional unreliable records.**

As previously noted, it is our experience that the software used by the City allows for the alteration of receipts after issuance and/or printing. We encountered this issue during an embezzlement investigation related to the Town of Wilson. In our Healdton investigation, we found instances in which printed receipts did not reconcile with the amounts or to the payees reflected in the computer system. We also identified at least one instance in which the software allowed a receipt to be issued, which was then altered to reflect a different amount in the computer system.

Receipt number 14549, shown in the image below, was printed reflecting the total collection of \$453.55 in cash including \$203.55 for utility payments and \$250.00 for a meter deposit collection:

**** RECEIPT ****					
ACCOUNT: 10-0105.06		DATE: 08/19/11		RECEIPT #: 014549	
JACKSON, DIANE 123 RUTH		TIME: 1:08:08 PM			
HEALDTON OK 73438		USER ID: AB		CITY OF HEALDTON 310 FRANKLIN PO BOX 926 HEALDTON OK 73438 580-229-1283	
REMARKS:					
CHECK	CASH	CR CARD	AMT PAID	TOTAL DUE	CHANGE
0.00	453.55	0.00	453.55	453.55	0.00
U UTILITY PAYMENT				203.55	
MTRD METER DEPOSITS				250.00	

The following receipt register was generated from the computer's history file showing the collection for receipt number 14549 was \$110.00, with the "description" for the collection omitted, left blank:

*** RECEIPT REGISTER *** CITY OF HEALDTON OK.		05/07/13	Print: 05/07/13 2:12:01 PM	PAGE 1
(Fund/Pre: ALL; Refr #: 000000-999999; Dates: 08/19/11-08/19/11; Mo-Yr: 08-2011-05-2013; Bank Cd:)				
REFR#*	DESCRIPTION	AMOUNT	DATE	
000000	AUTO POST RECONNECT FEE	9.34CR	08/19/11	
000000	auto post cable tv	431.83CR	08/19/11	
000000	AUTO POST INTERNET SERVICE	72.35CR	08/19/11	
000000	AUTO POST SAN TOTAL	251.64CR	08/19/11	
000000	AUTO POST WATER TOTAL	720.15CR	08/19/11	
000000	AUTO POST SEWER TOTAL	460.49CR	08/19/11	
000000	AUTO POST PENALTY TOTAL	320.00CR	08/19/11	
000000	AUTO POST CHG CR BAL TOTAL	19.77	08/19/11	
014549		110.00CR	08/19/11	
014551	MICHAEL GILLUM	100.00CR	08/19/11	
TOTAL		2,458.03CR		

In reviewing the *reprinted* report for utility billing payments, we noted that the \$203.55 payment for utilities was credited to the customer's account, as reflected in the image below:

03-0014.04	JACKSON, DIANE	203.6TH	08/18/11	0	0	203.55	9601	Cash Paym
			**TOTAL:	0		203.55		

The corresponding daily reports reflected the collection of \$2,456.03 which included cash in the amount of \$1,026.02, checks totaling \$1,312.64 and credit card payments totaling \$117.37. Based on the deposit sources for this deposit, we initially determined that the deposit did not include \$400 of cash, but instead, had a \$400 check inserted in place of this cash. However, based on the printed receipt noted above, the deposit appears to have been short an additional \$140 in cash (the \$250 cash collected for meter reading charges minus the unidentified \$110 cash collection).

Because the software allows the alteration of receipts after issuance and/or printing, there is no means to determine how many other receipts may have been altered in the City's computer system or how much more misappropriation may have occurred as a consequence of this software feature.

Objective II: Review bank records provided by the District Attorney's Office.

Finding: Our review of the personal bank records of Kardaleff indicated some correlation between cash shortages in City deposits and cash deposits to personal accounts.

The District Attorney provided personal bank records for the following accounts:

- Karen Kardaleff/B & H Special Account – Checking Account (Act #****80)
- Jay/Karen Kardaleff – Checking Account (Act #****88)
- Karen/John Kardaleff – Checking Account (Act #****90)
- Amber Dawn Cunningham/Karen Kardaleff – Checking Account (Act #****85)
- Jay/Karen Kardaleff – Savings Account (Act #****72)
- Kory/Karen Kardaleff – Savings Account (Act #****61)
- Vivian Glenn – Checking Account (Act #****38)

The bank records provided were reviewed specifically for cash deposits made into these accounts.

We noted, in the Kardaleff accounts ****80, ****88 and ****90, cash deposits that were made within a week of cash shortages identified in the City/PWA accounts. These cash deposits are shown in a table as Attachment A to this report.

No corresponding cash deposits were identified in the remaining three Kardaleff accounts.

We also reviewed Vivian Glenn's bank account for cash deposits and corresponding cash shortages in City deposits, noting only a single marginal and/or improbable correlation in April 2010.

Objective III: Perform a review of prior audit reports and findings.

- Findings:**
- The Council and/or management continually ignored findings reported in the City's annual CPA audits.
 - The Mayor's explanation was that the City Council does not have oversight responsibility, and that under the council-manager form of government, the Council may only interact with city personnel through the city manager.
-

Background

According to Louis Smitherman, who served as the City Manager from August 2010 through August 2012, he had expressed concerns regarding the City's finances. He had attempted to address the issue of City Treasurer Kardaleff not submitting financial records timely. Smitherman stated that he felt the Council was unconcerned about the lack of financial records, as they never took any action.

Oklahoma State law requires municipalities to have an independent audit performed annually. Rahhal, Henderson, Johnson PLLC, CPA has performed the annual audits for the City for fiscal years 2005 through 2009. For fiscal years 2010 and 2011, the firm did not provide an "opinion" due to insufficient records and discrepancies in financial records.

Finding: **The City Council and/or management continually ignored findings reported in the City's annual CPA audits.**

The prior year's independent audit reports for the City included findings related, but not limited to, reconciliation of books and records, and deficits in accounts.

The repeated findings in the audit reports included:

June 30, 2005 audit report:

- Utility account adjustments made without approval
 - Cash balance deficits in accounts
 - Not encumbering expenditures
 - Expenditures exceed appropriations
-

June 30, 2006 audit report:

- Utility account adjustments made without approval
- Not encumbering expenditures
- Expenditures exceed appropriations

June 30, 2007 audit report:

- Not reconciling books and records
- Cash balance deficits in accounts
- Not depositing daily
- Tickets missing/untraceable to disposition
- Utility account adjustments made without approval
- Not encumbering expenditures
- Expenditures exceed appropriations
- Employees receiving free cable
- Employee with broken meter being charged same amount each month

June 30, 2008 audit report:

- Not reconciling books and records
- Cash balance deficits in accounts
- Not depositing daily
- Tickets missing/untraceable to disposition
- Utility account adjustments made without approval
- Not encumbering expenditures
- Expenditures exceed appropriations
- Employees receiving free cable
- Employee with broken meter being charged same amount each month

June 30, 2009 audit report:

- Not reconciling books and records
- Cash balance deficits in accounts
- Not depositing daily

- Tickets missing/untraceable to disposition
- Utility account adjustments made without approval
- Not encumbering expenditures
- Expenditures exceed appropriations
- Employees receiving free cable
- Employee with broken meter being charged same amount each month

June 30, 2010: financial report:

- Financial information unreliable
- Not reconciling books and records
- Not encumbering expenses
- Utility account adjustments made without approval
- Not depositing daily
- No attempt to collect past due utility receivables

June 30, 2011: financial report:

- Financial information unreliable
- Not reconciling books and records
- Not encumbering expenses
- Utility account adjustments made without approval
- Not depositing daily
- No attempt to collect past due utility receivables

The audit reports for fiscal years ending June 30, 2010 and 2011 included the following statement:

We were unable to obtain sufficient records supporting financial statement amounts because of discrepancies in the records. The resolution of these discrepancies is not presently determinable.

Because of the significance of the matter discussed in the preceding paragraph, we are unable, and we do not express, an opinion on the financial statements referred to in the first paragraph.

Beginning in 2007, the City was warned through repeated audit reports that the books and records were not being reconciled. The same finding occurred in each of the annual audit reports through 2012.

This reconciliation process is fundamental for ensuring that books and records balance and that fraud schemes, such as the check-for-cash substitution scheme and/or the cash larceny scheme do not go undetected for long. It appeared the City Council and/or management failed to adequately follow-up these repeated findings and continued with business as usual.

Finding: The Mayor’s explanation was that the City Council does not have oversight responsibility, and that under the council-manager form of government, the Council may only interact with city personnel through the city manager.

According to the Mayor, since he is not an accountant, he had not really understood the audit findings. Instead, the Council appeared to have taken the position that oversight was the responsibility of the various city managers employed over the past several years. Mayor Smith also explained the council’s oversight responsibility was limited because of the City’s form of government. Under the council–manager form of government the Council “shall deal with the administrative service of the city solely through the city manager.”

The Mayor observed that each time the CPA firm would present their findings, the Council would direct the various city managers to find whatever records the CPAs needed, but nothing seemed to be resolved.

The City Charter, Section 2-4 outlines the powers of the Council. These powers include:

Except as otherwise provided in this charter, all powers of the city including the determination of all matters of policy, shall be vested with the council. Without limitation of the foregoing, the council shall have power, subject to the state constitution, law and this charter:...

(3) To adopt the budget, raise revenue, and make appropriations; and to regulate bond elections, the issuance of bonds, sinking funds, the refunding of indebtedness, salaries, wages, and other compensation of officers and employees, and all other fiscal and business affairs of the city;...

(4) To inquire into the conduct of any office, department, or agency of the city government, and investigate municipal

affairs; and for this purpose to subpoena witnesses, take testimony, and require the production of evidence.

The City's Charter language does not appear to be ambiguous. Section 2-4(3) grants the Council the right to regulate "all other fiscal and business affairs of the city." Section 2-4(4) includes the power to "investigate municipal affairs" of the City and to "subpoena witnesses, take testimony, and require the production of evidence."

Title 11 O.S. § 10-106 (4) includes similar language for cities operating under a council-manager form of government. By statute, council members may "Inquire into the conduct of any office, department or agency of the city, and investigate municipal affairs, or authorize and provide for such inquiries..."

In addition to the powers granted to the Council, all City officials, including members of the governing board, have a fiduciary responsibility to act in the best interest of the citizens and the municipality as a whole. This responsibility involves maintaining some level of fiscal oversight, particularly as the City Council and management received repeated significant audit findings from their own independent auditor.

Objective IV: Other concerns or issues were identified.

Finding: Checks were cashed for employees, some of which were drawn on accounts with insufficient funds.

Liz Hanna was hired as an account clerk in May 2010. In July 2012, she became the Court Clerk, and in December 2012, she became Deputy Clerk-Treasurer as well. Hanna was cleaning out former Treasurer Kardaleff's desk, following Kardaleff's termination in August 2012. Certain checks were found in Kardaleff's desk.

Although city hall shares an alleyway with a local bank, City employees had been allowed to cash personal checks, as well as two-party checks at city hall. For example, between July, 2010 and July, 2011 eleven checks, totaling \$1,220, were written by former employee Joe Roberts. All of these checks were included in the City's deposits, but were later returned as uncollectible and noted as insufficient funds. Roberts paid the City for these returned checks following their discovery.

Also found in Kardaleff's desk were \$154.75 in checks written to the City in December 2002 by former City Clerk Vivian Glenn. The former City employees' checks that were cashed and processed through the City's accounts were *not* included in the amounts reported under the findings related to the check-for-cash substitution scheme.

Finding: A partial bank deposit from 2002 was found in Kardaleff's desk.

In addition to the checks written by employees, checks dated in December 2002, in the sum of \$938.20, were discovered that appeared to be mostly customers paying on their utility bills. The checks were stamped "for deposit only Healdton Water Dept. Acct. #" and were found with completed deposit slips dated December 26, 2002, but the deposit apparently was never taken to the bank.

This find by Hanna in the process of cleaning out Kardaleff's desk provides evidence to support the observation that accurate and reliable reconciliations were not being done early in Kardaleff's tenure as city treasurer and the possibility that alleged misappropriations were occurring as early as 2002.

* * * * *

**Management's
response:**

Changes in policies and procedures have been implemented to reduce the risks of similar identified transactions reoccurring.

According to information provided by the current city manager, a number of changes in policies and procedures have been implemented to address the audit report findings from earlier fiscal years. Included in the management response provided were improvements in segregation of duties, daily deposit of collections and increased efforts to monitor financial operations and ensure board policies are being followed.

We were not engaged to and have not performed procedures to verify the implementation of the City's changes in policies and procedures. Our auditors did informally observe deposits made daily during our fieldwork. Based on the information provided, we concur with the changes as described and believe they should help reduce the risks of misappropriation for the City moving forward.

There are two key points that we would stress. One is the importance of maintaining those policies and procedures and continuing to monitor those policies and procedures over time to ensure they are being followed.

Another point would be to periodically (perhaps annually) perform a formal self-review and evaluation of the City's financial and other operations. The periodic review may include visits to other municipalities to obtain their policies, ordinances and procedures for financial controls, etc. and to evaluate those external policies and controls for possible adoption by the City of Healdton.

* * * * *

DISCLAIMER

In this report there may be references to state statutes and legal authorities, which appear to be potentially relevant to the issues reviewed by this Office. 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. Such determinations are within the exclusive jurisdiction of regulatory, law enforcement, and judicial authorities designated by law.

Attachment A

Kardaleff's Account Numbers ****80, ****88, ****90					
Deposit Transaction Date	Cash Deposited In Personal Acct		City Report Date	City Deposit Date	City Cash Shortage
7/21/2009	\$500.00		07/17/09	07/21/09	\$399.65
7/28/2009	\$1,000.00		07/27/09	07/28/09	\$295.00
			7/21 - 7/24/09	07/28/09	\$1,650.04
8/17/2009	\$400.00		08/14/09	08/17/09	\$565.00
9/29/2009	\$200.00		9/21-9/22/09	09/23/09	\$879.93
9/30/2009	\$200.00		9/24/2009	9/28/2009	\$229.42
1/18/2010	\$180.00		1/15/2010	1/18/2010	\$16.85
			1/18/2010	1/20/2010	\$533.00
3/5/2010	\$200.00		2/26/2010	3/3/2010	\$200.00
6/28/2010	\$100.00		6/25/2010	6/28/2010	\$18.49
			6/30/2010	7/1/2010	\$259.66
1/7/2011	\$900.00		12/30/2010	1/3/2011	\$766.00
1/17/2011	\$100.00		1/12/2011	1/13/2011	\$187.00
			1/13/2011	1/17/2011	\$16.40
			1/14/2011	1/17/2011	\$60.00
3/2/2011	\$940.00		2/24/2011	2/28/2011	\$100.00
			3/2/2011	3/3/2011	\$333.22
8/23/2011	\$300.00		8/22/2011	8/23/2011	\$325.00
8/31/2011	\$150.00		8/30/2011	9/2/2011	\$345.00
9/23/2011	\$1,200.00		9/23/2011	9/27/2011	\$1,150.00
10/10/2011	\$300.00		10/10/2011	10/11/2011	\$100.00
			10/7/2011	10/10/2011	\$369.32
10/24/2011	\$600.00				\$0.00
10/26/2011	\$200.00				\$0.00
11/15/2011	\$900.00				\$0.00
11/21/2011	\$900.00				\$0.00
11/28/2011	\$524.00		11/23/2011	11/28/2011	\$25.00
			11/28/2011	11/29/2011	\$375.00
12/16/2011	\$200.00		12/12/2011	12/13/2011	\$1,150.00
12/30/2011	\$300.00		12/20 -12/22/11	12/27/2011	\$917.19
			12/28 -12/29-11	12/30/2011	\$200.00



OFFICE OF THE STATE AUDITOR & INSPECTOR
2300 N. LINCOLN BOULEVARD, ROOM 100
OKLAHOMA CITY, OK 73105-4896

WWW.SAI.OK.GOV