



THE CITY OF SAN DIEGO

DATE: July 10, 2014

TO: Audit Committee Members

FROM: Eduardo Luna, CIA, CGFM, City Auditor
Office of the City Auditor

SUBJECT: Investigation of Federal Seized Assets Funds and Certifications

On June 9, 2014, the Audit Committee directed the Office of the City Auditor to conduct an independent investigation into discrepancies in the San Diego Police Department's Equitable Sharing Agreement Certification reports (Federal Reports).

For this investigation, we conducted interviews with personnel from the Office of the City Comptroller (Comptroller), the San Diego Police Department (SDPD), and the U.S. Department of Justice (DOJ). Federal Reports were obtained and reviewed for Fiscal Years 2001 through 2013. Additionally, we reviewed the work conducted by the City Comptroller. We also obtained and reviewed DOJ and U.S. Department of the Treasury (Treasury) program guidelines and requirements.

Based on our review, we substantiated the Comptroller's work through independent information obtained from the City's financial system, SAP.

Our investigation also determined that:

1. Federal revenues were not recorded in the appropriate segregated City Funds for Fiscal Years 2006 through 2011.
2. Both the Federal Report and the City's Seized Assets-Treasury Fund for Fiscal Year 2011 omitted \$12,500 in revenue received from the U.S. Treasury.



Background

The Comprehensive Crime Control Act of 1984, and other federal laws authorize federal officials to implement a nationwide asset forfeiture program. Under the laws, federal forfeiture proceeds may be shared with cooperating state and local law enforcement agencies. The SDPD participates in this program and receives revenues from both the DOJ and Treasury. The DOJ agencies that participate in joint operations include the Federal Bureau of Investigation, U.S. Drug Enforcement Administration, and Bureau of Alcohol, Tobacco, Firearms and Explosives. Federal agencies associated with the Treasury program include the Internal Revenue Service, U.S. Immigration and Customs Enforcement, and U.S. Secret Service.

Each year, the SDPD is required to file a Federal Report that details the revenues received and expenditures made relating to both DOJ and Treasury funds. Beginning in Fiscal Year 2008, a single form is used to transmit revenue and expenditure data to the DOJ on behalf of both the DOJ and Treasury programs. The current form is entitled, “Equitable Sharing Agreement and Certification” and will be referred to in this report as the Federal Report.

A U-T San Diego news article headline, dated May 22, 2014, read “Where did \$1 million of seized money go?” The article noted that the Fiscal Year 2011 beginning balance in the Federal Report relating to Seized Assets-Treasury Funds was \$1 million less than the ending balance for Fiscal Year 2010.

The article also noted:

Over the past five years, San Diego police received \$6.4 million from the Justice and Treasury programs... Most of the money the San Diego Police Department received came from the Justice Department — between \$650,000 and \$1.7 million each year for five years. Almost \$2 million was spent on unspecified building and improvements in 2011, the department reported. Most of the rest paid for gas, insurance and other costs related to police helicopters.

Currently, all Treasury asset sharing proceeds have been frozen by the U.S. Treasury pending a review of Fiscal Years 2010 through 2013. The SDPD was notified of the Treasury review on May 27, 2014.

First Comptroller’s Memorandum

The Office of the City Comptroller responded to the news article with a memorandum dated May 29, 2014. The memorandum concluded that the “apparent ‘loss’ of \$1 million was based on a reporting error.” The Comptroller also identified “under reported

expenditures of approximately \$1.8 million, most of which were omitted from the fiscal year 2009 Federal Report.”

The Comptroller stated that in the future, the Federal Reports will be “reviewed by the Office of the City Comptroller, verified against audited information and signed by the City Comptroller.”

Second Comptroller’s Memorandum

A subsequent memorandum from the Comptroller, dated June 11, 2014, found that while some DOJ revenues did not reconcile with the City’s financial system, all of the revenue received from the Treasury agreed with City data in the aggregate.

The Comptroller also found that expenditures for “Fiscal Years 2009 through 2013 were for police purposes, adequately supported by invoices or other documentation and properly classified in our accounting records.”

Additionally, the Comptroller noted that, “Fund expenditures have not been included in the City’s Schedule of Expenditures of Federal Awards for an undetermined number of years.” This relates to the requirement that federal expenditures are audited each year pursuant to the U.S. Office of Management and Budget Circular A-133, also known as the Single Audit Act.

Comptroller’s Recommendations

The Comptroller made the following six recommendations in his June 11, 2014 memorandum:

1. The Federal Reports will be reviewed by the Office of the City Comptroller, verified against audited information and signed by the City Comptroller.
2. Revenue reported to the City by the Department of the Treasury and the Department of Justice will be reconciled on a yearly basis to our accounting records to ensure that all revenue related to this program has been deposited in the Seized Asset Forfeiture Fund.
3. A citywide effort will be conducted to identify any financial reporting to other agencies that is currently not being reviewed by my office.
4. The Federal Reports will be amended and resubmitted to the Department of Justice and the Department of the Treasury. A yearly review and reconciliation of all revenue from other agencies should be incorporated as part of our financial statement preparation process to ensure that all federal revenue is evaluated for inclusion in the Schedule of Expenditures of Federal Awards in the City’s Single Audit report.

5. These four remediations will be documented in the City's internal controls process narrative format by July 1, 2014.
6. The total amount recommended to be transferred from the General Fund to the Seized Asset Forfeiture Fund to address the issues identified in the Revenue Reconciliation to Federal Sources and Expenditure Review sections above is \$14,748.

City Auditor's Investigation

As noted previously, the Office of the City Auditor conducted interviews with personnel from the Comptroller, the SDPD, and the DOJ. Federal Reports were obtained and reviewed for Fiscal Years 2001 through 2013. We obtained and independently verified the Comptroller's work based on information from SAP. The guidelines and requirements for both DOJ and Treasury programs were also reviewed.

Our investigation confirmed the Comptroller's conclusion that the \$1 million difference between the Fiscal Year 2010 ending balance and the Fiscal Year 2011 beginning balance in the Federal Report relating to Treasury funds was the result of a typographical error. We determined that an Associate Management Analyst from the SDPD made the error when manually entering the financial data into an electronic version of the Federal Report. An independent review by the Comptroller most likely would have caught the error prior to submission. Internal control process narratives were published by Comptroller's Office on June 30, 2014 to address the issues they identified during their review. The process narratives we reviewed include a step for the Comptroller to review the Federal Reports and ensure that they are consistent with the City's accounting records.

Additionally, the approximately \$1.8 million of under-reported expenditures in the Fiscal Year 2009 Federal Report was due to a transfer of valid seized asset expenditures into the City's seized asset Funds from the General Fund. These transfers were made by the Comptroller's office, but the SDPD was not aware of the transfer prior to reading about the transfers in the recent Comptroller's memoranda. Again, the new procedures outlined in the internal control process narratives for both SDPD and Comptroller personnel include steps to ensure that all transfers are captured for future Federal Reports.

Based on our review of the Comptroller's work, and verification of SAP financial data, the Comptroller's conclusion that expenditures for Fiscal Years 2009 through 2013 were appropriate has been substantiated. Similarly, the SDPD and Comptroller's plan to reconcile revenue data with reports received from DOJ and Treasury is appropriate. However, additional concerns related to this reconciliation will be discussed below along with other issues we identified.

We also believe that the Comptroller’s plan to review and approve the Federal Reports prior to SDPD transmitting them to the DOJ is appropriate.

Finally, the Comptroller’s plan to address the lapse in compliance with the Single Audit Act, including consultation with the DOJ to determine the best course of action, seems appropriate. However, compliance matters related to the Single Audit Act were outside the scope of this investigation.

Finding 1: Federal Revenues Were Not Recorded in the Appropriate Segregated City Funds for Fiscal Years 2006 through 2011.

There are currently four separate Funds in the City’s financial system, SAP, related to seized assets. The Funds are described in the table below.

Fund Number	Description
200220	Seized/Forfeit Assets-Finvest
200221	Seized/Forfeit Assets-Justice
200222	Seized Assets-CA
200223	Seized Assets-Treasury

The Finvest Fund (200220) was created to track proceeds related to the Financial Investigations (Finvest) Program. Finvest was a grant program established by the Bureau of Justice Assistance of the U.S. Department of Justice. According to a federal document, the Finvest program is intended “to help state and local law enforcement agencies implement specialized projects to investigate and prosecute narcotics-related financial crimes.” The same report indicates that in August of 1989, the SDPD was awarded a Finvest grant of \$210,000. According to the SDPD, grants of approximately \$200,000 per year were awarded from 1989-1992 to fund narcotics-related financial crime investigations. The SDPD is in contact with the U.S. Department of Justice to determine whether Finvest is still an active program. We determined that the Finvest grant program revenues, expenditures, and interest income should not be combined with the DOJ Fund.

Funds 200221 and 200223 relate to the U.S. Department of Justice Asset Forfeiture Program and the U.S. Department of the Treasury’s Forfeiture Fund, respectively. These funds were the subject of this report.

According to the Comptroller, there has been no revenue received in Fund 200222, relating to seized assets from the state of California, since 2004. The state seized assets Fund was not included in this report.

Federal guidelines for the DOJ program require that “a separate revenue account or accounting code” be used solely for funds from the DOJ. The federal guidelines for the Treasury program contain the same language. In addition, any interest income generated

Investigation of Federal Seized Assets Funds and Certifications
July 10, 2014

from the funds must be separately accounted for and spent according to the federal guidelines for each program. The federal rules were established to prevent the commingling of revenues from various sources and to separately account for interest income.

According to the Comptroller, in Fiscal Year 2006 an effort was made by the City to consolidate the activity of the three Federal Funds (200220, 200221, and 200223) into the Finvest Fund. The plan was to use General Ledger account codes to track revenues. However, there was no documented process established to ensure that revenue was recorded in the correct Fund or General Ledger account. As a result, the revenues were deposited inconsistently within the three Federal Funds.

In Fiscal Year 2013, revenues received from the DOJ were recorded in the City's DOJ Seized Assets Fund (200221) using a General Ledger (GL) account used exclusively for DOJ revenues. Similarly, Treasury revenues were recorded in the Seized Assets-Treasury Fund (200223) using a GL account used exclusively for Treasury revenues. This accounting process allows for proper segregation of revenues and interest income for each federal source.

In contrast to Fiscal Year 2013, none of the Treasury revenue received was posted to the Treasury Fund for Fiscal Years 2006 through 2011. In Fiscal Year 2010, for instance, Treasury revenue and DOJ revenue were posted to the unrelated Finvest Fund.

The table below summarizes the inconsistent revenue deposits for the City's DOJ and Treasury Funds. The table also summarizes the revenue deposits made to the unrelated Finvest Fund for Fiscal Year 2010 through Fiscal Year 2013.

Fiscal Year	DOJ Fund	Treasury Fund	Finvest Fund
2010	No revenue recorded	No revenue recorded	All DOJ and Treasury revenue recorded
2011	Some DOJ revenue recorded ¹	No revenue recorded	All Treasury revenue and some DOJ revenue recorded
2012	Most of the DOJ revenue was recorded ²	No Treasury revenue was transmitted to the City	No revenue recorded
2013	Most of the DOJ revenue was recorded ³	All Treasury revenue was recorded	No revenue recorded

¹ The DOJ Fund revenues were \$661,329.84 (66 percent) and the Finvest Fund revenues were \$338,830.12 (34 percent).

² A total of \$651,030.16 was transmitted by the DOJ and \$639,385.55 was recorded. The \$11,644.61 difference is roughly two percent of the total.

³ A total of \$1,766,794.42 was transmitted by the DOJ and \$1,740,171.83 was recorded. The \$26,622.59 difference is approximately two percent of the total.

Posting DOJ and Treasury revenues together in an unrelated or un-segregated Fund does not permit the separate accounting for interest income required under federal guidelines. For example, the Federal Reports for Fiscal Year 2010 and 2011 report no interest income despite balances of over \$1 million.

The Comptroller's Office published two new internal controls process narratives related to Seized Asset Forfeiture Funds on June 30, 2014. Internal controls process narrative PN-0153 relates to the SDPD's process for preparing the annual Federal Reports. Process narrative PN-0240 addresses the Comptroller's accounting procedures for Seized Asset Funds. The process narrative related to the Comptroller's procedures instructs the accountant to "combine the amounts" from the DOJ and Finvest Funds and compare the total to the amount on the Federal Reports for DOJ revenues, expenditures, and interest. Although it is probable that the original Finvest grant dollars that were last received in 1992 have been fully expended, if any Finvest grant dollars or interest earnings exist, they should be segregated and tracked separately in the existing Finvest fund. The City's segregated DOJ Fund and Treasury Fund should be used to track revenues, expenditures, and interest related to these programs.

Currently, as illustrated in the table above, the Finvest Fund contains revenues and interest income related to DOJ and Treasury programs. The Comptroller is in the process of responding to a U.S. Treasury review of Fiscal Years 2010 through 2013. The response to the U.S. Treasury review should resolve any identified segregation issues.

Federal guidelines for the DOJ and Treasury programs require that interest income generated from seized asset funds be separately accounted for and spent according to the criteria for each program. The DOJ guidebook states that the City must, "Not commingle Department of Justice equitable sharing funds with funds from any other source. Corrective measures must be taken if this occurs." An interview with DOJ representatives confirmed that Finvest grant funds should not be combined with DOJ revenues, expenditures, and interest.

Recommendation 1: The Comptroller should revise the internal controls process narrative PN-0240 for Seized Asset Forfeiture Fund Reconciliation to ensure that grant proceeds, if any, tracked in the Finvest Fund (200220) are not reported with U.S. Department of Justice revenues, expenditures, and interest, in the Equitable Sharing Agreement and Certification Report.

Recommendation 2: The Comptroller should make the necessary adjustments and transfers to assure proper segregation and accurate reporting of revenues, expenditures, and interest for DOJ, Treasury, and Finvest Funds for Fiscal Years 2010 through 2013.

Finding 2: Both the Federal Report and the City's Seized Assets-Treasury Fund for Fiscal Year 2011 Omitted \$12,500 in Revenue Received from the U.S. Treasury.

As noted previously, none of the Treasury revenue received was posted to the City's Seized Assets-Treasury Fund for Fiscal Years 2006 through 2011. Rather, the Treasury revenues were recorded in the other two Federal Funds for that timeframe.

The following tables summarize the seized assets revenues reported by the DOJ and Treasury, the revenues reported on the Federal Reports completed by the SDPD, and the revenues recorded in the City's Funds for Fiscal Year 2010 through 2013.

Fiscal Year	DOJ Revenue Report Data	Treasury Revenue Report Data	DOJ Federal Reports	Treasury Federal Reports	City's Seized Assets-DOJ Fund	City's Seized Assets-Treasury Fund	City's Finvest Fund
2010	\$1,545,097	\$887	\$1,545,097	\$887	\$0	\$0	\$1,553,197
2011	985,217	12,500	985,217	0	661,330	0	338,830 ¹
2012	651,030	0	651,030	0	639,386 ²	0	0
2013	\$1,766,794	\$22,202	\$1,766,794	\$22,202	\$1,740,172 ³	\$22,202	0

¹ This includes \$12,500 in Treasury revenue, and \$326,330 in DOJ revenue.

² A total of \$651,030.16 was transmitted by the DOJ and \$639,385.55 was recorded. The \$11,644.61 difference is roughly two percent of the total.

³ A total of \$1,766,794.42 was transmitted by the DOJ and \$1,740,171.83 was recorded. The \$26,622.59 difference is approximately two percent of the total.

As noted above, the Comptroller found that while some DOJ revenues did not reconcile with the City's financial system, all of the revenue received from the Treasury agreed with the amounts posted in the City's records in the aggregate. He also noted that there were potential misclassifications within the Federal Reports. We confirmed that there were misclassifications in the Federal Reports, and that the City did not consistently segregate DOJ and Treasury revenues and interest for the past several years. Specifically, we found that both the Federal Report and the City's Seized Assets-Treasury Fund for Fiscal Year 2011 omitted \$12,500 in revenue received from the U.S. Treasury.

The Comptroller recommended that revenue reports from the DOJ and Treasury be reconciled on a yearly basis with the City's financial records. An internal control process narrative related to SDPD (PN-0153) includes the process step for the SDPD Associate Management Analyst to review the revenue reports on a biweekly basis. While process narrative PN-0153 refers to biweekly reconciliation by the SDPD Associate Management Analyst, our recommendation is that the Comptroller's office perform this reconciliation on an annual basis as part of the Comptroller's verification of the Federal Report data. This reconciliation should be performed after the end of the fiscal year.

The Comptroller's annual reconciliation will allow a comparison between the data in SAP, the Federal Reports, and the complete year's worth of DOJ and Treasury revenue report data. It is essential that someone from the Comptroller's Office performs this verification as a control.

Recommendation 3: The Comptroller should revise internal controls process narrative PN-0240 for Seized Asset Forfeiture Fund Accounting to ensure that, on an annual basis, the Comptroller's Office reconciles DOJ and Treasury revenues reported in the City's Funds with revenue reports received from the DOJ and Treasury.

We would like to thank the Office of the City Comptroller and San Diego Police Department staff for their assistance and cooperation during this investigation. All of their valuable time and efforts spent providing us information is greatly appreciated. Attached is the Comptroller's response to the recommendations made in this report.

Respectfully submitted,



Eduardo Luna
City Auditor

cc: Honorable Mayor Kevin Faulconer
Honorable Members of the City Council
Scott Chadwick, Chief Operating Officer
Stacey LoMedico, Assistant Chief Operating Officer
Shelley Zimmerman, Chief of Police
Rolando Charvel, City Comptroller
Mary Lewis, Chief Financial Officer
Brian Pepin, Director of Council Affairs
Jan Goldsmith, City Attorney
Andrea Tevlin, Independent Budget Analyst



THE CITY OF SAN DIEGO
M E M O R A N D U M

DATE: July 10, 2014

TO: Eduardo Luna, CIA, CGFM, City Auditor

FROM: Rolando Charvel, City Comptroller

SUBJECT: Investigation of Federal Seized Assets Funds and Certifications Report

Below are responses to the Office of the City Auditor recommendations included in the Investigation of Federal Seized Assets Funds and Certifications Report.

Recommendation #1: The Comptroller should revise the internal controls process narrative PN-0240 for Seized Asset Forfeiture Fund Reconciliation to ensure that grant proceeds, if any, tracked in the Finvest Fund (200220) are not reported with U.S. Department of Justice revenues, expenditures, and interest, in the Equitable Sharing Agreement and Certification Report.

Management Response: Agree

Management agrees. The DOJ, Bureau of Justice Assistance awarded the San Diego Police Department ("SDPD") close to \$200,000 annually, between 1989 and 1992, to fund narcotics-related financial crime investigations. This funding paid for surveillance equipment, investigative "buy money" and training expenses. The proceeds from the assets seized during these investigations were shared amongst the participating agencies based upon an agreed asset sharing formula, just like the Department of Justice ("DOJ") and Department of the Treasury ("DOT") asset forfeiture programs. The City has not received revenue from seized assets related to the Finvest program for at least the last ten fiscal years. Although it was a separate DOJ program, the SDPD considered Finvest a seized asset-related fund and treated it as such, from an expenditure perspective, as well as for reporting purposes. A separate City fund was established for the Finvest program and combined in the Federal Reports as part of DOJ transactions and balances. Because the program dates back to 25 years ago and appears to be inactive, there is little institutional knowledge left on this topic. It is unclear why the funds were combined, if there was communication with DOJ regarding the inclusion of these funds at some point, or if it was a misinterpretation of the Equitable Sharing Program reporting guidelines by SDPD. On July 10, 2014, the City received confirmation from DOJ that Finvest activity should not be included in the Federal Reports. Process narratives PN-0153, *Seized Asset Forfeiture Fund Accounting & Reporting* and PN-0240 *Seized Asset Forfeiture Fund Reconciliation*, will be revised accordingly.

Recommendation #2: The Comptroller should make the necessary adjustments and transfers to assure proper segregation and accurate reporting of revenues, expenditures, and interest for DOJ, Treasury, and Finvest Funds for Fiscal Years 2010 through 2013.

July 10, 2014

Management Response: Agree

Management agrees. The Police Department has segregated seized assets revenue and expenditures in all seized asset funds since fiscal year 2013. As noted in our June 11, 2014 memorandum regarding Seized Asset funds, the Office of the City Comptroller worked on reconciling the City's accounting records to a revenue transaction listings provided by DOJ and DOT. As cash balances are reestablished based on this reconciliation, interest revenue will be reallocated accordingly. The process documented in PN-0153, *Seized Asset Forfeiture Fund Accounting & Reporting*, requires that the City maintain revenues, expenditures and interested properly segregated between the funds.

Recommendation #3: The Comptroller should revise internal controls process narrative PN-0240 for Seized Asset Forfeiture Fund Accounting to ensure that, on an annual basis, the Comptroller's Office reconciles DOJ and Treasury revenues reported in the City's Funds with revenue reports received from the DOJ and Treasury.

Management Response: Agree

Management agrees. The memorandum dated June 11, 2014, regarding Seized Assets, included a remediation step that required that revenue reported to the City by DOJ and DOT would be reconciled on a yearly basis to our accounting records to ensure that all revenue related to this program was deposited in the Seized Asset Forfeiture Fund. Process Narrative *PN-0153, Seized Asset Forfeiture Fund Accounting & Reporting* requires a three-way reconciliation on a biweekly basis between the accounting records, the tracking spreadsheets that SDPD prepares and the information from the federal government. The process calls for biweekly reconciliations due to the volume of revenue transactions associated with this program. The City Auditor recommends that an independent reconciliation be performed by the Office of the City Comptroller on an annual basis. We agree with this recommendation and will incorporate into our process narrative.


for Rolando Charvel
City Comptroller

SL/tm

- cc: Scott Chadwick, Chief Operating Officer
Stacey LoMedico, Assistant Chief Operating Officer
Mary Lewis, Chief Financial Officer
Shelly Zimmerman, Police Chief
David Ramirez, Executive Assistant Chief
Kenneth So, Deputy City Attorney
Kyle Elser, Assistant City Auditor
Andrew Horita, Fraud Investigator
Jeffrey Peelle, Accountant IV
Marta Sullivan, Program Manager, Police Department
Kyle Meaux, Senior Management Analyst