

APPENDIX

**TO REPORT ON INVESTIGATION
OF
STO BANK ACCOUNT BALANCE**



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The findings and observations presented in this Appendix elaborate on issues discussed within the body of our report issued in connection with our investigation of the STO bank account balance. These findings and observations are integral to the conclusions expressed in our report.

Accounting Controls / Office Hierarchy

The STO may be compared to a small to medium sized business. Currently, the STO handles in excess of \$137 million of receipts and disbursements annually on behalf of the County, City, SSD and non-resident tax authorities.¹ The STO issues tax bills to more than 96,000 property owners, records receipts and maintain accounts receivable. The office also receives payments from approximately 29,000 employers and / or merchants that are located in the City. The STO maintains records of employee withholding tax remitted by employers and processes EIT refunds based on tax returns filed by Scranton residents each year.

The responsibility for the operation of the STO and its accounting rests with the Tax Collector. Normal turnover in this elected position also means that employees often have more experience than the Tax Collector. Apart from changes in the administration of the office, the daily, weekly, monthly and annual tasks could be expected to change little and the continuity of operations relies to a large extent on the training and experience of the STO staff.

In addition to the system changes that took place during McDowell's tenure, key positions were vacated during this period by staff that had occupied them for many years. The loss of continuity in key positions may have contributed to some of the problems described here or elsewhere in this report. The following are also factors that contributed:

- Job descriptions and procedures are outdated or undocumented;
- Lines of authority within the STO are not well defined. The job descriptions for the Act 511 Administrator, Administrative Assistant to the Tax Collector and possibly the Chief Clerk position, appear to provide a layer of mid level management responsible for office operations;
- The Chief Clerk's position description identifies certain financial and / or reporting responsibilities in vague terms but does not provide for a role like that of a controller or chief financial officer;
- Certain responsibilities for financial oversight reside with the Chief Clerk and others with the Administrative Assistant to the Tax Collector;

¹ Amount is based on receipts and disbursements during 2005.



- Job qualifications / requirements for both the Chief Clerk position require only minimal accounting experience or training;
- There is no involvement in the oversight or reconciliation of earned income tax receipts and disbursements by the Act 511 Administrator;
- Individuals occupying staff positions are not cross trained and on-the-job training is limited; and
- Open positions may be filled without regard to qualifications.

The conversion to the Paragon accounting system took place in this setting. During our engagement, we interviewed both the current and former Chief Clerks. These interviews disclosed a lack of certain, basic control procedures. For example, bank accounts were reconciled only to manually prepared records of deposits and disbursements. The bank balances were not compared or reconciled to balances in the general ledger control accounts that captured transactions within the computerized system. Despite having an automated accounting system (Paragon), there is no evidence that the system was used to prepare financial reports other than trial balances that were used to prepare other reports “off-line”. For example, certain reporting and remittance functions are accomplished via subsidiary records / spreadsheets prepared by the Chief Clerk.

Interviews conducted with various staff members, including the current and former Chief Clerks, as well as the former independent auditors indicated that information was not shared freely between members of the STO staff, including individuals responsible for overseeing the accounting / financial operations. As a result, staff members had a limited understanding of office operations outside of their immediate area of responsibility. In some cases, there was a mistaken perception or assumption that certain procedures and controls were in place, or that others were performing tasks.

Limitations on communication between STO staff personnel were, in part, a function of security features designed into the 2005 accounting system. These security features were intended to enhance security over taxpayer information processed by the STO.

During the conduct of our investigation we received varying reports concerning the extent and nature of training, as well as parallel processing during the conversion period. STO staff personnel advised that there was no transition with parallel / dual processing, but rather an immediate conversion from what were known systems and procedures to the Paragon system during early 2005. These same staff personnel have advised there was only minimal consultation with staff or the outside accountants prior to and / or during this process. Former Tax Collector McDowell recalled STO management being involved in the process, as well as consultations with MLB Consultants and some involvement by the outside accountants. He also recalled a period of parallel processing at the end of 2004.



Within two years after the system conversion, the Chief Clerk and administrative assistant with the most knowledge of STO accounting procedures, retired from their positions. The current Chief Clerk advised that upon taking the job his general instructions from the Tax Collector were to “pay the bills, run trials and make distributions.” Prior to our interview, he had never seen a copy of his job description and by his own admission does not have any training as an accountant.

The current Chief Clerk manages the performance of the three designated tasks using instructions (“go-by’s”) provided to him, by mimicking or replicating work performed by the prior Chief Clerk, or with assistance from Paragon consultants.² Although he routinely runs trial balances, he was unable to produce a trial balance for a prior year-end in response to our initial request for one and contacted Paragon for assistance. Monthly closing procedures were not performed or followed for some period of time after conversion. Other evidence suggests that year-end closings were also not completed in every year.

The STO requires a professional accounting presence responsible for accounting, reporting and supervision of staff that assists with these functions. It seems likely that the presence of a trained accountant with sufficient authority to manage STO staff handling accounting and recordkeeping functions would have identified and corrected current deficiencies early in the conversion process. Standard control procedures such as reconciliation of accounts to third party or subsidiary records are needed.

During the conduct of this engagement we have informally communicated findings and recommendations to the current Tax Collector. Some procedural adjustments have been taking place in response to our findings. Others have been discussed for future implementation. Several members of the current staff serve as go-to resources for other staff and have shown a willingness to be involved in these procedural changes; however their training and overall knowledge of accounting procedures is limited.

As noted above, certain procedures have been updated and some system training has been provided by Paragon to STO staff at considerable expense. Certain procedures that were apparently abandoned previously have resumed and Paragon has been pressed to address system processing issues as they are identified.

² The current Chief Clerk did receive training and / or instruction in these functions from the former Chief Clerk.

Comparative Trial Balances

We requested and received accounting system generated trial balance reports for calendar years-ending 2005, 2006 and 2007 as part of our initial analysis and assessment of fluctuations in account balances. Selected information from our analysis of these trial balance reports is presented below.

In performing this analysis we identified apparent inaccuracies and deficiencies in the accounting reports generated from the Paragon system. This analysis highlighted deficiencies in STO accounting controls and procedures. Paragon representatives have also outlined problems with this process, including differences between the AR module (delinquency list) and the general ledger. Paragon attributes these differences to a failure by the STO to verify or balance the accounts, accepting and recording collections from prior years and making adjustments to prior periods.

Attachment 9 is a summary comparing the trial balances for each of the four funds described above at December 31, 2005, 2006, 2007 and 2008. The source documents used to prepare Attachment 9 are also enclosed (**Attachment 10**). We have seen trial balances prepared on various dates that reflect different balances for the same effective date (i.e. year-end date). Changes in account balances reflected on the trial balances are likely the result of processing work / adjustments to prior periods after the accounting period is otherwise closed.

When viewing the trial balances, it is important to understand that the balances shown on them are often cumulative in nature. For example, the \$193,112,683.57 shown on the 2008 trial balance as real estate distributions (AC# 02-00-29910) is the cumulative total for distributions during 2005, 2006, 2007 and 2008, not the amount distributed during 2008. Ordinarily, period activity is closed out to an account that represents net activity such as fund balance. The cumulative nature of the balances that are carried in the Paragon system is cumbersome and requires a comparison of the trial balances provided to us for successive periods to determine activity in a specific year.³

Our analysis of the comparative trial balances highlighted certain anomalies in the accounts. For example, the various due to / due from accounts within the funds are not in balance. This is illustrated for each fund in the table below:

³ Other reporting options may be available in the system but are not known by STO users.

	2005	2006	2007	2008
Fund 01 (Due to)	\$(2,199,692)	\$(3,367,191)	\$(5,986,652)	\$(5,569,882)
Fund 02, 03, 04 (Due From Fund 01)	\$ (357,611)	\$ 1,169,738	\$ 3,899,029	\$ 3,481,245
Out of Balance	\$(2,557,303)	\$(2,197,453)	\$(2,087,623)	\$(2,088,637)
Beginning Entries	\$ 2,197,453	\$ 2,197,453	\$ 2,197,453	\$ 2,197,453
Remaining Imbalances	\$ (359,850)	\$ 0	\$ 109,830	\$ 108,816

*The EIT / OPT Suspense Accounts in Fund 01 are not included.

As noted in the body of our report, our analysis indicates that the out-of-balance condition identified above arises from a failure to record corresponding receivables from "Fund 01" on the general ledgers of Funds 02 through 04 at the time of the 2005 system conversion. A simple balancing of these accounts on a monthly basis would have disclosed this problem immediately after the conversion took place.

Another observation from the trial balances is that while the Paragon system / trial balances captures collections for each type of tax by tax year, distributions have been aggregated. Coupled with the cumulative balances, this lack of consistency in the data and / or details captured by the accounting system makes an analysis of the disbursements at other than a gross level impossible, particularly in the case of the EIT.

STO Collection and Distribution Procedures

Taxpayers can make payments in person, by mail addressed to the STO or through a lockbox arrangement with Fidelity Bank. While there are obvious differences in the handling and deposit of cash, all of these receipts are processed in essentially the same manner.

Real estate tax bills are sent at the beginning of each year for the county, SD and City taxes and an account receivable is set up for the amounts due from each property owner. As collections are received, they are applied to taxpayer accounts reducing the outstanding accounts receivable. Receipts are applied against an identified amount due and any credits, discounts or penalties due are processed within the system and recorded to the appropriate accounts on the STO general ledger (i.e. collections, credits, discounts, etc.).

By contrast, receipts for business privilege, mercantile, OPT and EIT cannot be applied against a predetermined bill or amount due. The first step in the receipt process for these taxes involves the recording of cash receipts / deposits to an employer's account. These receipts are posted to a suspense account on the STO's general ledger through an entry generated by the Paragon system (i.e. an AR / CR entry). The suspense account is a temporary holding area for these receipts, which must be detailed from forms or other documentation provided by the merchant or employer. Due to the amount of detail that



must be verified and input, this process of detailing is performed by staff in the STO's back office. This detailing process, or "split form", results in receipts being cleared from suspense and recorded to the appropriate collection accounts via system generated entries (i.e. an AR / JE entry).

The detailing process for EIT involves two steps. The first step is splitting or segregating tax receipts into resident and non-resident categories based on the periodic returns filed by the employer moving the collection from suspense to the respective collection account. In the event that the employer does not provide a breakdown of the funds received as resident / non-resident, a decision concerning the allocation of funds must be made to process the "split form." Prior to 2008, a 60/40 allocation was used (resident / nonresident). For most of 2008, any amounts that cannot be identified from employer reports or prior entries were recorded as resident tax collections (100%).

The second step involves detailing the receipts in an employer account into employee records that reflect earnings and tax withholding for each individual taxpayer. To the extent that the tax has been correctly allocated to the resident / non-resident categories in step one, there are no changes to collection accounts on the general ledger. Should a receipt, detailed at the employer level be incorrectly recorded as resident / non-resident or in the wrong tax year, the detail process results in a system generated general ledger entry transferring the collections from one tax type, or year, to another (AR / JE). The second step also provides for the allocation of non-resident receipts to outside tax authorities using town codes that are part of the employee record.

For the past four years, the procedure for the distribution of taxes to the county, SD and City and has been based on the aggregate activity recorded on the STO's general ledger (see **Attachment 7** to our report). The cumulative activity in each tax collection account is captured from the trial balance at the end of each month. Collections are then compared to cumulative distributions for the same type tax, and the difference is disbursed during the subsequent month. If everything is recorded correctly, this process should result in monthly disbursements of the tax collected during the prior month. However; to the extent errors in recording receipts, disbursements or adjustments are not corrected or not adjusted on a timely basis, an over or under payment would result.

We also note that in connection with resident EIT, this process results in a distribution based on the first level of detail described above. In other words, receipts of EIT withholding have not been detailed at the employee level and as such, may be subject to change if it is later determined that the employee is a non-resident. While not normally thought of as such, the payment of current EIT collections on this basis is similar to estimated payments.

The procedure for distribution of the non-resident collections is driven by the town codes that are part of the employee / taxpayer records in the system. The general ledger / trial



balance reflect disbursements that are based on both estimates and payments or “transfers” generated by the Paragon system. This transfer uses amounts from detail records for employees to establish an account payable for payment to the tax authority based on the town code. Where estimated payments have been made, the amount payable is reduced to reflect the net amount due. The transfer process relies on the receipt and accuracy of information captured in the system from employer returns and employee W-2’s.

Liability for Non-Resident Wage Tax at the End of 2004

In addition to separate liabilities representing amounts due to the other funds arising from collections throughout 2005, 2006 and 2007, the trial balances for Fund 01 include a liability captioned “Due for NonRes Collections.” This \$4,084,411 liability represents cash that was on the books as non-resident collections at the end of 2004. Another account captioned “Capital Improvement Fund” reflects a liability of \$207,993. The work papers for the 2004 audit indicate that these two accounts comprise the non-resident cash balance of \$4,292,404 at the end of 2004 described in our report. At the time of conversion (February 2005), these amounts (\$4,084,411 and \$207,993) were recorded in the operating fund as a liabilities and the balances have not changed since the account was established.⁴

The number assigned to the account “Due for NonRes Collections” (01-00-20805) suggests that a fifth fund, representing non-resident collections may have been contemplated at some point. However; beginning in February 2005, receipts and disbursements for non-resident wage tax were recorded in accounts that are part of the “city trust fund” in the Paragon system (Fund 04). Neither a Fund 05 nor a corresponding “due from” account in Fund 04 was ever established in the Paragon accounting system until the beginning of 2009.

If the “Due for NonRes Collections” and “Capital Improvement Fund” liabilities are treated as due to Fund 04, the imbalance between the funds described above is significantly greater. As noted, our analysis indicates that the out-of-balance condition identified above arises from a failure to record corresponding receivables from “Fund 01” on the general ledgers of Funds 02 through 04 at the time of the 2005 system conversion.

⁴ Entries were recorded in the “Due for NonRes Collections” account during 2005, including a credit / amount due for January 2005 and distributions in August 2005, but were reversed later. John Kolcharno described these entries to us during an interview.