I. INTRODUCTION

The Office of the Inspector General (OIG) conducted an investigation in response to a complaint that alleged the misappropriation of wage-tax checks paid to the City of Philadelphia (City) by a federal agency. The investigation established that a Department of Revenue manager was able to exploit internal control weaknesses in Revenue’s payment-processing procedures and embezzle at least $400,000 that went undetected for over a decade. The OIG identified ninety-six occurrences of theft and related cover-up accounting entries beginning in 2000 and ending in 2005, prior to the current administration. During the course of this lengthy investigation, the staff of the Departments of Revenue and Law provided full assistance to the OIG investigators.

The OIG is providing this policy recommendation report to assist management in improving Revenue’s payment-processing procedures.
II. BACKGROUND

The investigation establishes that a retired Revenue Collection Manager, embezzled City wage-tax funds beginning in the mid-1990s and continuing until his retirement in December 2005. During this time period, a single manager was responsible for providing management oversight for the City’s entire revenue collection process, beginning with the checks arriving in the mailroom and ending with the deposit of the funds in the City’s bank accounts. He abused his position of trust and used his knowledge of the City’s processes to exploit the system’s vulnerabilities. The embezzlement was detected in November 2008, when a federal agency disputed the amounts presented on a Law collection notice.

In the course of this investigation, the OIG reviewed hundreds of check transactions and interviewed many individuals associated with the payment-processing procedures. Accordingly, the OIG has identified internal control weaknesses in the payment-processing procedures that enabled the manager to embezzle City funds. The OIG recommends that Revenue institute the following process improvements to minimize opportunity for embezzlement, and to recognize savings.

III. FINDINGS AND RECOMMENDATIONS

Finding 1:

All ninety-six occurrences of theft and the related cover-up accounting entries identified were related to paper checks mailed to the City by a federal agency or a posting of a fabricated federal agency check. Checks received in the mail by the City undergo a labor-intensive process that begins at Revenue Department’s Incoming Mail Unit and moves through several other units.

In 2009, the city collected $81 million from the federal government for the payment of the City wage taxes for federal employees. Only $15 million or 18% was by way of electronic fund transfer from ACH Filers. The remaining $66 million was received by the City’s Incoming Mail Unit and had to be manually processed.

Recommendation:

All the problems discovered in this investigation resulted from mail payments. We did not discover any problems with electronic payments. The OIG recommends that the Revenue Department request all wage-tax payments from federal agencies to be wired or directly deposited to the appropriate City bank account. The benefits of a direct deposit arrangement with federal agencies are as follows:

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1 Source: TIPS Reports on 1/21/10. Amounts represent payments received by the City during the calendar year and may include delinquent payments and refunds as well as current payments.

2 "Automated Clearing House" is a nationwide electronic funds transfer network which enables participating financial institutions to distribute electronic credit and debit entries to bank accounts and to settle such entries.
1. Eliminates the possibility of a payment being lost or delayed in the mail;
2. Greatly minimizes the possibility of a payment being lost or stolen during internal processing;
3. Reduces staff-time needed to process, thus saving the City money;
4. Eliminates the time between a check's issue and deposit, thus enabling the City to have instant access and earn interest on those funds; and
5. Benefits the environment by reducing the paper and ink needed to print checks.

**Finding 2:**

During the time of the investigation, WinTeller, the software application used by Revenue to manage cashier payment-processing, did not prevent a cashier from processing a “Cash Out” check endorsement. A “Cash Out” endorsement is when a cashier gives back part of a check in cash and credits the rest of the check to the payor’s account.

**Recommendation:**

The significance of this material weakness in the cash collection process prompted the OIG to recommend a programming change prior to the release of this report to prevent the future occurrences of “Cash-Outs.” The OIG was informed by the Revenue Department that this edit was made in May 2010 by the software’s proprietor, Integrated Bank Technology.

**Finding 3:**

The manager was able to breach Revenue’s payment-processing procedures and embezzle because no one reviewed his work when he filled in as a cashier. According to Payment-Processing Procedures Manual for Cashiering Unit Supervisors Section 5-1, a Cashier Supervisor must verify every cashier’s settlement by the following means:

1. Verify that the cash and check totals on the Check Lister equal the totals on the cashier receipt-tape;
2. Cross-check the corresponding totals on the cashier receipt-tape; and
3. Cross-check the encoding machine tape with the Check Lister.

When the manager worked as a cashier, no one followed these steps or reviewed his work. If someone had followed the procedures set forth above, he or she would have noticed that the checks and cash totals on the validation tape did not match the check totals on the encoding tape or match those on the Check Lister.

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3 The “Check Lister” is a form used by a cashier in the daily settlement process that lists the total of each check-drop and the bank deposit totals for cash and checks.
Recommendation:

Segregation of duties is one of the most critical aspects of any organization's internal controls because it reduces the risk of mistakes and inappropriate action. Responsibilities should be separated and assigned to different employees. The money handling duties should be separated from the record keeping duties.

The OIG recommends the following:

1. Cashier Supervisors must follow the procedures stated in the Payment-Processing Procedures Manual for Cashiering Unit Supervisors as written in Section 5-1;

2. Revenue managers should be prohibited from working as cashiers; and

3. Notices should be posted that advise employees to immediately notify the appropriate supervisor, the department Integrity Officer, or call the OIG's tip line if and when they become aware of any employee breaching payment-processing procedures. A manager may have good intentions in taking on extra duties during busy times, but he or she should ensure that there is always a proper separation of responsibilities.

Finding 4:

No single document identifies the cashiers with their assigned cashier window numbers. Cashier numbers are referenced in all the Tax Payer Information Processing System (TIPS) postings the cashiers generate while processing tax payments. At the beginning of each workday, the cashiers must sign the “Key Check List” to obtain a key, and in the presence of the supervisor, unlock and remove a cash drawer from the vault. At the end of the day, the cashiers print and initial the receipt-tapes from the cashier machine that lists the day’s transactions. The cashiers then return the cash drawers and keys to the vault, and sign the Key Check List. The Key Check List is the control document for the issuing of cash drawer keys but does not reference the cashiers numbers.

The absence of the cashier numbers on the Key Check List and the illegibility of the initials on the cashier receipt-tapes hindered the identification of the cashiers responsible for generating questionable TIPS postings. In order to discover the identities of the cashiers responsible for those questionable postings, the OIG needed to interview numerous Revenue employees and attempt to compare initials on cashier receipt-tapes.

Recommendation:

The OIG recommends that a column be added to the Key Check List next to the column for cashier signatures to include the assigned cashier numbers. The additional column on the Key Check List will make the Key Check List the single document that matches a specific cashbox and cashiering activities to a specific cashier. Thus, should an audit be required in the future, it will be clear from reviewing this single document, which cashier handled each Revenue transaction. This change will leave a clear audit trail and alleviate the time consuming process of attempting to match a cashier to a transaction through interviews of numerous employees.
Finding 5:

TIPS contained incorrect address information for several federal agencies. Rather than listing the agency's address, TIPS listed the personal addresses of federal employees. Thus, Revenue mailed tax delinquent notices to the wrong addresses from March 26, 2004 to November 13, 2008. A spokesperson explained that the agency did not address the City's delinquent tax balance concerns in a timely fashion because the agency did not receive the notices. This lack of communication between the federal agencies and the City prevented the reconciliations of the federal accounts and left the ongoing embezzlement undiscovered for years.

Recommendation:

The OIG recommends that Revenue Department review the current addresses on TIPS for all major taxpayers to ensure accuracy. The OIG also recommends that Revenue revise the current process used to update major taxpayers' contact information to ensure that federal agencies receive the appropriate notices from Revenue.

Finding 6:

There was no process within the Revenue Department to match the amount of money coming in to the amount of money deposited. Revenue's Cashiering Unit's daily settlement process did not reconcile the total check value entered on the cashier's machines, as received and posted to TIPS, with the total check value deposited in the City's bank accounts as noted on the encoding machine tape. Had the settlement process included such reconciliation, when the manager entered federal checks on the cashier machine at a lower-than-face value and pocketed the difference, the shortages would have been evident.

Recommendation:

The OIG recommends that on a daily basis for each cashier, the supervising cashier compare the total value of checks processed on TIPS as listed on the cashier receipt-tape with the total value of checks to be deposited in the City's bank accounts as listed on the encoding machine tape. This added step of comparing check totals in the settlement process will provide an additional safeguard that all funds paid to the City are actually credited to a TIPS account and properly deposited in the bank.

Finding 7:

Normally, checks received by the Mailroom have a coupon, but federal agency checks rarely contained a coupon. The Mailroom gives the checks without coupons to the Exception Processing Unit to research the accounting information and generate a coupon or bill. Then, the checks are processed.

For each compromised federal agency check the manager intercepted from the normal process, he directed an Exception Processing Unit employee to generate a coupon and leave the amount owed blank. The manager then personally wrote a dollar amount on the coupon that was less than the face value of the check and directed a cashier to process the check at the lesser value, pocketing the difference in cash.

4 "Coupon" is the Department of Revenue's term for an invoice that lists the taxpayer's accounting information including the dollar amount owed.
Policy Recommendation Report

Recommendation:

The OIG recommends that the Revenue Department edit the programming for the coupon-generating process on TIPS to prevent the generation of coupons without a dollar amount. The OIG also recommends that Revenue train its cashiers not to process checks with coupons that contain hand-written dollar amounts.

Finding 8:

The Revenue Department processes checks in two different ways:

1. Checks are received by mail; or
2. Personally presented at a cashier’s window.

Checks received by mail are processed by the Remit Pro Unit, and the Remit Pro Unit routinely copies these checks. Unlike the Remit Pro Unit, checks presented to a cashier for payment are not copied. The compromised checks were received by mail and should have been sent to the Remit Pro Unit for copying and processing. However, the manager circumvented the normal process. The manager intercepted the checks, and instead of being copied and processed by the Remit Pro Unit, he gave them to the cashier to process. Therefore, none of the compromised checks were copied.

This investigation was difficult and time consuming because the City did not have copies of the compromised checks. In order to prove and ascertain the magnitude of the embezzlement, the OIG needed to obtain check copies for the time period beginning in the year 2000 and ending in 2005, from each of the federal agencies that paid City wage taxes. With the exception of one agency, a contact had to be developed for each federal agency because the contact information on TIPS was often incorrect, outdated or unavailable. Once a contact was established, approvals had to be obtained from within each agency for the release of the requested check copies. Only then, could the OIG, assisted by the Law Department, begin the time consuming process of reconciling each check copy with the respective posting of deposit on TIPS.

Recommendation:

The OIG recommends that all checks be copied, especially those of a material value.

Finding 9:

All checks processed by a cashier should contain a proper validation stamp. However, in this case, the compromised checks either lacked that validation stamp or contained the words “Cash-Out” with a dollar amount taken out.

The check deposit process begins when a customer presents a check with a coupon for payment at a cashier window. The coupon information is entered on a cashiering machine screen, and the check and coupon are then validated. The validation information entered by the cashiers is the source for the respective TIPS.
postings. The validation information stamped on checks and coupons (top and bottom) includes the following information:

1. date processed;
2. tax type;
3. transaction number;
4. account number;
5. deposit amount;
6. cashier number; and
7. any change given back.

After processing a number of checks, a cashier bundles the checks and writes the total value of that bundle on an IBM card along with his or her cashier number, date and initials. The initial check-drop is labeled as “Sub1” on the IBM card. Several times during the day, the bundled checks are dropped off in a check-drop bin in front of the encoding machine. The subsequent check-drops are labeled on the respective IBM cards as “Sub2”, Sub3 and so on (Sub-Numbers).

An encoding clerk is responsible for entering each check’s value into an encoding machine, which prints the check’s value on a check for bank processing. When the encoding clerk finishes processing all the checks in a check-drop, the encoding machine generates a tape (encoder tape) listing each check and the total of checks processed. After the initial check-drop is processed, the encoding clerk completes the top part of the Check Lister by listing the cashier’s cashier number and the date. For each check-drop, the encoding clerk writes the check-drop’s Sub-Number and the check total amount on the cashier’s Check Lister. The Check Lister, checks and encoder tapes are stored behind the encoding machine until needed for the daily settlement.

Each day during the settlement process, a cashier reconciles the total of cash and checks received with the total amount on the cashier register-tape. These amounts should be equal. If the amounts fail to reconcile, the cashier recounts the cash and verifies each check with the amount listed on the cashier’s register-tape.

When the encoding clerk processes a cashier’s last check-drop for the day, the encoding clerk totals the check drop amounts, staples the encoder tape to the Check Lister and returns the checks to the cashier. The cashier completes the Check Lister by transferring information from the cashier register-tape. In the presence of the cashier, the supervisor reviews the work and notes any discrepancies. The cash is wrapped and secured with the checks in the vault.

All Revenue payment processing employees should be familiar with the City’s payment-processing procedures and know that “Cash-Outs” are not permitted. The lack of validations or the “Cash-Out” validations on the compromised checks should have alerted anyone handling the compromised checks to the processing improprieties.

The lack of proper validation on the compromised checks hindered the OIG’s efforts to identify the responsible cashier. In order to trace the compromised checks to the responsible cashier, using check copies obtained from the federal government, the OIG first matched each properly validated check with its respective TIPS posting. For the compromised checks validated with a “Cash Out,” we subtracted the “Cash Out” amount from the check amount and matched that total to a TIPS posting of equal value. Although these
checks were improperly validated, they each contained a cashier number that could be traced to a specific cashier. We identified the cashier who processed each of the remaining checks when we traced the check amount to an amount on an encoder tape for that cashier.

**Recommendation:**

The OIG recommends that the encoding clerks receive additional training to recognize and report improperly validated checks to the appropriate level of Revenue management, the department Integrity Officer or to the OIG.

**Finding 10:**

Several employees were surprised by the manager’s unorthodox procedures, yet they did not question him or report his misconduct. This is especially concerning in a department where large amounts of the City’s funds are held and processed.

**Recommendation:**

The OIG recommends that the Revenue Department develop a policy that requires employees to immediately report improprieties to the appropriate Revenue Manager or department Integrity Officer. The OIG regularly speaks to city departments about fraud awareness and ethical responsibilities. We recommend providing such training to the Revenue Department.