

**Performance Audit 21-05:
Chattanooga Police Department
Confidential Funds**

November 2021

City Auditor

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OFFICE OF INTERNAL AUDIT

Stan Sewell, City Auditor

November 10, 2021

To: Mayor Tim Kelly
City Council Members

RE: Chattanooga Police Department Confidential Funds Audit (Report #21-05)

Dear Mayor Kelly and City Council Members:

The attached report contains the results of our confidential fund audit. Our audit determined that the Chattanooga Police Department administers confidential funds in accordance with state regulations and departmental procedures.

We would like to take this opportunity to thank the dedicated officers and employees of the CPD for their courtesy, cooperation and assistance during this audit.

Sincerely,

Stan Sewell, CPA, CGFM, CFE
City Auditor

Attachment

cc: Audit Committee Members
Joda Thongnopnua, Interim Chief of Staff
Julia Bursch, Deputy Chief of Staff
Eric Tucker, Interim Police Chief
Zac McCullough, Assistant Police Chief
Brian Russell, Narcotics/Vice Division Sergeant
Traci May, Narcotics/Vice Division Sergeant
Brian Smart, Manager Financial Operations
Jim Arnette, Tennessee Local Government Audit

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AUDIT PURPOSE

This audit was conducted in accordance with the Office of Internal Audit's 2021 Audit Agenda. The objective of the audit was to determine if the Chattanooga Police Department ("CPD") administers confidential funds in accordance with state regulations and departmental procedures.

BACKGROUND

State law requires the Tennessee Comptroller of the Treasury ("Comptroller") to develop procedures for handling cash transactions in undercover narcotics operations by county and municipal drug enforcement programs.¹ The Comptroller procedures apply to all cash transactions in undercover narcotics operations, which for confidentiality reasons are distributed in cash.² Examples of confidential transactions include payments to informants for information and purchasing narcotics in undercover investigations.

To comply with the Comptroller procedures, the CPD maintains two (2) bank accounts for undercover operations: Narcotics and Part I Offenses. The CPD uses funds from the Narcotics account for drug-related undercover operations, and funds from the Part I Offenses account for all other types of undercover operations, including prostitution, burglary, homicide, and organized crime investigations.

Accessing Confidential Funds

CPD officers can access confidential funds by completing a Transaction Record of Each Advance or Return of Confidential Funds (A-2 form). The A-2 form details each advance or return of confidential funds and must be approved by the police chief or designee. Advances and return of confidential funds are also reported on the Custodian's Activity Log (A-1 form). The A-1 form serves as a record of payments into and out of the confidential fund accounts, allowing the custodian to monitor disbursements and account balances.

Accounting for Confidential Funds

After receiving confidential funds, officers must comply with the following requirements to account for funds in their possession:

- 1) Maintain an Officer's Activity Log for Confidential Funds (A-3 form). The A-3 form documents all confidential fund transactions made by the officer during the month.

¹ T.C.A. § 39-17-420(e).

² The CPD has expanded the scope of the Comptroller procedures to apply to cash transactions in all undercover operations.

- 2) Prepare an Accountability of Confidential Funds (A-4 form) for each expenditure. The A-4 form includes the date, amount and purpose of each confidential fund expenditure. Officers are required to attach all available receipts to the A-4 form.
- 3) Prepare a Receipt for Payment to Informant (A-5 form) for each informant payment. The A-5 form also serves as an agreement between the officer and the informant as to how the funds will be used. Approval by a supervisor is required for informant payments exceeding \$200.00.
- 4) Notify the Narcotics/Vice supervisor when making an informant payment. The Narcotics/Vice supervisor is responsible for preparing an Informant Payment Record (A-6 form) for each informant receiving confidential funds. The A-6 form records all payments made to the informant and must be maintained with the informant's file in a secure location.
- 5) Submit the required accounting forms to the CPD log custodian at the end of each month.³

Prior Audits of Confidential Funds

In June 2019, the Office of Internal Audit (“OIA”) performed an audit of confidential funds and determined the CPD’s administration of confidential funds substantially complied with state regulations and departmental policy.⁴ Consistent with the findings from the prior audit, the OIA made the following recommendations to strengthen internal controls over confidential fund disbursements:

- 1) Amend the CPD policy manual to include procedures for purchasing equipment and supplies with confidential funds, reporting missing or unaccounted for funds to the Tennessee Comptroller and district attorney general, and training officers on the procedures for handling confidential funds;
- 2) Develop a centralized case management system for all divisions involved in handling confidential funds;
- 3) Develop procedures to be followed when officers without confidential fund privileges are provided confidential funds;

³ The log custodian is responsible for preparing the Monthly Reconciliation Reports (A-7 forms) and performing quarterly audits of confidential funds. According to CPD Policy Manual SOP-1 Part VII § I.1, the results of the quarterly audits are not required to be reported since the log custodian sends A-7 forms to the City’s Finance department each month concerning the status of confidential funds.

⁴ CPD Policy Manual SOP-1 Part VII § I.2 requires regular audits of confidential funds by the OIA.

- 4) Discontinue the use of confidential funds for operations that do not require confidentiality; and
- 5) Formalize the guidelines for determining the amount of payments to informants.

In October 2020, the OIA conducted a post-audit review and determined the CPD had fully implemented all the recommendations from the prior audit.

Financial Information

Exhibit 1.

Narcotics Fund (9250)	FY2020	FY2021
Revenues	\$427,764	\$329,295
Equipment	\$24,567	\$189,146
Investigative Services	\$100,587	\$123,235
Evidence Purchased	\$31,500	\$29,900
Payments to Informants	\$46,040	\$47,415
Supplies & Services	\$166,077	\$69,845

Part I Fund (9025)	FY2020	FY2021
Revenues	\$0	\$4,730
Equipment	\$0	\$0
Investigative Services	\$3,0392	\$9,000
Evidence Purchased	\$4,550	\$570
Payments to Informants	\$16,280	\$2,730
Supplies & Services	\$0	\$0

Source: FY2020-FY2021 Confidential Fund Annual Reports (R-3 Reports)

AUDIT FINDINGS

Procedures governing the administration of confidential funds

In June 2021, the Comptroller revised the procedures for handling cash transactions in undercover operations by drug enforcement programs. The following procedures and directives currently apply to all confidential fund transactions:

Training. Law enforcement officials handling confidential funds must review and be familiar with the Comptroller procedures. Documentation of the review must be maintained by the law enforcement agency.

Request for funds. The police chief must account for confidential funds in a separate column of the cash journal or through separate bank accounts. The Report of Confidential Funds Requested or

Returned (R-1 form) must be signed by the police chief or designee and provided to the Finance department with each request.

Receipts and deposits. Pre-numbered receipts must be issued for all confidential funds received for undercover operations.⁵ Funds must be deposited to the appropriate bank account(s).

Disbursements. Disbursements must be made by pre-numbered checks. All checks must be signed by the police chief or designee and made payable to the person receiving the funds. Employees handling confidential funds must have a fidelity bond or liability insurance.

Internal accounting forms. Law enforcement agencies subject to the Comptroller procedures must use forms approved by the Comptroller to account for confidential funds.

Purchasing equipment and supplies. Purchases of equipment and supplies should be made through normal purchasing processes. However, if confidentiality is necessary, documentation is required to support the purchase, including invoices, price quotes, and a memorandum explaining the justification for making the purchase with confidential funds.

Maintaining Informant files. Separate files must be maintained for each informant. An Informant Payment Record (A-6 form) must be included with the informant file and made available for audit.

Use of funds by secondary agencies. Contracts or other written acknowledgment of receipt of funds and acceptance of responsibility must be obtained for any drug funds remitted to another agency. The agreements must be signed by the police chief or designee of the agency receiving the funds and the agency providing the funds. Copies of the agreements must be retained for audit purposes.

Availability of records and reports for audit. All books and records pertaining to confidential fund disbursements (except informant files, surveillance tapes, and evidence) are subject to inspection and audit.

Reporting missing funds. Missing or unaccounted for funds must be reported to the district attorney general. A copy of the report must also be submitted to the Comptroller. The police chief is responsible for taking action to recover any misappropriated funds.

⁵ This includes funds transferred to the CPD from the Finance department and funds returned on settlement of cash advances.

To determine if the CPD procedures governing confidential funds conform to the revised Comptroller procedures, we cross-referenced the Comptroller’s procedures (above) to the corresponding procedures in the CPD Policy Manual. As illustrated in Exhibit 2 below, the CPD procedures for confidential funds comply with the Comptroller procedures and requirements.

Exhibit 2.

Comptroller Procedures	Compliance	CPD Policy Reference
<i>Training</i>	Yes	SOP-1 Part VII § D.4
<i>Request for funds</i>	Yes	SOP-1 Part VII §§ B & C.2
<i>Receipts and deposits</i>	Yes	SOP-1 Part VII §§ B & C.2
<i>Disbursements</i>	Yes	SOP-1 Part VII § D.1-3
<i>Internal accounting forms</i>	Yes	SOP-1 Part VII § K
<i>Purchasing equipment and supplies</i>	Yes	SOP-1 Part VII § B
<i>Maintaining informant files</i>	Yes	SOP-1 Part VII § E.1(e)
<i>Use of funds by secondary agencies</i>	Yes	SOP-1 Part VII § G
<i>Availability of records for audit</i>	Yes	SOP-1 Part VII § I
<i>Reporting missing funds</i>	Yes	SOP-1 Part VII § I.3

Auditee Response: *We agree with the audit finding.*

Compliance with procedures for confidential funds disbursements

Our audit testing confirmed that CPD officers and employees responsible for administering confidential funds complied with the Comptroller procedures and departmental policy.

Audit Test 1: Requested and Returned Funds

Standard(s): The CPD log custodian is required to submit a Report of Confidential Funds Requested or Returned (R-1 form) together with a warrant voucher to withdraw confidential funds from the Finance department. The log custodian is responsible for depositing the funds in the appropriate bank account(s).

Audit Procedure: We examined all R-1 forms and warrant vouchers submitted to the Finance department during the audit period. We also examined all deposit receipts from the confidential fund accounts and traced the deposit/return totals to the Monthly Reconciliation Reports (A-7 forms) and Quarterly Reports (R-2 reports).

Findings: We verified the requested/returned funds were deposited into the appropriate bank account(s) and recorded accurately on the A-7 forms and R-2 reports. The police chief approved all R-1 forms and warrant vouchers submitted during the audit period.

Audit Test 2: Custodian's Activity Log

Standard(s): The CPD log custodian must document advances and return of confidential funds on the Custodian's Activity Log (A-1 form). Separate A-1 forms are required for each confidential fund account.

Audit Procedure: We analyzed a statistical sample of A-1 and A-2 forms and compared transaction details on the A-1 forms to the transaction details on the corresponding A-2 forms.

Findings: In the sample tested, the transaction details reported by the log custodian on the A-1 forms matched the transaction details reported by officers on the corresponding A-2 forms.

Audit Test 3: Monthly and Quarterly Reports

Standard(s): The log custodian must submit a Monthly Reconciliation Report (A-7 form) and Quarterly Report (R-2 Report) to the Finance department and the police chief.

Audit Procedure: We examined a random sample of A-7 forms and R-2 reports and compared the account balances to the balances reported on the A-1 forms to detect any missing or unaccounted for funds.

Findings: We reconciled the account balances on the A-7 forms and R-2 reports with the account balances on the A-1 forms. We did not detect any missing or unaccounted for funds. We also confirmed the A-7 forms and R-2 reports were submitted timely to the Finance department and police chief.

Audit Test 4: Annual Federal Reporting

Standard(s): The log custodian must submit an annual report to the US Department of Justice, the US Department of Treasury, and the Finance department detailing all drug fund transactions.⁶

⁶ The Comptroller procedures do not require annual reporting to federal agencies. However, law enforcement agencies receiving confidential fund grants from the US Department of Justice must comply with the grant conditions and reporting requirements.

Audit Procedure: We reviewed copies of the FY2020 and FY2021 confidential fund annual reports to verify compliance with federal grant requirements and CPD policy.

Findings: We confirmed the log custodian prepared and submitted timely annual reports to the designated federal agencies and Finance department during the audit period.

Audit Test 5: Advances and Return of Funds

Standard(s): Officers receiving confidential funds must complete a Transaction Record of Each Advance or Return of Confidential Funds (A-2 form). The police chief or designee must approved the A-2 form.

Audit Procedure: We examined the A-2 forms from a statistical sample of undercover investigations involving confidential funds to determine if officers properly followed procedures for obtaining confidential funds.

Findings: In the sample reviewed, officers completed the A-2 forms with accurate and detailed information about the advance/return of confidential funds. The police chief approved all A-2 forms from the sample.

Audit Test 6: Accounting Responsibilities

Standard(s): Officers must account for confidential funds in their possession by: 1) maintaining an Officer's Activity Log (A-3 form); 2) preparing an Accountability of Confidential Funds (A-4 form); 3) preparing a Receipt for Payment to Informant (A-5 form); 4) obtaining approval from a supervisor for informant payments exceeding \$200.00; and 5) notifying the Narcotics/Vice supervisor when a payment is made to an informant.

Audit Procedure: Using the same statistical sample from Audit Test 5, we reviewed the investigative file information, officer accounting forms, and log custodian records to determine if officers properly followed procedures to account for confidential funds in their possession.

Findings: In the sample reviewed, officers complied with all confidential fund accounting procedures.

Audit Test 7: Informant Payment Records

Standard(s): Narcotics/Vice supervisors must prepare and maintain an Informant Payment Record (A-6 form) for each informant receiving payment. The A-6 form must be maintained with the informant's file in a secure location.

Audit Procedure: Using the same statistical sample from Audit Tests 5 and 6, we examined the A-6 forms for the informants receiving payment and traced the payment information to the corresponding Receipt for Payment to Informant (A-5 form).

Findings: We confirmed that Narcotics/Vice supervisors followed the required procedures for maintaining secure informant files. In the sample reviewed, the payment information recorded by the supervisor on the A-6 form matched the payment information reported by the officer on the A-5 form.

Auditee Response: *We agree with the audit findings.*

APPENDIX A: SCOPE, METHODOLOGY AND STANDARDS

Based on the work performed during the preliminary survey and our assessment of risk, the audit covers the administration of confidential funds by the CPD from July 1, 2020 to June 30, 2021. When appropriate, we expanded our scope to meet the audit objectives. We reviewed source documentation and records from the CPD and Finance department. We used original records and copies as evidence verified through physical examination.

We examined evidence on a test basis and applied other procedures required to meet the audit objectives. Those procedures included:

- Reviewing relevant state laws, regulations, and departmental policies and procedures;
- Evaluating the internal control framework governing confidential fund disbursements;
- Reviewing best practices and industry standards for handling cash transactions in undercover operations by law enforcement agencies;
- Conducting a risk assessment to identify high-risk activities and potential fraud risks; and
- Interviewing management and staff responsible for administering confidential funds.

The sample size and selection of the data we examined for the audit were statistically generated using a desired confidence level of 90 percent, expected error rate of five (5) percent, and a desired precision of five (5) percent. We used statistical sampling to extrapolate the conclusions of the test work performed on the data sample to the entire population from which it was drawn and obtain estimates of sampling error. When appropriate, we used judgmental sampling to improve the efficiency of the audit.

We conducted this performance audit from September 2021 to November 2021 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our audit findings and conclusions.

City of Chattanooga Fraud, Waste, and Abuse Hotline

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