



Office of the Public Auditor

Commonwealth of the Northern Mariana Islands

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August 25, 1998

Ms. Lucy DLG Nielsen
Secretary, Department of Finance
Commonwealth of the Northern Mariana Islands

Dear Ms. Nielsen:

Subject: Final Letter Report on the Audit and Investigation of Misappropriation of Government Collections at the Department of Finance's Division of Revenue and Taxation, July 1, 1995 to July 31, 1996 (Report No. LT-98-08)

This report presents the results of our audit and investigation of the misappropriation of government collections by a former cashier at the Department of Finance's Division of Revenue and Taxation. The objectives of our audit and investigation were to (1) determine the internal control weaknesses that permitted the theft to occur, and (2) make recommendations to improve internal controls over undeposited collections.

Our investigation showed that weaknesses in internal controls over collections resulted in misappropriation of cash collections of \$13,340. The former cashier, however, admitted taking only \$11,900 in cash collections. We referred the matter to the Attorney General's Office for criminal prosecution.

On January 31, 1997, the former cashier was convicted of theft of \$12,908 in government collections. He was sentenced to five years' imprisonment, but with only nine months to be actually spent in jail and the remaining four years and three months on active probation. He was required to pay restitution to the government of \$12,908 plus nine percent interest compounded quarterly. Restitution will be in minimum monthly installments of \$250 which will begin no later than sixty days following his release from jail. He was also required to maintain full-time employment during the term of his suspended sentence. The former cashier served the nine months of his jail term from February 6 to November 6, 1997, and on February 13, 1998 started making restitution of \$250 per month.

We recommend that the Secretary of Finance require the Director of Revenue and Taxation to develop and implement the following policies and procedures: (1) each cashier should have his/her own password when entering the cash receipt system; (2) there should be no manual alterations on the official receipts (ORs), and when an error is committed, the cashier should void the OR and make a replacement; (3) when verifying the actual collections, the auditor from the Compliance Branch should also reconcile the actual count against the corresponding ORs; (4) the custody of unused ORs should be given to an individual not assigned to receive collections and issue official receipts, such as the Collections Branch Manager; and (5) the custodian of unused official receipts should keep a record of all corresponding issuances of ORs to each cashier.

In his letter response dated August 7, 1998 (**Appendix A**), the Acting Secretary of Finance stated that recommendation 1 for each cashier to have his or her own password is not applicable to the system because the present cash receipting software does not identify individual users. However, the Department of Finance (DOF) is in the process of installing new Point of Sale Systems (POS) which will be designed to allow only individuals with valid passwords to log onto the terminals. The Acting Secretary concurred with recommendations 2 to 5 and provided us with a memorandum dated August 10, 1998 (**Appendix B**) that was issued to address the recommendations.

Based on the response we received from the Acting Secretary of Finance, we consider Recommendations 2 to 5 closed, as the actions taken by DOF completely addressed our recommendations. We consider recommendation 1 resolved, and will monitor the progress of the installation of the POS to ensure that it will eventually address our recommendation. The additional information or action required to close Recommendation 1 is presented in **Appendix C**.

BACKGROUND

The Division of Revenue and Taxation (DRT) was established under DOF pursuant to Public Law 1-8. DRT is responsible for collecting all locally raised revenues which include taxes, license fees and payment for services with the exclusion of custom duties and excise taxes.

On July 29, 1996, the Internal Affairs Section under DOF requested the Office of the Public Auditor (OPA) to conduct an audit of DRT, particularly its collection system. The audit was prompted by the discovery of irregularities in three official receipts. Our initial investigation of the matter showed that the receipts had been altered to reduce the amount of actual collections, with the difference between actual and reported amounts of collections probably pocketed by the former cashier. In an interview, the former cashier admitted committing theft in all three irregularities. The former cashier also confessed that he had been taking money out of the daily collections from around October 1995 to July 1996, and that the amount taken was usually \$200 for every receipt altered. Due to the former cashier's admission, the Internal Affairs Section requested OPA to audit the collection branch as a whole to determine the extent of the internal theft discovered, and to determine the internal control weaknesses that enabled the theft to occur.

OBJECTIVES, SCOPE AND METHODOLOGY

The objectives of our audit and investigation were to (1) determine the internal control weaknesses that enabled the theft to occur, and (2) make recommendations to improve internal controls over undeposited collections.

Our audit covered ORs issued from July 1, 1995 to July 31, 1996. To accomplish our objectives, we accounted for the accuracy of daily collections by independently adding up the unaltered amount of collections in the ORs attached to the cashier's reports and comparing the total amount with the teller-validated deposit tickets. We accounted for the difference between our independent computation and the deposit ticket by identifying the ORs with altered amounts. We verified the correct amount of collections by obtaining the taxpayer's copy of the OR or the tax form filed with DRT. After we established the correct amount of collections, we compared it with what was actually deposited; the resulting difference was identified as the amount probably misappropriated.

We ensured completeness of daily collections by accounting for the numerical sequence of the report numbers of each set of collection reports and ORs. We determined the promptness of deposits by comparing the date of the ORs and the teller-validated dates on the deposit tickets. We also obtained an understanding and evaluation of DRT's system of internal control through observation and inquiries as to DRT's collection process.

We conducted our field work at OPA in Gualo Rai, DRT in Dandan, and DOF on Capitol Hill, Saipan from August 1 to 31, 1996. We again conducted interviews of DRT personnel from April 28, to May 20, 1998 in order to determine whether new controls or changes had been introduced into the computerized collection system. Where applicable, the audit was made according to Government Auditing Standards issued by the Comptroller General of the United States. Accordingly, we included such tests of records and other accounting procedures as were considered necessary under the circumstances.

PRIOR AUDIT COVERAGE

OPA conducted an examination of cash collections of DRT on October 13, 1988. The audit report dated January 5, 1989 stated that collections were being deposited intact and reported to DOF on a timely basis. DRT was also in compliance with internal control procedures and regulations except for the individual cashiers' access to unused ORs which was incompatible with their cashiering function.

FINDINGS AND RECOMMENDATIONS

Misappropriation of Collections

Auditing standards, whether applicable for government or private enterprise, require that an organization have adequate internal controls. The audit of DRT collections showed that portions of money collected were misappropriated by a former cashier before the daily collection was deposited in the bank, and the former cashier's method for misappropriating the collections was not detected because of inadequate internal controls in the DRT collection system. As a result, cash totalling \$13,340 was taken in portions of daily collections for a period of eight months, without DRT auditors and supervisors detecting the occurrence.

Internal controls are generally defined in accounting and auditing as the plan of organization and all the coordinate methods and measures adopted to safeguard assets, check the accuracy and reliability of accounting data, promote operational efficiency, and encourage adherence to policies. A good internal control system includes the following requirements: competent personnel, assignment of responsibility, division of work, separation of accountability from the custodian, adequate records and equipment, rotation of personnel, internal auditing, and physical protection of assets. As the number of transactions and personnel increases, and when an organization is using a computerized system that shifts a significant number of manual procedures to a mechanized system, an organization's system of operation becomes more complex. Sometimes the result is that individual employees (subordinates and supervisors alike) are no longer familiar with all the procedures for processing and recording transactions, which tends to hinder discovery of errors and irregularities. In order for a system such as the computerized collection system of DRT to be effective, to be progressively improved, and to be continuously equipped with adequate internal controls, key personnel such as supervisors should be adequately educated on how the system works. An adequate level of understanding would be achieved if a supervisor is able to point out errors in transactions and deviations from procedures, and can suggest ways to improve efficiency or institute better controls.

The Scheme for Misappropriating Portion of Cash Collections

The audit showed that the cashier altered some of the duplicate and triplicate copies of the ORs (forwarded to Treasury and retained by DRT, respectively) in order to reduce the amount of collections to be reported, and then pocketed the difference. What the cashier did was: (1) print the OR showing the actual amount collected and issue the original OR copy to the payer, (2) alter the amount in the duplicate and triplicate copies [e.g., erase \$350 and write \$150] and sign his initial beside the alteration to make it appear there was a mistake in entering the collection amount, (3) edit the recorded data pertaining to the altered OR in the temporary computer file so that subsequently printed collection reports would show the altered amount, and (4) update the computerized collection records which now contained the wrong data, and then print the reports needed to complete the remittance package for submission to Treasury and for retention in DRT files.

Because of the alterations in the ORs and computer records, it would then appear that the cashier's accountability based on the actual count of collections was equal to the total collections based on printed reports generated by the computerized system. No shortage would appear, the DRT auditors failed to notice any irregularity, and the scheme was repeated 79 times within eight months. The conspicuous alteration in the ORs, however, should have alerted DRT auditors and supervisors.

While the cashier confessed to deliberately taking a total of \$11,900 in cash collections, the audit disclosed that the misappropriated amount may have been more than \$13,340. The court, however, convicted the cashier of embezzling \$12,908.

This occurred because of weaknesses in internal controls, enumerated as follows:

1. Unrestricted Access to the Computerized Cash Receipt System

In a computerized cash receipt system, the control purpose of a "password" is to limit access to a computer terminal and identify the cashier accountable for the collections registered in his/ her terminal.

At present, there are only two regular cashiers, one alternate cashier who works part time as a cashier, and three computer terminals in the collection branch. To access and use each terminal of the cash receipt system, a password is required. All cashiers, however, use the same password, and therefore each has access to all three terminals. Consequently, one cashier (Cashier A) can use another cashier's (Cashier B) terminal to print and issue receipts and it would be the initials of Cashier B printed in the OR as if he or she was the issuer, not Cashier A.

This occurred because all cashiers were given unrestricted access to the computerized cash receipt system by sharing one password. As a result, sharing the same password for the three terminals and granting access to all cashiers negated the control purpose of using passwords.

2. Allowing Cashier to Alter Information in the OR and the Receipt Detail Report

The Receipt Detail ¹ (RD) report lists the information for each OR generated by the cash receipt system. The ideal control would be elimination of the ability to alter the RD report once OR information is entered. However, the system allows a cashier to edit any information in the RD report before the final copy is printed. The cashier can also alter the amount in the ORs provided he or she initials the alteration.

¹ This report lists the following information in each receipt: official receipt number in numerical sequence, name of taxpayer, taxpayer's identification number, revenue account codes, amount of collection, cashier's initial, date and time of collection, mode (cash or checks) of payment. For checks received, it also provides the code number of the drawee bank. It also shows if a receipt is void.

This was what occurred at DRT, as this audit shows. The former cashier typically would print the OR showing the actual amount collected and issue the original copy of the OR to the taxpayer. Then, the former cashier would alter the duplicate and triplicate copies of the OR to show a reduced amount collected and sign his initials beside the alteration to make it appear that there had been a mistake in entering the collection amount. The former cashier would then edit the amount of collections pertaining to the altered OR in the RD file and update the computerized collection records at the close of collection hours. Subsequently, other printed collection reports such as the Cashier Deposit Reconciliation Report Summary² (CDRRS) and the Account Posting Summary Report³ (APSR) would also show the altered amount of collections. The auditor from the Compliance Branch did not notice the irregularity because their actual count matched the total collections on the CDRRS.

This occurred because there was no procedure to prevent manual alteration of the ORs and RD report, thereby substantially increasing the risk of fraud.

3. OR Details Not Reconciled with the Receipt Detail Report and Actual Collections

To verify cashiers' accuracy of collections, the best control measure is for the auditors to add up the amount of collections in all issued ORs and reconcile the total collection with the CDRRS and the actual count. The auditor should also check the details of the ORs against the RD report for any irregularity. A cashier's accountability based on the summary of the issued ORs should equal the total collections based on actual count and on printed reports generated by the computerized system.

At the close of collection hours, the cashiers print the computer-generated collection reports (CDRRS, RD report and APSR) which all show each cashier's total collections for the day. Each cashier compares actual collections against the CDRRS and prepares the deposit ticket. In the presence of the cashier, the auditor from the Division's Compliance Branch counts the cash and checks in each cashier's collection box and matches the count with the CDRRS. The cashier and the auditor sign the CDRRS after the verification procedure.

It has been the practice to compare only the actual collections counted with the total amount of collections in the CDRRS. The auditor does not review the details in the ORs and compare them with the details shown per RD report. Duplicate ORs were not scanned during the review procedure.

As a result, irregularities on the ORs were not detected at the point of verification.

² This report shows a breakdown of total collections in cash and in checks. It also provides the initials of the cashier accountable for the collections and the auditor who verified the cashier's accountability.

³ This report provides breakdown of collections as to amount, revenue account description and revenue account code. The series of receipt numbers covering the collections is also provided.

The next two control weaknesses did not directly contribute to the aforementioned misappropriation. However, they were noted in the review of internal controls and are reported because of the potential risks.

4. Incompatibility of Function

Sound internal control requires separation of accountability from custody. Our audit showed that the head cashier, apart from his cashiering function, controls the receipt from Treasury and issuance to cashiers of blank or unused official receipts. This occurred because DRT policies do not require that a person with incompatible duties control the receipt and issuance of blank ORs, a policy that could result in irregularities. For example, when ORs are issued to the Division, the cashier could retain a certain series of ORs and issue ORs without reporting the collections. Unless the Division accounts for all ORs issued to it, the unreported collections would remain undetected.

5. No Record of Issuances of ORs to Each Cashier

The custodian of unused ORs should have a record, in numerical sequence, of all ORs received from Treasury and the corresponding issuance to each cashier. Each cashier should be issued a new series of ORs only after using up those previously issued.

At DRT, the head cashier maintains a log sheet of all ORs received from Treasury. However, there is no record of the series of ORs issued to each cashier. This occurred because no policy exists requiring accounting for all issuances of ORs to each cashier. As a result, there is no record to identify the cashier accountable for the collections covered by the series of ORs issued to him.

Conclusion and Recommendations

DRT has weaknesses in its internal controls over collections. As a result, collections can easily be misappropriated without immediately being detected.

Accordingly, we recommend that the Secretary of Finance require the Director of Revenue and Taxation to develop and implement the following policies and procedures:

1. Each cashier should have his/her own password when entering the cash receipt system to prevent access to other terminals where other cashiers have already logged in and to ensure proper identification of the cashier accountable for the collections registered in the terminal.
2. There should be no manual alterations on the ORs. When an error is committed, the cashier should void the OR and make a replacement. All three copies of the voided OR should be retained in the file.

3. When verifying the actual collections, the auditors from the Compliance Branch should also reconcile actual count against the corresponding ORs. The auditors should add up all ORs covered by the cashier's report and reconcile the total amount with the CDRRS and the actual count. The auditor should also check the ORs physically against the RD report for any irregularity.
4. The custodianship of unused ORs should be given to an individual not assigned to receive collections and issue ORs, such as the Collections Branch Manager.
5. The custodian of unused ORs should keep a record of all corresponding issuances of ORs to each cashier.

DOF Response

In his letter response dated August 7, 1998 (**Appendix A**), the Acting Secretary of Finance stated that recommendation 1 for each cashier to have his/her own password is not applicable to the system because the present cash receipting software does not identify individual users. However, DOF is in the process of installing new Point of Sale Systems (POS) which will be designed to allow only individuals with valid passwords to log onto the terminals.

The Acting Secretary concurred with recommendations 2 to 5 and provided us with a memorandum dated August 10, 1998 (**Appendix B**) that was issued to address the recommendations. The memorandum was issued to all cash collection points to reemphasize procedures that must be followed to ensure strict internal controls on cash collections as recommended by OPA.

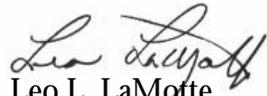
OPA Comments

Based on the response we received from the Acting Secretary of Finance, we consider Recommendations 2 to 5 closed, as the actions taken by DOF completely addressed our recommendations. However, we consider recommendation 1 resolved. We will monitor the progress of the installation of the POS to ensure that it will eventually address our recommendation. The additional information or action required to close Recommendation 1 is presented in **Appendix C**.

Our office has implemented an audit recommendation tracking system. All audit recommendations will be included in the tracking system as open or resolved until we have received evidence that the recommendations have been implemented. An *open* recommendation is one where no action or plan of action has been made by the client (department or agency). A *resolved* recommendation is one in which auditors are satisfied that the client cannot take immediate action, but has established a reasonable plan and time frame of action. A *closed* recommendation is one in which the client has taken sufficient action to meet the intent of the recommendation or we have withdrawn it.

Please provide to us the status of recommendation implementation within 30 days along with documentation showing the specific actions that were taken. If corrective actions will take longer than 30 days, please provide us additional information every 60 days until we notify you that the recommendation has been closed.

Sincerely,



Leo L. LaMotte
Public Auditor, CNMI

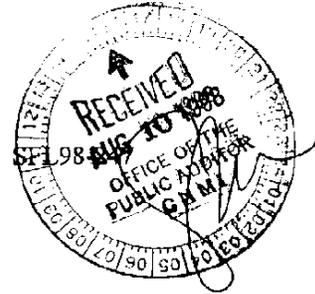
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August 7, 1998

Mr. Leo L. LaMotte
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Commonwealth of the Northern Mariana Islands
J.E.Tenorio Building
Gualo Rai
Saipan, MP 96950

RE: Response on Draft Letter Report - Misappropriation of Collections at the Division of Revenue & Taxation

Dear Mr. LaMotte:

This letter is written in response to your draft letter report on the misappropriation of collections at the Division of Revenue and Taxation. Thank you for granting us the additional time to compile the information that we need to prepare our response.

The following is our specific response in the order of your recommendations:

1. The cash receipting system was developed using the Developing Focus software. The password protection that the audit is referring to is on the program directory (Progdir) menu system and not on the cash receipting system itself. This cash receipting software, as it is written, does not identify individual users. The recommendation that each cashier have his or own password, therefore, is not applicable on this system.
2. We concur with Recommendation Number Two that there should be no manual alterations on the ORs. Since this incident, all cashiers have been verbally instructed to completely void erroneous entries to cash receipts and reissue new receipts. All voided cash receipts are included in the file of cash receipts issued that day.
3. We concur with Recommendation Number Three. The Secretary of Finance will issue a directive to all cash collection points instructing all individuals, who verify the actual cash collections, to also reconcile actual count against the corresponding

ORs. Additionally, the individual must also add up all the ORs included in the cashier's report and reconcile the total amount with the Cashier Deposit Reconciliation Report Summary. The individual must also check each OR against the Receipt Detail to note any discrepancy, particularly alterations on ORs.

4. We concur with Recommendation Numbers Four and Five. The Secretary of Finance will issue a directive to all cash collection points instructing them to maintain a record of all cash receipts issued to the collection points and the corresponding issuance of cash receipts to each cashier, and to designate a custodian of unused cash receipts who is not a cashier.

Please note that Finance is in the process of installing new Point of Sale Systems (POS) at various collection points. These POS terminals have a more sophisticated security system, which are designed to allow only individuals with valid passwords to log onto the terminals, and to prohibit manual alterations of cash receipts. The POS terminals utilizes regular tape receipts, and not preprinted cash receipts. Because of the complexity of transactions at the Division of Revenue and Taxation, the new taxation software that is currently being developed under Synon will be utilized for the cash receipting system at the Division.

If you have any questions on this matter, please do not hesitate to call.

Sincerely,



ROBERT A. SCHRACK
Acting Secretary of Finance

cc: Acting Director, Revenue and Taxation
Acting CNMI Treasurer



Office of the Secretary
Department of Finance

P.O. Box 5234 CHR8 SAIPAN, MP 96950

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MEMORANDUM

TO : Distribution List

FROM : Acting Secretary of Finance

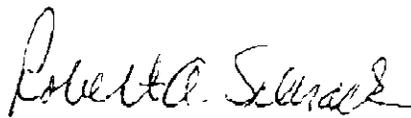
SUBJECT : Manual Alteration of Cash Receipts

DATE: 08/10/98
SFM98-360

Although we are in the process of installing new Point of Sale (POS) terminals, I would like to re-emphasize the following procedures that must be followed to ensure strict internal controls on cash collections:

1. Manual alteration on erroneous entries on cash receipts is prohibited. The cash receipt should be voided and a new receipt issued to the customer. The voided cash receipt (with all three copies intact) should be marked void and included in the batch of cash receipts for that day.
2. All individuals who are verifying the cash collection of a cashier must not only verify the cash but also the following:
 - a) The actual cash count must be verified against the corresponding cash receipts.
 - b) All the cash receipts in the cashier's report must be individually added up and reconciled to the total amount in the Cashier Deposit Reconciliation Report Summary. Any irregularities must be noted.
3. Each collection point must designate a custodian, who is not directly involved with receiving collections, of unused cash receipts. A record of all cash receipts issued to the collection point and to each cashier must be maintained.

Your strict adherence to the above procedures will strengthen our internal controls over cash collections. If you have any questions on this matter, please call the Acting CNMI Treasurer.



ROBERT A. SCHRACK

Distribution List:

CNMI Treasury, Capitol Hill	CNMI Treasury, BMV
CNMI Treasury, Labor & Immigration	Department of Commerce
CHC, Public Health, and Dental Services	Revenue and Taxation
Superior Court	Supreme Court
Resident Department of Finance, Tinian	Resident Department of Finance, Rota
Customs Services (Seaport, Airport, Garment, Post Office)	

cc: CNMI Public Auditor

AUDIT AND INVESTIGATION OF
MISAPPROPRIATION OF GOVERNMENT COLLECTIONS AT
THE DEPARTMENT OF FINANCE'S
DIVISION OF REVENUE AND TAXATION

STATUS OF RECOMMENDATIONS

Recommendations	Agency to Act	Status	Agency Response/ Action Required
<p>1. Each cashier should have his/her own password when entering the cash receipt system to prevent access to other terminals where other cashiers have already logged in and to ensure proper identification of the cashier accountable for the collections registered in the terminal.</p>	<p>DRT</p>	<p>Resolved</p>	<p>In his letter response dated August 7, 1998 (APPENDIX A), the Acting Secretary of Finance stated that recommendation 1 for each cashier to have his/her own password is not applicable to the system because the present cash receipting software does not identify individual users. However, DOF is in the process of installing new Point of Sale Systems (POS) which will be designed to allow only individuals with valid passwords to log onto the terminals.</p> <p>We will monitor the progress of the installation of the POS to ensure that it will eventually address our recommendation.</p> <p><i>Further Action Needed</i></p> <p>Provide OPA an update on the status of the POS installation for us to ascertain that our recommendation has been addressed by the new system.</p>

AUDIT AND INVESTIGATION OF
MISAPPROPRIATION OF GOVERNMENT COLLECTIONS AT
THE DEPARTMENT OF FINANCE'S
DIVISION OF REVENUE AND TAXATION

STATUS OF RECOMMENDATIONS

Recommendations	Agency to Act	Status	Agency Response/ Action Required
2. There should be no manual alterations on the ORs. When an error is committed, the cashier should void the OR and make a replacement. All three copies of the voided OR should be retained in the file.	DRT	Closed	<p>The Acting Secretary concurred with recommendations 2 to 5 and provided us with a memorandum dated August 10, 1998 that was issued to address the recommendations. The memorandum was issued to all cash collection points to reemphasize procedures that must be followed to ensure strict internal controls on cash collections as we recommended.</p> <p>Based on the response we received from the Acting Secretary of Finance, we consider Recommendations 2 to 5 closed, as the actions taken by DOF completely addressed our recommendations.</p>
3. When verifying the actual collections, the auditors from the Compliance Branch should also reconcile actual count against the corresponding ORs. The auditors should add up all ORs covered by the cashier's report and reconcile the total amount with the CDRRS and the actual count. The auditor should also check the ORs physically against the Receipt Detail for any irregularity.	DRT	Closed	
4. The custodianship of unused official receipts should be given to an individual not assigned to receive collections and issue official receipts, such as the Collections Branch Manager.	DRT	Closed	
5. The custodian of unused official receipts should keep a record of all corresponding issuances of ORs to each cashier.	DRT	Closed	