

DEPARTMENT OF BUILDING AND FIRE SAFETY
Special Investigation
September 1998 through January 1999



DOUGLAS R. NORTON, CPA
AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

DEBRA K. DAVENPORT, CPA
DEPUTY AUDITOR GENERAL

June 18, 1999

The Honorable Jane Dee Hull, Governor

Mr. N. Eric Borg, Director
Department of Building and Fire Safety

At your request, we have conducted a limited investigation of the alleged theft of public monies during the period September 1998 through January 1999 at the Department of Building and Fire Safety. The purpose of our investigation was to determine the amount of money misappropriated during that period, if any, and whether the Department's internal controls over cash receipts were adequate to prevent their misappropriation.

Our limited investigation consisted primarily of inquiries and the examination of selected records and other documentation. Therefore, our investigation was substantially less in scope than an audit conducted in accordance with generally accepted auditing standards. Accordingly, we do not express an opinion on the adequacy of the financial records or the internal controls of the Department of Building and Fire Safety. We also do not ensure that all matters involving the Department's internal controls that might be material weaknesses under standards established by the American Institute of Certified Public Accountants or other conditions that may require correction or improvement have been disclosed.

Our finding and recommendations as a result of our limited investigation are set forth below.

Background

The Department of Building and Fire Safety enforces safety standards for manufactured homes, mobile homes, factory-built buildings, and recreational vehicles. The Department also enforces the State Fire Code and provides training for fire personnel and the general public. The Department is funded primarily by state appropriations, but also receives cash for providing training and issuing licenses and permits.

Theft of Public Monies

During the period September 1998 through January 1999, public money totaling \$71,332 was embezzled from Department receipts. Management did not establish or enforce simple internal controls that could have prevented the theft.

Beginning in September 1998, Department cash receipts were embezzled through a lapping scheme. Lapping is a recognized fraud scheme in which the embezzler uses later receipts to replace those already stolen. Basic internal controls typically prevent or detect lapping schemes. However, the Department of Building and Fire Safety lacked such controls; therefore, management failed to detect repeated lapping of deposits. The actual deposit of most receipts was delayed for several weeks.

Management is directly responsible for all of an entity's activities, including its system of internal control. The lapping scheme at the Department remained undetected because management did not establish internal controls that would have prevented it. Specifically, management did not ensure that cash was adequately safeguarded, controlled, and recorded.

- Many employees could easily access the Department's large sums of cash receipts and petty cash because the Department provided them with the combination to the safe and allowed it to remain unlocked during the workday. In addition, employees could interchange petty cash with cash receipts. They could also use the petty cash fund to make change for their own currency.
- Management allowed employees to make deposits weekly instead of daily, and did not require employees to obtain the current validated deposit receipts from the State Treasurer. Consequently, there was no way for management to ensure that the deposits were actually made and that amounts were correct.
- In the first week of January 1999, management noticed that several deposit batches recorded in the Department's records had not been deposited; however, management failed to take corrective action. Some of these deposit batches had been outstanding for several months.

Despite management's inaction, this lapping scheme was halted the last week of January 1999, after a State Department of Administration, General Accounting Office employee inquired about the Department's outstanding deposits. This inquiry caused management to examine the deposit process and institute "emergency cash-handling procedures." As a result, the Department discovered that 11 deposit batches, totaling \$71,332, were never deposited with the State Treasurer's Office. Of that amount, \$3,986 was cash and the remaining \$67,346 was checks and money orders.

Recommendations

To help ensure proper control over public monies, Department management should implement policies and procedures outlined in the *Arizona Accounting Manual*. These policies and procedures would include, but are not limited to, the following:

Management should ensure that cash is accounted for from the moment it is received.

- For cash received over-the-counter, issue prenumbered and numerically controlled receipt forms or ring it through a cash register.
- For cash received through the mail, record amounts on a mail log.
- Summarize cash receipt forms, cash register tapes, and amounts recorded on mail logs daily and reconcile to the amount of cash and checks on hand.
- Review and approve such reconciliations at a supervisory level.
- Deposit cash intact and on a daily basis.
- Obtain validated State Treasurer's deposit receipts for each day's deposit.
- Compare validated State Treasurer's deposit receipts to approved cash receipt summaries and amounts recorded in the Department's records and approve at a supervisory level.

Management should also ensure that all cash is safeguarded.

- Restrict cash-handling duties to a limited number of employees and do not permit those employees to perform the various reconciliations or make the deposits.
- Restrict safe combinations and keys to cash boxes to a limited number of employees.
- Lock safes and cash boxes when they are not in use.

Further, management should ensure proper use of the petty cash fund.

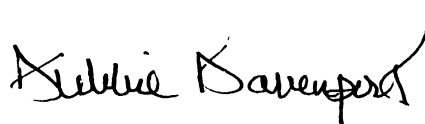
- Designate one employee as the petty cash fund custodian.
- Do not allow employees to use the petty cash fund as a change fund.
- Do not allow employees to use the petty cash fund to make change for their own currency.

Finally, management should ensure that the Department's written cash policies and procedures are updated periodically. Departure from these procedures should be thoroughly investigated and resolved by management on a timely basis.

These findings are included in our Report on Special Investigation that has been submitted to the State of Arizona, Office of the Attorney General for review.

This letter is intended for the information of the Department of Building and Fire Safety. However, this letter is a matter of public record and its distribution is not limited.

We have reviewed this letter with N. Eric Borg, Director; but should you have any questions concerning its contents, please let us know.



Debbie Davenport
Deputy Auditor General

Jane Dee Hull
GOVERNOR



N. ERIC BORG
DIRECTOR

DEPARTMENT OF BUILDING AND FIRE SAFETY

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OFFICE OF ADMINISTRATION • OFFICE OF MANUFACTURED HOUSING • OFFICE OF STATE FIRE MARSHAL

June 17, 1999
ADOC #99-028

Debbie Davenport
Deputy Auditor General
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Re: Department Response to Investigation Findings

Dear Ms. Davenport:

On January 29, 1999, the Department became aware of a misuse of public funds and requested through the Attorney General that the Auditor General conduct an investigation. The Department has cooperated fully with the investigation and concurs with the findings in the investigative report.

The Department has implemented almost all of the recommendations provided by your office. The remaining changes are in process and will be in place shortly. Personnel actions have been taken with the involved individuals. A periodic review process will be implemented to ensure that procedures are kept current and that any deviation will be discovered and corrected in a timely basis.

We appreciate the efforts of your staff in helping us resolve this matter. I would like to make a special note of the professionalism and courtesy displayed by George Graham and Holly Froom. Their conduct was outstanding.

Please contact me should you require further information.

Sincerely,

A handwritten signature in cursive script that reads "N. Eric Borg".

N. Eric Borg, Director
DEPARTMENT OF BUILDING AND FIRE SAFETY
State of Arizona

c: George Graham