

**Performance Audit 19-02:
Police Confidential Funds**

June 2019

City Auditor

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OFFICE OF INTERNAL AUDIT

Stan Sewell, City Auditor

June 27, 2019

To: Mayor Andy Berke
City Council Members

Subject: Confidential Funds Audit (Report #19-02)

Dear Mayor Berke and City Council Members:

The attached report contains the results of our Confidential Funds audit. Our audit found that the Chattanooga Police Department's administration of confidential funds substantially complies with applicable laws, regulations, and procedures. However, we also identified opportunities to strengthen the internal control framework for confidential fund disbursements.

In order to address the noted areas for improvement, we recommended actions to: a) enhance policies and procedures governing confidential funds; and b) strengthen existing controls to reduce the risk of misuse or misappropriation of confidential funds.

We would like to take this opportunity to thank the management, officers and staff of the Chattanooga Police Department for their courtesy, cooperation and assistance during this audit.

Sincerely,

Stan Sewell, CPA, CGFM, CFE
City Auditor

Attachment

cc: Audit Committee Members
David Roddy, Police Chief
Stacy Richardson, Chief of Staff
Maura Sullivan, COO
Daisy Madison, CFO
Zach McCullough, Asst. Police Chief
Mark Smeltzer, Captain
Jason Lewis, Lieutenant
Steve Campbell, Sergeant
Brian "Waldo" Russell, Sergeant
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 2019 Audit Agenda. The objectives of this audit were to determine if:

- a) Confidential funds are administered in compliance with applicable law and regulations, in particular the *Tennessee Comptroller Procedures for Handling Cash Transactions Related to Undercover Investigative Operations*; and
- b) Cash expenditures of confidential funds comply with Chattanooga Police Department (CPD) policies and procedures.

BACKGROUND

Section 39-17-420 of the Tennessee Code requires that one-half of all criminal court fines collected from narcotic drug offenses be turned over to the local government of the arresting agency, and deposited into a special revenue drug fund (the "Drug Fund").¹

The Drug Fund is a special revenue account separate from the General Fund.² Expenditures from the Drug Fund (excluding confidential cash expenditures discussed below) must comply with normal purchasing guidelines and be used exclusively for the following purposes:

- Drug enforcement programs;
- Drug educational programs;
- Drug treatment programs; and
- Nonrecurring general law enforcement expenditures.

Confidential cash expenditures for undercover police investigations are governed by the administrative rules and regulations promulgated by the Tennessee Comptroller of the Treasury.³ Examples of confidential cash expenditures for undercover investigations include:

- Payments to confidential informants;
- Payments to independent undercover agents;

¹ All cash and proceeds from the sale of seized property forfeited pursuant to T.C.A. § 53-11-451 are also deposited to the Drug Fund.

² Special revenue accounts operate outside the City's General Fund, and funds in the special revenue account do not revert to the General Fund at the end of the fiscal year. See T.C.A. § 39-17-428.

³ See Tennessee Comptroller's *Guide for Cash Transactions Relating to Undercover Operations* (2012 edition).

- Money spent to purchase narcotics as part of an undercover drug operation; and
- Gasoline or minor maintenance for undercover vehicles, or an informant’s vehicle when used in an undercover operation.

Confidential funds are administered and disbursed by the CPD through separate checking accounts.⁴ The CPD maintains two (2) confidential fund checking accounts for undercover operations: one (1) account for narcotic investigations and another for investigations involving Part I offenses, *e.g.*, prostitution, burglary, homicide, and organized crime. Both confidential fund checking accounts are funded by revenues from the Drug Fund and are to be administered in accordance with the procedures established by the Tennessee Comptroller.

Financial Information

Exhibit 1. Confidential Funds Revenue & Expenses

Narcotics Fund (9250)	FY2016	FY2017	FY2018
Revenues	390,352	551,696	389,134
Travel	2,750	450	2,529
Equipment	12,038	26,891	16,045
Investigative Services	134,330	185,455	138,825
Supplies & Services	107,512	99,854	71,701
Part I Fund (9025)	FY2016	FY2017	FY2018
Revenue	3,105	15,205	8,877
Travel	0	0	0
Equipment	0	0	4,800
Investigative Services	11,542	15,687	8,722
Supplies & Services	0	0	0

Source: Confidential Funds Annual Reports

FINDINGS AND RECOMMENDATIONS

Amend the CPD Policy Manual to align with Tennessee Comptroller requirements for confidential funds

Our audit testing confirmed that the CPD’s administration of confidential funds substantially complies with the *Tennessee Comptroller Procedures for Handling Cash Transactions Related to Undercover Investigative Operations*. However, certain requirements mandated by the Tennessee Comptroller are not explicitly addressed in the CPD Policy Manual. For example, the CPD Policy Manual does not delineate the processes and procedures for the following:

⁴ The Municipal Technical Advisory Service (MTAS) recommends the use of separate checking accounts for confidential funds as a best practice.

- a) *Equipment and supplies.* Purchases of equipment and supplies must be made through the normal city purchasing process. If confidentiality is necessary, then documentation must be filed in support of the disbursement, including invoices, price quotes, and a memorandum explaining the justification for making the purchase with confidential funds.⁵
- b) *Missing or unaccounted for funds.* Misuse of confidential funds, or unaccounted for funds, must be reported to the district attorney general and the Tennessee Comptroller. The police chief is responsible for initiating appropriate action to collect unaccounted for confidential funds.⁶
- c) *Training.* All law enforcement officials involved in the handling of confidential funds must review and be familiar with the Tennessee Comptroller guidelines. Documentation of the review must be maintained by the CPD.⁷

Recommendation 1:

We recommend the CPD Policy Manual (SOP-4) be amended to include procedures for: (1) purchases of equipment and supplies using confidential funds; (2) reporting missing or unaccounted for confidential funds to the district attorney general and Tennessee Comptroller; and (3) formalized training for officers and other individuals involved in the handling of confidential funds.

Auditee Response: We concur with the audit finding and recommendation.

Strengthen controls over confidential funds

Our review determined that expenditures and disbursements of confidential cash funds substantially comply with applicable CPD policies and procedures. However, we identified key opportunities to improve and strengthen existing controls over confidential funds, including:

- a) *Case file management.* Investigative divisions utilize different case management systems, creating inefficiencies in the data archive and retrieval process. CPD would greatly benefit from

⁵ We noted some expenditures where normal purchasing processes should have been used. However, all confidential fund expenditures were justified.

⁶ We did not identify any missing or unaccounted for funds during the audit period of calendar year 2018. However, to meet the audit objectives we expanded our scope to review allegations of misconduct by officers with access to confidential funds. We noted some funds were not properly accounted for in FY2017 and the Tennessee Comptroller and District Attorney General were not notified as required by T.C.A. § 8-4-503 and the Comptroller guidelines.

⁷ Some officers who handle confidential funds have not received training.

a centralized case management system to facilitate access to case file materials and other records subject to supervisory review and audit.

- b) *Verification of funds.* In many cases, investigators “loan” funds to other officers without access to confidential funds. To ensure that all officers, and their supervisors, are aware of the policies and procedures for handling confidential funds, we recommend the CPD implement specific procedures to be followed when officers not under the supervision of the Narcotics/Vice or Intelligence units are provided confidential funds.⁸
- c) *Cash Expenditures.* We observed instances where confidential funds were used for general drug enforcement and operational expenditures, such as internet access, post office boxes, and meals. Tennessee law and Comptroller guidelines generally disallow the use of confidential cash funds for general law enforcement expenditures, which should follow normal purchasing guidelines, unless confidentiality is absolutely critical to the purchase.⁹
- d) *Informant Payments.* Narcotics informants are paid based on performance and informal guidelines established by CPD management. However, these guidelines are neither included nor incorporated by reference in the CPD Policy Manual. Furthermore, there are no established guidelines for determining informant payment amounts for intelligence-based information.

Recommendation 2:

We recommend the CPD implement the following additional controls to safeguard the integrity of confidential fund disbursements: (1) develop a centralized case file management system for all CPD divisions handling confidential funds; (2) implement procedures to be followed when officers without confidential fund accounts are provided confidential funds; (3) discontinue the use of confidential cash funds for general drug enforcement activities; and (4) formalize departmental guidelines for determining the amount of informant payments and incorporate the same in the CPD Policy Manual.

***Auditee Response:** We concur with the audit finding and recommendation.*

⁸ Same as previous special project finding/recommendation (8/2017).

⁹ See T.C.A. § 39-17-420 and Tennessee Comptroller guidelines.

APPENDIX A: Scope, Methodology and Standards

Based on the work performed during the preliminary survey and the assessment of risk, the audit covers the administration and disbursement of confidential funds from January 1, 2018 to December 31, 2018. When appropriate, the scope was expanded to meet the audit objectives. Source documentation was obtained from archived CPD records and the Oracle system. Original records as well as copies were used as evidence and verified through physical examination.

To develop our recommendations, we examined CPD operating procedures, confidential fund accounting records and case files, interviewed CPD personnel, and conducted a detailed analysis of Tennessee law and regulations governing confidential funds.

The sample size and selection of the case files we reviewed were statistically generated using a desired confidence level of 90 percent, expected error rate of 5 percent, and a desired precision of 5 percent. Statistical sampling was used in order to infer the conclusions of test work performed on a sample to the population from which it was drawn and to obtain estimates of sampling error involved. When appropriate, judgmental sampling was used to improve the overall efficiency of the audit.

We conducted this performance audit from February 2019 to May 2019 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 that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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