



Internal Audit Review:
Vice Narcotics Investigative Unit Buy Fund

Robert Threatt
Internal Audit Manager
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INTRODUCTION

Scope & Objectives

The City's fiscal year 2022-23 internal audit plan called for a review of the Vice Narcotic Investigative Unit's Buy Fund (Buy Fund). The following objectives were the focus of the review engagement.

- To determine whether the unit's Buy Fund was managed in accordance with City policies and procedures.
- To assess whether established Buy Fund policies and procedures provide for effective internal controls to safeguard program assets.

Methodology

- Performed a cash count of the unit's Buy Fund.
- Interviewed personnel from the Police Department's Vice Narcotics Investigative Unit and the Finance Department.
- Reviewed Buy Fund transactions and supporting documentation.
- Observed the physical controls in place to safeguard Buy Fund assets.
- Performed a cash count of the unit's Buy Fund.

Background

The Carlsbad Police Department's Vice Narcotics Investigative Unit (VNIU) is responsible for targeting those responsible for the use, distribution, sale, and proliferation of illegal drugs in the community. The unit is also responsible for enforcing laws related to gambling, liquor laws, prostitution, and other illegal activities. The Buy Fund supports the unit's activities and is intended to be used for purposes such as prop and drug purchases, flash money, informant payments and to purchase supplies to support the unit's operations.

The Vice Narcotics Investigative Unit is comprised of a sergeant who serves as the unit's supervisor, three detectives and two task force officers. Use of the Buy Fund is governed by two police department policies, Policy 607 Vice Narcotics Investigative Unit-Buy Fund (Policy 607) and Policy 608.5 Narcotics Informant Payment Procedures (Policy 608.5) as well as City of Carlsbad Administrative Order No. 85, Cash Funds Policy (Admin Order 85).

Policy 607 Vice Narcotics Investigative Unit-Buy Fund provides guidance concerning the purpose and scope of the Buy Fund, documentation requirements, budgetary levels and mandated audits. Policy 608.5 Narcotics Informant Payment Procedures provides the approval criteria for payments to informants, guidance for payments at different dollar value thresholds and approval documentation requirements. The City's Administrative Order No. 85 Cash Funds Policy establishes the city's cash handling standards.

Summary of Results

The VNIU Buy Fund review engagement was comprised of two objectives. The first objective called for a determination of whether the Buy Fund was managed in accordance with city policies and procedures. The second objective, called for an assessment of whether those policies and procedures provide for effective internal controls to safeguard Buy Fund assets.

The first component of the review engagement was an evaluation of the city's compliance with established Buy Fund and citywide policies and procedures. This was achieved by interviewing VNIU personnel regarding the procedures they adhere to and performing a detailed review of Buy Fund records to confirm their assertions. First, a physical cash count was performed to evaluate the accuracy of the program's recordkeeping and adherence to the policies referenced earlier. All Buy Fund transactions associated with the fiscal quarter ending March 31, 2023, were then reviewed to ensure they were documented in accordance with existing policies and procedures.

As a result of procedures performed, it was noted that Buy Fund activities were largely compliant with established policies and procedures and documentation was consistent throughout. However, there were two audit recommendations identified during this segment of the review, associated with maintaining segregation of duties.

The second objective called for an assessment of whether established Buy Fund policies and procedures provide for effective internal controls and safeguarding of program assets (cash). This was achieved while performing many of the same procedures identified in the first objective. Performing a cash count and evaluating physical controls, reviewing transactional documentation, and interviewing staff provided an effective evaluation of the Buy Fund's system of internal controls. While it was noted that existing policies do provide for effective controls and strong physical controls are present, there were opportunities identified for strengthening city policies and implementing procedures to bring about stronger control activities and the safeguarding of Buy Fund assets.

OBJECTIVE 1: ADHERENCE TO POLICIES AND PROCEDURES

To determine whether the Buy Fund is managed and accounted for in accordance with authorized policies and procedures.

Determining whether the Buy Fund is managed and accounted for in accordance with established policies and procedures was achieved by employing several different review procedures. Initial steps involved identifying and reviewing the relevant policies and procedures, which were identified as Police Department policies 607 and 608.5 as well as Administrative Order No. 85, Cash Funds Policy. Key VNIU personnel were interviewed and Buy Fund recordkeeping and documentation were evaluated to determine the degree to which the program is adhering to established policies and procedures.

The initial step in evaluating Buy Fund recordkeeping and documentation involved a physical cash count as of the month ended February 28, 2023. The cash count verified that the balance of the Buy Fund, without exception, agreed with the records maintained by VNIU staff.

The second procedure involved a detailed review of Buy Fund transactions (disbursements) from the fiscal quarter ending March 31, 2023. This included the evaluation of transactions from January, February, and March 2023. To evaluate staff's adherence to the referenced policies, the backup documentation associated with each disbursement was subjected to a detailed review.

For each disbursement, VNIU personnel are required to prepare a Carlsbad Police Department VNIU Investigative Unit Buy Fund disbursement form. The disbursement form enables staff to thoroughly document each transaction by recording approval signatures, witnesses, case numbers, if applicable, and payment details. Often the disbursement form includes attachments, such as invoices, receipts or other supporting documents that corroborate the recorded disbursements.

During the review of the Buy Fund documentation there were several disbursements identified where the VNIU Supervisor approved and disbursed funds, without a second approver reviewing the transaction prior to the disbursement of cash. It is noted that Policy 607 and 608.5 are the primary Buy Fund policies and in only a few instances do they provide detailed, procedural direction. While Policy 607 does call for the preparation of a monthly summary report, which is reviewed and approved by the Investigations Commander, this procedure takes place at month end, well after the cash disbursements are completed. The other relevant city policy, Administrative Order No. 85, establishes the city's cash handling standards and in Section 2.8 it indicates that fund (cash) custodians are not permitted to both approve and disburse funds. Segregation of duties is a standard internal control associated with financial transactions. Such a control serves to mitigate the likelihood of inappropriate disbursements and theft. Given direction from Admin Order 85 and the VNIU Supervisor's primary responsibility to disburse and safeguard Buy Fund cash assets, approval is required from a second authorized approver. Given the Buy Fund carries a balance of up to \$10,000 in cash at any point in time, this is an important standard.

It was noted during the review, nearly half of the annual Buy Fund balance was disbursed to pay for supplies or services, which most entities purchase with a city credit card or check and not cash. While Policy 607 states that it is appropriate to buy such supplies with cash from the Buy Fund, using a city credit card or issuing a check against a purchase order would reduce the overall risk represented by the Buy Fund, as the VNIU could carry a lower cash balance.

Recommendation #1: To adopt cash handling best practices and comply with Administrative Order No. 85, Section 2.8, the VNIU management should identify a separate authorized approver as soon as practical. This second staff member shall serve as the approving authority for all VNIU cash disbursements by reviewing and approving cash transactions prior to disbursement. This must be someone other than the VNIU Supervisor as that role serves as the disbursing authority and cash custodian for the Buy Fund.

Recommendation #2: As required for change funds in Administrative Order No. 85, Section 2.3.6, it is recommended that VNIU personnel with oversight or management responsibilities associated with the Buy Fund, attend annual cash handling training. Historically, the Finance Department has provided such training. The County of San Diego also has an annual cash handling training course available to public agencies. Lastly, there are also commercial continuing professional education (CPE) offerings online that provide training associated with widely accepted cash handling standards.

OBJECTIVE 2: EFFECTIVE CONTROLS

To assess whether the VNIU's policies and procedures provide effective controls for safeguarding Buy Fund assets.

To assess whether the Buy Fund policies and procedures provide for sound controls and effectively safeguard assets, the program's policies and processes were evaluated against cash handling best practices. The policies and processes were evaluated using interviews, a cash count and reviewing disbursement documentation. As a result of the procedures performed, several opportunities for strengthening internal controls and safeguarding assets were identified.

As noted in the review procedures associated with Objective 1, there is an opportunity to strengthen the Buy Fund's segregation of duties. During the review, it was observed that Buy Fund personnel consistently adhered to direction from all known policies. For several years that was comprised of only Policy 607 and Policy 608.5. Then in May 2020 Administrative Order No. 85, Cash Funds Policy, was issued and established citywide cash handling standards. While the Buy Fund does not fall within the limited scope of cash funds defined by the administrative order, the cash handling standards it establishes are universally applicable to cash transactions.

Recommendation #3: Given the material balance and activity of the Buy Fund and the unique nature of VNIU operations, it is recommended that VNIU staff collaborate with the Finance Department to develop a Buy Fund cash handling procedure. The procedure should incorporate guidelines from Policy 607 and cash handling standards referenced in Administrative Order No. 85. The purpose of the procedure is to provide detailed cash handling guidance to VNIU staff. Adherence to these procedures will contribute to sound internal controls and will help safeguard Buy Fund (cash) assets.

Administrative Order No. 85, Cash Funds Policy, Section 2.14 authorizes the development of department specific cash handling policies so long as they do not contradict or supersede those in the administrative order. This enables staff to develop stand-alone, local procedures that adhere to citywide cash handling standards while addressing unique Buy Funds operations.

To process disbursements in support of VNIU operations, the Buy Fund always maintains a cash fund balance. This is achieved through annual funding from the city's General Fund. Typically, once, or twice a year, the Buy Fund is replenished with the allocated budget. The

Budgetary Process section of Policy 607 provides general guidelines staff are to follow during the replenishment process.

The policy for the replenishment process currently indicates that the Finance Department is to issue a check to the VNIU Supervisor who then cashes the check at the city's bank. After cashing the check, the VNIU Supervisor transports the cash back to the unit where it's secured in the VNIU safe. It is noted that similar to segregation of duties, the policy associated with the cash replenishment process, Policy 607, provides a general framework but lacks definitive procedures. For a process that is typically detail intensive, this represents an opportunity for strengthening the city's internal controls associated with cash handling.

During the Buy Fund review, a cash replenishment deposit of \$7,000, dated February 9, 2023, was selected and documentation was reviewed. This included reviewing the transaction documentation and discussing the process with the VNIU Supervisor. As a result, it was discovered that the Finance Department made the determination that the documented policy, which called for the city to cut a check in the name of the VNIU Supervisor, did not provide for sufficient control of City funds.

To address the matter, on an interim basis, the Finance Department revised the replenishment process and strengthened the associated controls. The interim process calls for a check to be cut to "petty cash" and issued to the Treasury Accountant. If there is a significant amount of time between the check being cut and personnel meeting at the bank, Accounts Payable secures the check. Then at an agreed to date and time, the Treasury Accountant meets the VNIU Supervisor at the City's bank of record. The check is cashed by the bank, and then after completing a chain of custody form prepared by the Finance Department, the VNIU Supervisor takes possession of the cash and transports it back to the VNIU safe. This deviation from Policy 607 ensures the check remains in the control of Finance Department staff until cashed.

After reviewing the replenishment documentation, the applicable section of Policy 607 and discussing the process with the VNIU Supervisor and Finance Department staff, it is noted there are control weaknesses associated with the replenishment process outlined in Policy 607. While interim procedures provide increased control, it was noted that at times, there has been a gap in time between when the check is cut and issued to the Treasury Accountant and when that staff member meets the VNIU Supervisor at the bank. This gap represents a risk to the city, as a petty cash check is a live check that anyone can deposit.

During the procedures referenced in this review, it is noted that the physical controls of the Buy Fund cash balances were found to be secure. The Buy Fund cash balance is secured in a safe, located in a secured office, within the Police Department Headquarters. It is noted there are three layers of physical barriers preventing unauthorized access. Given these observations, the risk of unauthorized access is quite low.

Recommendation #4: It is recommended that the Finance Department evaluate the feasibility and cost effectiveness of utilizing an armored transport service to deliver the cash replenishment directly to the VNIU department at Police Headquarters. This represents a best practice, and the service is often coordinated directly by large banks. If armored transport is not utilized, it is recommended that Accounts Payable secure the petty cash

check until just prior to the Finance Department staff meeting the VNIU Supervisor at the bank. This will serve to reduce the risk the check is unsecured for periods of time prior to being cashed at the bank.

Once the new process is finalized, the Finance Department and VNIU staff should take steps to ensure the relevant policies and procedures are updated to reflect the new process.

SUMMARY OF RECOMMENDATIONS

Recommendation 1: To adopt cash handling best practices and comply with Administrative Order No. 85, Section 2.8, the VNIU management should identify a separate authorized approver as soon as practical. This second staff member shall serve as the approving authority for all VNIU cash disbursements by reviewing and approving cash transactions prior to disbursement. This must be someone other than the VNIU Supervisor as that role serves as the disbursing authority and cash custodian for the Buy Fund.

Management Response: VNIU agrees with the recommendation and will implement a second authorized approver in the form of the Unit Commander to verify/approve transactions.

Recommendation 2: As required for change funds in Administrative Order No. 85, Section 2.3.6, it is recommended that the VNIU Supervisor and Investigations Commander, attend annual cash handling training given their roles in overseeing the Buy Fund cash balances. Historically, the Finance Department has provided such training. The County of San Diego also has an annual cash handling training course available to public agencies. Lastly, there also are commercial continuing professional education (CPE) offerings online that provide training associated with widely accepted cash handling standards.

Management Response: VNIU agrees with the recommendation and will attend annual cash trainings.

Recommendation 3: Given the material balance and activity of the Buy Fund and the unique nature of VNIU operations, it is recommended that VNIU staff collaborate with the Finance Department to develop a Buy Fund cash handling procedure. The procedure should incorporate guidelines from Policy 607 and cash handling standards referenced in Administrative Order No. 85. The purpose of the procedure is to provide detailed cash handling guidance to VNIU staff. Adherence to these procedures will contribute to sound internal controls and will help safeguard Buy Fund (cash) assets.

Administrative Order No. 85, Cash Funds Policy, Section 2.14 authorizes the development of department specific cash handling policies so long as they do not contradict or supersede those in the administrative order. This enables staff to develop stand-alone, local procedures that adhere to citywide cash handling standards while addressing unique Buy Funds operations.

Management Response: The Finance Department agrees with the recommendation. Finance staff will work collaboratively with VNIU staff to either amend an existing or

establish a new policy to ensure the scope sufficiently incorporates cash handling standards referenced in Administrative Order No. 85.

Management Response: VNIU agrees with the recommendation. VNIU staff will work collaboratively with Finance staff to either amend an existing or establish a new policy to ensure the scope sufficiently incorporates cash handling standards referenced in Administrative Order No. 85.

Recommendation 4: It is recommended that the Finance Department evaluate the feasibility and cost effectiveness of utilizing an armored transport service to deliver the cash replenishment directly to the VNIU department at Police Headquarters. This represents a best practice, and the service is often coordinated directly by large banks. If armored transport is not utilized, it is recommended that Accounts Payable secure the petty cash check until just prior to the Finance Department staff meeting the VNIU Supervisor at the bank. This will serve to reduce the risk the check is unsecured for periods of time prior to being cashed at the bank.

Once the new process is finalized, the Finance Department and VNIU staff should take steps to ensure the relevant policies and procedures are updated to reflect the new process.

Management Response: Management agrees with the recommendation. Finance staff will pursue options for armored transport services and evaluate applicable cost benefit considerations. In the interim, upon issuing a check made out to “petty cash,” staff will immediately secure the check in a safe or locked cabinet until needed for routing to the bank.