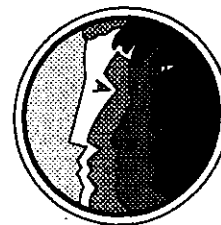


City of Berkeley



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CONSENT CALENDAR
 October 7, 1997

To: Honorable Mayor and
 Members of the City Council

From: Ann-Marie Hogan, City Auditor *amh*

Subject: REVIEW OF THE MANUAL CHECK PROCESS

RECOMMENDATION:

That City Council request the City Manager ensure that all recommendations in the Auditor's report are implemented or all findings are cleared by implementation of alternative recommendations within two months and report back to Council by 12/31/97 on the disposition of each recommendation.

BACKGROUND:

During the first 9 months of Fiscal Year 1996/97, 36 manual checks totaling \$2,298,832 were issued. The review identified concerns throughout most of the manual check process. Most significantly, the review found that the internal control structure over the manual check process was not always adequate, or was not always functioning properly. In some instances, one or more internal controls can be rendered ineffective. As a result, a manual check can be issued without going through the required review and approval process. Internal controls comprise the plan adopted by the City to safeguard assets, check the accuracy and reliability of accounting data, and encourage adherence to prescribed managerial policies.

Concerns identified during the review include the following:

- * Too many people can sign a City check.
- * Blank manual check stock and the signature plate (contains signature of City Manager and City Auditor) are not adequately safeguarded against unauthorized use.
- * The above conditions can give some employees the opportunity to issue manual checks without proper approval or review.



* At the time of fieldwork, a manager in the Finance Department could perform tasks required to acquire goods, pay for goods with City funds, and record the purchase and payment in FUNDS; with payment by manual check or by system generated check. As a result, unauthorized use of City money could go undetected.

* Vendor invoices can be paid twice in error.

* Written procedures do not describe, or do not adequately describe, many manual check procedures.

* Accounts Payable batch input totals are not checked for accuracy when payment is authorized by purchase order.

* Vendors are sometimes assigned multiple vendor numbers in error. One result is that considerable effort is required to correct vendor payment information generated by the automated accounting system before it is reported to the Internal Revenue Service.

Several of the concerns identified above affect the accounts payable process regardless of whether payment is made with a manual check or a system generated check. Steps to remedy this situation will include improved procedures, improved documentation, more timely posting and reconciliation, and removal of inappropriate combinations of access and authority.

The Finance Department has either agreed to implement, or appears to have already implemented, a number of the Auditor's recommendations. Implementation of all of the remaining recommendations, or of alternative recommendations which respond to these findings, should be completed expeditiously and documented in a report to Council by December 31, 1997.

FINANCIAL IMPLICATIONS:

Inefficiencies caused by improper functioning of the current system of internal controls

Risk of double payment

Risk of unauthorized use of City money.

Potential for the Internal Revenue Service to penalize the City for issuing incorrect 1099 forms.

CONTACT PERSON:

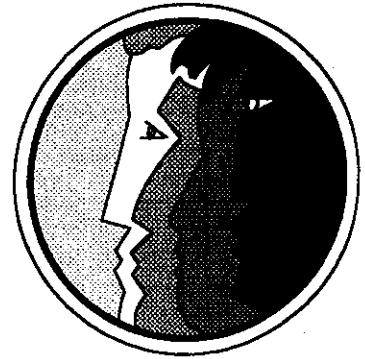
Ann-Marie Hogan, City Auditor, 644-6440.

Approved by:



Ann-Marie Hogan, City Auditor

City of Berkeley



*REVIEW OF THE
MANUAL CHECK PROCESS*

April 1997

Prepared by:

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I. INTRODUCTION

A. PURPOSE AND OBJECTIVE

Good business practices dictate that manual checks be used only in extraordinary circumstances, since they provide fewer controls than system generated checks. A review was performed to determine whether controls are in place which provide a reasonable assurance that manual checks issued by the Finance Department are:

1. issued only when a system generated check will not meet the City's needs.
2. issued only for authorized purposes.
3. not duplicated by checks generated by the automated accounts payable system, FUNDS\$ (double payment).
4. adequately supported with documentation which justifies the expenditure, and issued for the correct amount.
5. recorded in the accounts payable ledger.

The review was initiated at the request of the City Auditor.

Section II of this report, Findings and Recommendations, identifies whether or not the auditee has concurred with the recommendations. The auditee's complete response to the findings and recommendations in this report, and the City Auditor's response to their comments, are included in Attachment 1 and 2.

B. BACKGROUND

Issuing a manual check

Manual checks are authorized, prepared and accounted for in the Finance Department by staff in the Customer Service Division (Accounts Payable Unit) and the Accounting Division (Operations Unit). The Deputy Director of Finance and the Treasury Manager oversee the manual check process.

The City pays its accounts payable obligations (excluding payroll) from Bank of the West checking account 184-004075, regardless of whether payment is by a system generated check or a manual check. This checking account is referred to as the City's general account. Almost all checks issued from this general account are generated using the City's automated accounting system, FUNDS\$, and are not manual checks. During Fiscal Year 1995/96, 33 manual checks

Review of the Manual Check Process

were issued, totaling \$336,781. During the first 9 months of Fiscal Year 1996/97, 36 manual checks, totaling \$2,298,832, were issued. Manual checks are issued using the 87,000 series of checks so that manual checks can be readily identified. During March 1997, system generated checks were using the 170,000 series of checks.

The Director of Finance, the Deputy Director of Finance, or the Treasury Manager determine when it is appropriate to issue a manual check. Authorization to issue a manual check is documented by one of the three managers initialing the invoice or voucher to be paid by manual check. Approval to issue a manual check is not given until one of these managers has verified that the invoice has not already been paid, that support documentation is adequate, that payment has been authorized in writing (by the department which ordered and received the goods or services), and that money is available.

Once a manual check has been authorized, a designated Accountant II in Finance-Operations is provided with the invoice, the related support documentation, and the check being replaced (if applicable). The Accountant II in turn, releases a manual check from the manual check inventory. The Accountant II maintains a log which identifies each manual check signed out from inventory, the date it was signed out, to whom the check was given, the signature of the employee receiving the check, and the name of the payee.

Staff in the Accounts Payable (AP) Unit prepare the manual check, and obtain the signatures of the City Auditor and City Manager, as required by the Charter of the City of Berkeley, Section 61. The signature of the City Manager is obtained by using a rubber signature stamp, which is kept in a secured location in the Finance -AP Unit. The signature of the City Auditor is obtained at the Auditor's Office. The City Auditor personally signs all manual checks unless she is not available. In her absence, authorized staff in the Auditor's Office use a signature stamp. Prior to signature, support documentation is reviewed for adequacy and for payment authorization. Each time the City Auditor signs a check, or her signature stamp is used, this activity is recorded in a log.

Manual check - when there is a purchase order

When a purchase order (PO) is issued, money equivalent to the maximum authorized expenditure for each PO is set aside (by means of an encumbrance), and can't be used for other purposes. All payments authorized by a PO must be processed through the Purchase Inventory (PI) module of the City's automated accounting system, FUNDS. When a payment is processed through PI, the encumbered amount is liquidated by the amount of the payment. Finance-AP has used two methods of processing manual check activity through PI. Both are discussed below.

Review of the Manual Check Process

Prior to December 1996, each transaction paid for by manual check was processed almost as if a manual check had never been issued. Once a good or service was "received on-line" in PI (by the department that ordered the goods), the transaction was processed in the PI module by Finance-AP staff, liquidating the encumbrance. "Received on-line" means that acknowledgment of receipt is entered into the PI module. Information in PI then interfaced with Accounts Payable (AP) in GMBA, the City's general ledger. Here the payment was posted, and a system check generated. This entire procedure was done solely so that the encumbrance relating to the manual check would be liquidated. Staff in Finance- AP had to remember to physically void the system generated check to prevent a vendor from being paid twice in error. Double payment could occur if the vendor received both the manual check and the system generated check that had not been voided. The final step was to post the issue of the manual check, and void the system check in GMBA-Accounts Payable. This was done by a designated AOAI in Finance-Operations. The Accountant II, who earlier released the manual check from check inventory, provided a designated Accounting Office Assistant II (AOAI) in Finance-Operations with all the support documentation they had received for each manual check issued. The AOAI reviewed this documentation and information available in on-line inquiry in FUNDS. As necessary, accounting entries were made in GMBA-Accounts Payable to correctly post manual check activity, and to void the system check. These entries were reviewed and approved by an accountant.

Beginning December 1996, the Finance Department modified the procedure discussed above so unwanted checks would not be generated each time a manual check was issued. The new procedure requires staff in Finance-AP to enter the manual check number and check date, for the transaction to be paid for by manual check, during the edit phase of processing in GMBA-Accounts Payable. This prevents a system check from being generated, correctly posts only the manual check activity, and liquidates the encumbrance. To insure that manual check information is correctly input into accounts payable during the edit phase of processing, the Deputy Director of Finance reviews the Accounts Payable Edit report, comparing data entered with the invoice and other support documentation. This new procedure is also the procedure recommended by HTE, the accounting software developer. Since this new procedure had been tested by the City quite some time ago and no problems were identified, (although it was not authorized for use) the auditor informally recommended this new procedure be implemented during November 1996.

Manual check - when there is no purchase order

A manual check can also be issued when there is no purchase order. Payments made without a purchase order are referred to as voucher payments. Posting of each manual check, and voiding of checks replaced by the manual check, are input directly into GMBA - Accounts Payable by a designated AOAI in Finance-Operations. Entries are made in GMBA-AP based on support documentation received and information already recorded in FUNDS. All entries are reviewed and approved by an accountant. Of course, with a voucher payment, there is no encumbrance in

the system (as with a PO).

Manual check - filing of support documents

Support documentation for each manual check is filed in the Operations Unit and in the Accounts Payable Unit.

C. SCOPE AND METHODOLOGY

The review covered the period August 1995 through March 1997. Records obtained through April 8, 1997 were used to perform the review.

We conducted our review by using the following methodologies:

- Examining and testing accounts payable records and reports.
- Interviewing personnel in Finance and the Auditor's Office.
- Reviewing written policies and procedures, Administrative Regulations (ARs), and the City Charter.
- Interviewing staff from another City which uses the HTE (FUNDS) accounting system.
- Contacting HTE support staff, and using HTE On-Line Help.
- Interviewing the City's bank representative.

The review was conducted in accordance with the Government Auditing Standards except for standard 3.11, Independence. Independence was impaired because the Auditor's Office is involved in the manual check process. Auditors, including the auditor that conducted this review, the Audit Manager, and the City Auditor are responsible for signing manual checks with the signature of the City Auditor. The City Auditor's signature is only provided after confirmation that support documentation is adequate and payment has been authorized. Not meeting standard 3.11, however, did not affect the results of the review.

II. FINDINGS AND RECOMMENDATIONS

Finding 1: Lack of internal controls over the issuing of manual checks

Several conditions exist which unnecessarily increase the risk to the City that a manual check will be issued for an unauthorized purpose and that it will not be detected or timely detected. The following was observed:

1.1 Too many employees can sign City checks, increasing the risk that a manual check will be issued for an unauthorized purpose and not be detected, or timely detected. The increase in risk occurs because internal controls designed to provide a reasonable assurance a manual check will only be issued for an authorized purpose are not always effective for all methods of obtaining a signature. Additionally, by having signatories other than the City Auditor and City Manager, the City is not in compliance with the Charter of the City of Berkeley, Section 61, Article 10. It requires the City Auditor sign, and the City Manager countersign, all checks.

1.2 Procedures are not in place which insure an employee's bank signatory authority is revoked before their last day of employment. As a result, there is an unnecessary risk a former City employee may inappropriately have access to City funds and financial information.

1.3 Conditions exist which give some employees the opportunity to issue a manual check without proper review and approval, or for unauthorized purposes, and in some cases to take steps to conceal this activity.

1.1 Too many employees can sign City checks.

Although all manual checks examined during our review were signed by the City Auditor and counter-signed by the City Manager (as required by the City Charter), the following conditions exist which are a concern:

1.1A. In addition to the City Manager and City Auditor, there are three authorized bank account signatories who can sign checks issued from five City bank accounts. As a result, manual checks can be issued without proper review and approval.

1.1B. Although only about 9 manual checks (including payroll checks) are issued each month, there are 3 City Manager signature stamps kept in different locations. Some of the authorized signatories have access to one of these stamps, which would enable them to issue a check without proper review and approval.

1.1C. In addition to the City Manager and City Auditor, there are three authorized bank account signatories who can sign checks issued from five City bank accounts. As a result, the City is not in compliance with City of Berkeley Charter, Section 61, Article 10 which requires the City Auditor sign, and the City Manager counter sign all checks.

1.1A. In addition to the City Manager and City Auditor, the Deputy Director of Finance, former Acting Director of Finance and a Deputy City Manager are authorized signatories for 5 of the City's major bank accounts with Bank of the West. Accounts include those which are used to pay most City obligations: the general account and the payroll account. All 5 accounts require the signature of any 2 of these individuals to issue a check. Additionally, since the 3 additional signatories are high level management, it is a concern that some of them have the ability to perform and/or authorize tasks in the manual check process without going through the standard review and approval process to issue a manual check. This is discussed further later in this finding.

During the audit, the Deputy Director of Finance and the Treasury Manager stated that signatories, in addition to the City Manager and City Auditor, were needed for the following reasons:

1.1A-1. The Deputy Director of Finance requires signature authority for the Bank of the West general fund account (1 of the 5 bank accounts with Bank of the West) to perform the following tasks:

- a. Make the investments through a dealer;
- b. Authorize the bank to accept delivery of the securities;
- b. Authorize an Accountant (or the Treasury Manager in their absence) to instruct the bank to wire funds to the dealer to pay for the securities, after they have been received;
- d. Authorize staff to instruct the bank to wire the funds to the State and Federal Government for payroll withholdings and the SRIP disability unfunded liability wire to ITT Hartford.

1.1A-2. They believe signatories other than those of the City Manager and City Auditor were added to the five Bank of the West Accounts by the City Manager so that in an extreme emergency, where the City Auditor and/or City Manager were not available and their signature stamps could not be used, checks could be issued from these accounts.

It should be noted that, during the course of field work, the Deputy Director of Finance stated that he would fully support the recommendation to remove his bank signatory authority as long as there was another means for him and his staff to buy and sell investments for the City. He stated he periodically sends the bank written instructions to give some of his staff authority to conduct

specific business with the bank. He is concerned that he will not be able to accomplish this task timely if he is not an account signatory for specific accounts. However, the City Auditor has stated she is willing to use her bank signatory authority to timely transmit written instructions, prepared by Finance Department management, to the bank. This would eliminate the Deputy Director's first concern. Additionally, there appears to be no reason why arrangements could not be made with the bank to have alternate signatories which could only be used in a specific emergency situations. This would eliminate the Deputy Director's second concern.

1.1B. There are 3 City Manager signature stamps with various degrees of availability to various City employees, including some of the account signatories. Since there are only about 9 manual checks (including payroll checks) issued each month, it appears that only one City Manager signature stamp is warranted. Written procedures which address who has access to the City Manager's signature stamps, and what purposes they can be used for, are not available.

One stamp is located in Finance-AP and is used to sign manual checks initiated in Finance-AP (focus of this review). The other 2 are located in the City Managers's Office. One of these 2 signature stamps is located with the City Manager's secretary and the other is located in the City Manager Budget Unit. Stamps in the City Manager's Office appear to be used primarily to approve budget modifications, and to issue manual payroll checks. Approval of budget modifications could be accomplished through other means. One City Manager signature stamp could be kept in Finance or the City Manager's Office and be used to sign all manual checks.

1.1C. Although the City Charter requires that the City Auditor and City Manager sign all City checks, there are in fact 5 authorized signatories. As a result, the City is not in compliance with City of Berkeley Charter, Section 61, Article 10 which requires the City Auditor sign, and the City Manager countersign, all checks. It states:

“Payment by the City, excepting redemption of bonds and interest coupons, shall be made only upon vouchers certified by the head of the appropriate department and approved by the City Manager, and by means of warrants on the City Treasury, or by checks drawn upon deposits maintained in a bank or banks, issued by the Auditor and countersigned by the City Manager”.

Documentation supports that the City Manager's Office has told the City Council the City will comply with this requirement. In a December 10, 1990 memorandum to the City Council from a prior City Manager, Michael Brown, he concurred all City checks must be signed by the City Manager and City Auditor as required by the City Charter.

1.2 Procedures are not in place to insure that an employee who is an authorized bank account signatory for the City has this authority removed prior to the last day of employment with the

City. For example, the prior Acting Director of Finance retired on October 4, 1996. However, as of March 17, 1997 (more than 5 months after he left the City), he was still an authorized signatory for all five Bank of the West accounts. As a result, there is an unnecessary risk that a former employee may inappropriately have access to City funds and financial information.

1.3 Conditions exists which give some employees the opportunity to issue a manual check without proper review and approval, or for unauthorized purposes, and in some cases to take steps to conceal this activity.

Concern A

A manager in the Finance Department can perform, or give written approval for subordinates to perform, tasks required to execute all of the following:

1. Acquisition of goods and services.
2. Payment for goods and services with City funds.
3. Recording the purchase and the payment of these goods and services in the City automated accounting system (FUNDS).

The fact that a manager can directly or indirectly perform so many tasks in the manual check process, can render many internal controls over the manual check process ineffective.

It is also a concern that the current Acting Director of Finance may be added as a bank account signatory, replacing her predecessor who was a signatory. This is a concern because this manager can also currently authorize or perform a number of tasks in the purchasing and manual check process. As stated above, this can render some of the internal controls ineffective.

Concern B

Manual check stock and the signature plate are not adequately restricted to insure they are used only for authorized purposes. As a result, at least one supervisor could issue a manual check without this payment going through the typical manual check review and approval process.

It must be noted that, during the review, no instances came to the auditor's attention where a check had been issued for an unauthorized purpose, or where support documentation was determined to be inadequate. What did come to the auditor's attention was existence of conditions which interfered with the proper functioning of the Finance Departments system of internal controls over the manual check process. Internal controls comprise the plan adopted by

the City to safeguard its assets, check the accuracy and reliability of its accounting data, and encourage adherence to prescribed managerial policies. Prompt implementation of the recommendations to follow will correct these conditions.

Recommendations for Finance:

1. Remove all authorized bank account signatories from Berkeley bank accounts except the City Manager and City Auditor. Have the City Manager or City Auditor submit the signature cards directly to the bank to insure no additional bank account signatories are added.

Make arrangements with the bank to have alternate authorized signatories which would replace that of the City Manager and City Auditor in the event they become incapacitated.

Finance's Response - Do not concur (Response from Auditor)

2. The Property Checklist form (Administrative Regulation 2.4 effective February 25, 1997) should be used to insure that each employee's bank signature authority is removed prior to their last day of employment with the City.

Develop a written procedure which would permit the City Manager and/or City Auditor to expeditiously direct the bank (in writing) to give specific employees in the Finance Department authority to conduct specific business with the bank.

Finance's Response - Partially concur. (Response from Auditor)

3. Physically secure the manual checks kept in Finance-Treasury from the possibility of access without signature in the manual check inventory log.

Do not allow the employees to have access to any manual check stock without signing it out of inventory. This includes the manual check stock currently in the Treasury Unit vault.

Finance's Response - Concur

4. Managers with authority to approve issuance of a manual check should not be able to perform the following:

- A) Requisition or buy goods, and also approve them for payment.
- B) Be an authorized bank account signatory for the general fund account.
- C) Have authorization to obtain the signature plate.
- D) Have the ability to post both the purchase and the payment of the purchase in FUNDS.

Finance's Response - Partially concur (Response from Auditor)

Recommendation for City Manager's Office

5. Maintain only one City Manager signature stamp in Finance or the City Manager's Office. It should only be used to sign checks or to approve bank withdrawals. Alternate methods should be used to replace other current uses of the stamp, such as approving budget modifications. Develop written policies and procedures which address what purposes the City Manager stamp can be used for, who is authorized to use this stamp, and how access to the stamp will be restricted.

City Manager's Response - Partially concur. Will develop written policies and procedures.

Recommendation for Auditor's Office

6. Access to the signature plate should be removed from the Auditor's Office and restricted to the operator of the check signing machine, which is currently in Information Systems.

If proper controls are established, this would be more efficient and effective than maintaining the plate in the Auditor's Office. The employee(s) who safeguard the signature plate and check signing machine should not have access to check stock or signature stamps, and should not be involved in preparing or accounting for City checks. Written policies and procedures should be developed for the signature plate machine operator by the Finance Department before this change is effected. They should include:

A) procedures which insure checks are issued in numerical sequence and all checks are accounted for. A log can be used for this purpose.

B) procedures which insure that all checks which should be void are stamped void prior to being signed.

C) procedures which insure that only the machine operator uses the plate, and the plate is not used to sign manual checks.

Auditor's Office Response - Concur. Implementation contingent on Information Systems or another appropriate department accepting responsibility for securing the signature plate.

Finance's Response - Will support implementation of recommendation.

Finding 2: Approval to issue a manual check is not always documented.

Four of the 20 manual checks reviewed (20%) were issued without the required written approval of Finance Department management. This is a significant internal control weakness since the purpose of requiring this signature is to confirm that:

1. Finance Department management found a manual check necessary.
2. Finance Department management determined the request for payment was adequately supported, and payment not previously made.
3. Staff has been authorized to release a manual check from inventory.

Current procedure prohibits the release of a manual check from inventory without written authorization from the Treasury Manager, Deputy Director of Finance, or the Finance Director. This requirement is not addressed in the Finance Departments' current written policies and procedures pertaining to manual checks. This may be the reason this procedure is not always followed. Because this internal control is not functioning properly, manual checks could be issued for unauthorized purposes and go undetected. It should be noted that support documentation for the 4 unauthorized manual checks appeared adequate, and had not been paid by a system generated check. As stated in reference to finding 1, this finding concerns the proper functioning of the system of internal controls.

Recommendation for Finance

1. Update written procedures for manual checks to:
 - A) Document staff who can authorize the issue of a manual check.
 - B) Identify what tasks must be completed before a manual check is authorized. This should include verifying that the invoice has not yet been paid, that payment was authorized by an authorized signatory from the department which received the goods or services, that documentation adequately supports that payment is due, and that funds are available.
 - C) Prohibit manual checks from being signed out from inventory without the written authorization of appropriate staff. Management should take necessary steps to insure staff always follow this procedure.

Finance Department management should emphasize to staff the importance of only releasing manual checks from inventory after written authorization and adequate support documentation are received.

Finance's Response - Partially concur

Finding 3: Unnecessary risk of double payment

Internal controls are not in place which would provide a reasonable assurance a vendor will not be paid twice in error. This can occur because:

1. Manual check activity is often not timely posted (often 1-2 months). In this situation, a manual check is issued to a vendor but this payment is not timely posted. Subsequently, Finance staff receive another request to pay this same invoice. Seeing no payment posted in the accounting system, they generate a system check to pay this same invoice again. This condition could occur regardless of whether a payment is processed as a voucher or PO.

The reason manual check activity is not timely posted was not identified. If all required documentation and approvals are obtained before a manual check is issued, as it should be, staff should be able to post this activity within 24 hours. Staff in the Finance Department did state that they were sometimes delayed in completing their part in the manual check process because they were waiting for something from a co-worker. There also appears to be a low priority placed on the timely recording of manual check activity. For example, manual check 87,381 was issued on July 25, 1996 for \$576.50. It was not posted until March 24, 1997, 8 months after the auditor brought it to the attention of Finance Department staff. This is a concern because the bank reconciliations identified that this check had not been posted, and this should have served as a reminder to post this payment.

2. Manual check activity could be improperly processed through FUNDS. When there is a PO, there are 2 methods which have been used to process a manual check through FUNDS. If done improperly, both methods can result in a vendor being paid twice for an invoice. This is discussed in further detail below.

3. A determination whether or not an invoice has already been paid may not always be made prior to issuing a manual check. Authorization for a manual check was not documented for 4 of the 20 manual checks reviewed. As part of the authorization process, a determination is to be made whether or not an invoice has already been paid. Since required written authorization to issue a manual check is not always obtained prior to issuing a manual check, it is a concern staff may not always be confirming an invoice has not already been paid prior to issuing a manual check. This was discussed in more detail in Finding 2.

Additionally, it is a concern that the Finance Department is only recording double payments in FUNDS after efforts to have the vendor return the overpayment are not successful. As a result,

instances where the City paid a vendor twice in error, and the overpayment was returned by the vendor within a month or two, would be difficult to detect. The unrecorded double payment would also be hard to detect because it is not uncommon for manual check activity not to be recorded in the accounting system for 1-2 months. This provides sufficient time for most vendors who intend to return a double payment to the City, to do so. When cash receipt and disbursement activity is not recorded when it occurs, the integrity of the accounting data becomes a concern.

Example of confirmed double payment

During the audit, one instance was identified where a vendor was paid \$50,259 twice in error. Both checks were cashed. Manual check 87,383 was issued July 31, 1996, but was never recorded in FUNDS. The automated accounting system also issued (and recorded) check 166,143 on August 7, 1996. According to the Treasury Manager, the overpayment was repaid. However, the repayment is only evidenced by a \$50,259 deposit on November 26, 1996 (3.5 months after the overpayment) to the City's general bank account. There is no documentation to support that this deposit was a repayment by the vendor. The repayment was also never recorded in FUNDS. The Treasury Manager stated that the overpayment, and eventual return of this money, would not be posted since the money was eventually returned. As a result, FUNDS does not properly reflect that the \$50,259 overpayment ever took place. It appears this double payment occurred because manual check activity was not timely posted. Unaware that a manual check had been issued, staff processed the transaction through PI, and a system check was generated.

Example of a potential double payment

Manual check 87,398 was issued on January 22, 1997 for \$15,735. It paid a vendor for invoices 20-27. Beginning December 1996, the procedure for recording manual checks in FUNDS was changed so that processing manual checks through PI would no longer result in a system check being generated. The new procedure was not followed. Seven days later, on January 29, 1997, the accounts payable system generated check 175,248 which was issued for \$15,735 (posted January 27, 1997), also to pay for invoices 20-27. Check 175,248 was not void in Accounts Payable until February 24, 1997, about a month after it had been issued. Two days later, manual check 87,398 was posted on February 26, 1997. In this instance, the vendor could have been paid twice in error.

The vendor would have had over a month to return any second payment they received in error. Finance Department staff may have become aware this vendor was paid twice when they tried to post manual check 87,398 and received a warning message that these invoices had already been paid. When the overpayment was returned, system generated check 175,248 was void in FUNDS, and manual check 87,398 was posted 2 days later.

Improper recording of manual check activity (concern 3.2 identified above)

Controls are not in place which provide a reasonable assurance that manual check activity is properly processed through accounts payable. Concerns are identified below:

When there is a purchase order

1. To record a transaction paid for with a manual check in accounts payable (procedure effective December 1996), the manual check number and date must be entered for the transaction during the accounts payable edit phase of processing. If the manual check information is not entered at this time, this will result in GMBA-AP generating a check and the vendor being paid a second time. Current procedures do not provide a reasonable assurance that manual check information will be input during the edit phase of processing in GMBA-AP. This would most likely occur because:

- A) staff forget to enter the check number and check date during the edit phase of process.
- B) staff processing the transaction in FUNDS are not aware a manual check was issued (untimely posting as discussed above), and therefore do not enter required information during the edit phase of processing
- C) the manual check is incorrectly processed directly in GMBA-AP like a voucher, and is not processed through PI as required when there is a PO. One such instance was observed during the audit. In this instance, this transaction would automatically appear for payment in PI (after goods are received on-line), and could be paid again in error.

Under the old procedure (prior to December 1996), each time a manual check was issued, the transaction was processed through accounts payable as if the manual check payment had never been made. This was done to liquidate the encumbrance, but also resulted in the generation of another check by the accounting system. Staff in Finance-AP would then void this system generated check. Procedures during this time did not provide a reasonable assurance staff would remember to void this check instead of sending it to the vendor in error.

Recommendations for Finance

1. Require each manual check issued be posted in FUNDS within 24 hours of the check issue date. Require the accountant who oversees the manual check inventory to report all exceptions to the Deputy Director within 24 hours. The cause for the exception should be identified, and the problem condition corrected so it will not happen again. This procedure should be included in the written policies and procedures for manual checks.

Finance's Response - Concur

2. Record all double payment activity in FUNDS\$, regardless of whether the overpayment is later returned to the City, to insure the integrity of the accounting data. Instances where invoices are paid twice in error should also be properly documented in the vendor file and the manual check records.

Properly record in FUNDS\$ the double payment involving checks 87,383 and 166,143, and any subsequent reimbursement to the City. Maintain support for this activity in the vendor file and the manual check records.

Finance's Response - Concur

3. Establish an internal control(s) which will provide a reasonable assurance that the manual check number and date are entered during the accounts payable edit phase of processing when there is a purchase order. One such method identified by the Finance Department during the audit would require the accountant, who signs the manual checks out of inventory, to review and sign off on the AP edit report for this check. This would insure that the manual check would be properly recorded, and that a second check would not be generated in error. This should occur within 24 hours of a manual check being signed out of inventory. If the edit report is not timely provided to the accountant, the accountant should immediately report this to the Deputy Director of Finance. The reason the AP Edit report was not timely made available to the accountant should be determined, and this condition corrected.

Finance's Response - Concur

Finding 4: Totals in the Accounts Payable Edit Report are not checked for accuracy.

When payment information in the Accounts Payable Edit Report originates from the PI module (payments authorized by purchase orders), totals in the Accounts Payable Edit Report are not reconciled with independent batch totals obtained from the invoices processed for payment. Such a reconciliation is already performed for payments authorized by voucher (no purchase order). During the audit, the Deputy Director of Finance agreed that such a reconciliation should be performed.

Payment information is processed through accounts payable in groups of transactions which often contains 40-100 transactions. Payment information is entered for both system generated checks and for manual checks. The Deputy Director of Finance stated he makes sure information in the AP Edit report is correct by comparing information in the invoices with information in the edit report for each transaction. This task should continue to be done, at least on a sample basis. However, this procedure alone can easily miss errors, such as transposed payment entry.

Recommendation for Finance

1. Before each Accounts Payable Edit report is approved by the Deputy Director of Finance, totals in the Accounts Payable Edit Report should be reconciled with batch totals obtained from the invoices processed for payment. Any differences should be researched, and corrections made. This procedure should be added to the written policies and procedures.

Finance's Response - Concur

Finding 5: Many vendors are incorrectly assigned multiple vendor numbers

Many vendors have been assigned more than one vendor number in GMBA (City's general ledger) in error. This creates the following problems:

1. Payment activity under 2 or more vendor numbers must be reviewed to determine if an invoice has been paid prior to issuing a manual check. Having to look at payment history under multiple vendor numbers increases the likelihood an invoice that was paid will be overlooked and paid again by manual check in error. Payment activity under 2 or more vendor numbers must also be reviewed to identify total payments to a vendor.
2. The vendor's correct mailing address is often difficult to determine because it is not uncommon for vendors with multiple vendor numbers to have more than one mailing address. Having a vendor with more than one mailing address increases the chance a manual check (and a system generated check) will be sent to the wrong address.
3. It appears multiple vendor numbers will cause the City's automated accounting system (FUNDS) to sometimes not report, or to incorrectly report, tax information to vendors and to the Internal Revenue Service.(IRS). This could result in penalties being assessed to the City. There is also a cost to the City when, in order to avoid incorrect reporting, staff must manually identify and correct 1099 errors.

The IRS requires the City to report total annual payments for 1) services and 2) the rental of equipment or property, made to many vendors. This information is reported to both the vendor and the IRS on form 1099. The IRS uses this form to make sure these vendors are properly reporting their taxable income. Multiple vendor numbers can result in:

- A. The City sending vendors and the IRS two or more 1099 forms (1 for each vendor number), when only one should be sent.

B. Vendors not receiving all form 1099s because some forms are sent to incorrect vendor mailing addresses.

C. Vendors (and the IRS) being sent incorrect 1099s or no 1099. This could occur when payments made under some vendor numbers do not exceed \$600 (minimum payment before a form 1099 must be issued), but total City payments to these vendors exceeds \$600. The City is subject to a \$50 penalty from the IRS for each vendor which does not receive a correct 1099.

According to the Treasury Manager, many vendors have multiple vendor numbers in GMBA because many Finance Department employees were giving vendors new numbers instead of updating information for their existing vendor number. To correct this problem, the Treasury Manager stated she recently became the only person who can create new vendor numbers. Before creating a new vendor number, she stated she first makes a determination whether there is already a vendor number for the vendor. The review found that although staff in Finance-AP may have been instructed not to add new vendor numbers, all staff in Finance-AP still have access in FUNDS to perform this task.

The Treasury Manager stated she planned to work with Information Systems at a later date to remove the unnecessary vendor numbers in GMBA. Nothing formal had been arranged as of March 17, 1997, the date the fieldwork in this area was concluded.

Recommendations for Finance

1. Finance should submit a written project request to Information Systems. It should request that Information Systems work with Finance to develop a method or program which can be used to efficiently eliminate instances where a vendor has been assigned more than one vendor number in error. The problem with vendors with multiple vendor numbers should be corrected within 6 months from the date this report is issued.

*Finance's Response - Response does not concur or non-concur with audit recommendation.
(Response from Auditor)*

2. Only employees who are authorized to add new vendor numbers in GMBA should be given FUNDS access to perform this task. Employees authorized to add new vendor numbers should receive training, and written procedures, regarding how to correctly perform this task.

Finance's Response - Partially concur. Finance has stated only a future FUNDS upgrade will allow the FUNDS access recommendation to be implemented.

Finding 6: Accounting system does not always identify duplicate invoices

Invoice references are not always entered, or are not always entered in a consistent format. As a result, the accounting system is not always able to warn staff in Finance-AP of duplicate invoices before these invoices are paid again in error. There are no written policies and procedures to eliminate this problem. A Senior Accountant in the Finance Department agreed such procedures are needed.

Recommendation for Finance

1. Develop written procedures which establish standards so invoice reference information is consistently entered in FUNDS. This task should be completed within 6 months from the date this report is issued.

Finance's Response - Concur

Finding 7: Invoices are sometimes paid without written approval from an authorized employee of the department receiving the goods or services.

For 2 of the 20 manual checks reviewed (10%), 1 or more of the invoices which were paid for with these checks lacked written approval for payment from an authorized signatory of the department that received the goods or services. Either the invoice or a voucher should be signed, authorizing payment. Because manual checks were sometimes issued when invoices had not been approved for payment by an authorized signatory, payment could be made to a vendor for goods or services that were not approved for payment, or which did not benefit the City.

Before an employee is authorized to approve an invoice for payment, written approval from their department director and the City Manager is required. This is an important internal control which was designed to help insure invoices are only approved for payment when goods or services are received, and payment is due. Current procedure in Finance require payment be approved by an authorized signatory before a manual check is issued. However, written procedures do not address this requirement.

Written procedures in the Auditor's Office require staff to confirm "payment authorization" has been obtained before a manual check receives the signature of the City Auditor. As shown above, this was not always done. It appears this was due to confusion regarding whether an authorizing signatory had to be obtained to approve payment when a purchase order was involved, since goods and services were received on-line by authorized staff.

Recommendation for Finance

1. Prior to Finance Department approval of an invoice for payment by manual check, it must be verified that each invoice is signed by an authorized employee of the department that received the goods or services. Management should ensure that this procedure is always followed. This should be included in the written policies and procedures for issuing manual checks.

Finance's Response - Concur

Recommendation for Auditor's Office

2. Clarify current written procedures. Require Auditor's Office staff verify "payment authorization" for each manual check by confirming only that the manual check was authorized by the Finance Department. Auditor's Office staff would not be responsible for verifying that payment was approved in writing by the department that received the goods or services.

City Auditor's Response - Concur.

Finding 8: Improper maintenance of manual check log by the Auditor's Office

The Auditor's Office maintains a log which is to be used to identify each manual check signed by the City Auditor or stamped with her signature stamp. During the period August 1995 through November 1996, 15 checks had not been recorded in the log. The City Auditor stated this occurred when checks were delivered to the City Auditor for her signature but were never recorded in the log as required.

Before a manual check receives the City Auditor's signature, support documentation is reviewed by authorized staff or the City Auditor to insure it supports payment is due, and is authorized for payment. Gaps in the check numbers logged are a concern because it means either or both of these events may not have occurred for these manual checks.

Written procedures state, "It is the responsibility of the Auditor's Office staff member using the signature stamp to assure that the log is properly completed." Written procedures do not identify who is responsible for recording manual checks signed by the City Auditor, and what procedure is to be followed if there is a gap in the check issuance sequence. The City Auditor stated the Audit Manager was responsible for overseeing the log was properly maintained, following up on any concerns or omissions, and documenting findings in the log.

Recommendation for Auditor's Office

1. Update written policies and procedures to identify who is responsible for researching gaps in the "Signature Stamp Use Log", and updating the log with the results of the research. This employee's supervisor should periodically review the log to insure the log is being properly maintained.

City Auditor's Response - Concur

Finding 9: Incorrect encumbrance balances

Users too often make incorrect increases or incorrect decreases to encumbrance balances when entering manual check and related void check transactions into GMBA- Accounts Payable. When encumbrance balances are not correct, the incorrect amount of money is set aside to pay a specific expense. Users may rely on this incorrect encumbrance information in FUNDS, and believe they have more or less money available to spend than is actually available. Efforts to identify and correct incorrect encumbrance balances are performed infrequently.

Thirteen manual checks authorized by a purchase order were reviewed. The encumbrance activity for 4 of these transactions (31%) was initially incorrectly recorded in FUNDS. This occurred when manual check activity was not properly entered. Errors were corrected months later. It appears staff entering manual check information into FUNDS do not always know how to enter this information so that the encumbrance balance in PI and GMBA are correct. According to a Senior Accountant in Finance-Operations, written procedures are needed to correct this problem.

Periodically, an encumbrance reconciliation is performed to identify encumbrance balance errors. The outstanding encumbrance balance for each PO in PI is compared with the outstanding balance in GMBA. Staff stated that differences are researched, and adjustments prepared, so that the encumbrance balance for each PO is correct in PI and GMBA. Staff are not preparing the encumbrance reconciliation and correcting entries often enough. As of April 8, 1997 (date fieldwork completed) the last time an encumbrance reconciliation was performed (and identified variances corrected) was for the period ending May 23, 1996. This is almost a year ago. It should be noted that this reconciliation will not identify when a payment (which was authorized by PO) was not properly processed through PI and the encumbrance properly liquidated in the amount of this payment.

Examples of encumbrance errors

1. Manual check 87,402 was issued on January 29, 1997 for \$398,544, but the encumbrance was only liquidated for \$206,922. As a result, the encumbrance balance was overstated by \$191,622. FUNDS users would believe this \$191,622 represented money which was still available, which is incorrect. This activity was posted on February 26, 1997. The Finance Department researched this encumbrance error during April 1997 after it was brought to their attention by the auditor.

2. Manual check 87,398 was issued to replace system check 175,248. Both checks were for \$15,735. When manual check 87,398 was issued, the encumbrance was again liquidated for \$8,122 in error. This activity was posted on January 27, 1997. The \$8,122 represents 3 invoices, 6-BHA-20,21,22 which were liquidated twice in error, but paid only once. As a result, FUNDS incorrectly reported \$8,122 was not available, when in fact it should have been available. According to staff, this occurred due to human error. The error was researched after being brought to the attention of Finance Department staff by the auditor.

Recommendations for Finance

1. Develop written procedures which will show staff how to correctly record manual check and void check activity in accounts payable so encumbrance balances in PI and GMBA are correct.

When manual check activity is recorded in GMBA-AP, the encumbrance entry should be reviewed and approved before the entry is posted if possible.

Finance's Response - Concur

2. Prepare a formal encumbrance reconciliation at least quarterly. It should be prepared within 30 days after the quarter to be reconciled has ended. Encumbrance errors identified by the reconciliation should be corrected within 2 weeks of completion of the reconciliation. This requirement should be incorporated into the written policies and procedures.

Finance's Response - Recommendation implemented prior to audit (Response from Auditor)

III. CONCLUSION

The review found errors in processing and/or internal control weaknesses throughout most of the manual check process. Some of the problem conditions are quite serious. For example, internal control weaknesses exist which could allow employees to issue a manual check for an unauthorized purpose, or without proper review, and to take steps to hide this activity. Written

Review of the Manual Check Process

procedures are brief, and do not adequately describe the manual check process. Tasks to be performed are too frequently not addressed, or are not described in sufficient detail.

Internal control weaknesses also exist which can result in a vendor being paid twice in error. Untimely posting of manual check activity, often taking 1 or 2 months, is the primary reason why a vendor would be paid twice in error. Proper recording of manual check activity is also a concern. In one instance, a vendor was paid \$50,259 twice in error. The overpayment was not returned for 3.5 months, and the double payment and subsequent return of this money was never recorded in FUNDS.

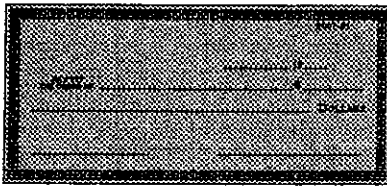
Manual checks were sometimes issued without required written authorization from Finance Department management. Before the Finance Department authorizes the issue of a manual check, they make sure an extraordinary situation exists which requires a manual check, and that everything is in order so payment can be made. When this control does not function properly, manual checks could be issued when it is not appropriate to do so.

Internal control weaknesses also exist which would allow a manual check to be issued without going through the typical review and approval process for manual checks. As a result, a manual check could be issued for an unauthorized purpose. The primary reasons this can occur is because manual check stock is not adequately restricted, and too many people can issue a manual check without going through the required review process.

Other concerns were identified which affect the entire accounts payable process, and not just the manual check process. For example, the accounts payable system's ability to notify users when a double payment is going to occur is not being properly utilized. Also, many vendors are assigned multiple vendor numbers in error. Among other problems, this makes it more difficult to research a vendor's payment history to determine whether they have already been paid for a service or goods before issuing a manual check.

The auditor did not find evidence of any use of manual checks for other than legitimate City of Berkeley expenditures. What was found, rather, were ineffective processes. Conditions were found which, taken together, signify that internal controls over the manual check writing process are not adequate or not functioning properly.

Steps to remedy this situation will include improved procedures, improved documentation, more timely posting and reconciliation, and removal of inappropriate combinations of access and authority. The Finance Department reported, subsequent to the last day of audit field work, that they have begun to implement a number of the suggested improvements. Timely implementation of the full set of recommendations should improve the entire accounts payable process.



REVIEW OF THE MANUAL CHECK PROCESS

Finance Department Responses

I**ntroduction.** The Finance Department understands and supports the stated intent of this audit: To determine whether controls are in place which provide a reasonable assurance that manual checks issued by the Finance Department are issued properly and only when needed; and that the checks are handled and accounted for properly. While we do not agree with each and every conclusion reached by the Auditor, we do support the recommendations to improve and tighten up the control process. Each of the eight (8) findings identified in the report as related to the Finance Department are addressed below.

An area of major disagreement lies in what is implied in the report rather than the specific words used by the author. Findings #1 and #2 appear to imply that there is such a lack of control over manual checks that ample opportunities exist throughout the process for staff collusion or outright abuse by those with manual check writing authority.

While processes can be improved, controls tightened and procedures documented to a greater extent, we believe that the Auditor found more than a **reasonable assurance** that adequate controls are in place. The Finance Department takes strong exception to the statements and implications made particularly in the early part of the report.

It should be clearly noted that the Auditor did not find one instance of an improperly issued check. In fact, as we will address in our responses to specific findings, some of the conclusions reached by the Auditor that the improper issuance of a manual check is even reasonably possible appears to be unfounded.

S**pecific Findings.**

Finding 1: Lack of internal controls over the issuing of manual checks

- 1.1 *Too many employees can sign City checks, increasing the risk that a manual check will be issued for an unauthorized purpose and not be detected, or timely detected.*
- 1.1A. *Currently, as noted in the report, the City Auditor, City Manager, Deputy City Manager, Finance Director, and Deputy Finance Director are approved to sign checks.*

The City Auditor and the City Manager are the designated signatories according to the Charter; and, in actuality, the Auditor could not locate a single check issued by the City that was signed by anyone other than those two authorized signers. There are none. Therefore, there is no Charter violation.

Until July 1, 1997, the Finance Department officially reported to the Deputy City Manager. With the change of Finance now reporting directly to the City Manager, there is no reason for the Deputy City Manager to have that signing authority and it has been discontinued. The Finance Director is listed as a signatory in case of extreme emergencies.

Being prepared for an emergency with a visible contingent plan is only prudent management. All parties to the manual check process are fully aware that the signature of the Finance Director is not valid unless it is an extreme emergency such as a natural disaster. As stated above, it has never been used on a manual check. Finally, the suggestion made in the Auditor's report that a signature authority could be established with the bank that was activated only in the case of an emergency is not viable. It puts the responsibility on the bank to determine when the authority should be activated. No bank is going to accept that responsibility.

The Deputy Finance Director has been listed in order to allow him to manage the City's investment portfolio and cash. The audit report did not mention that the addition of the Deputy Director to the signature authority of the City was initiated at the Bank's request in order for him to authorize appropriate Finance staff to send wires to pay for securities purchased and for payroll-related liabilities. It was not made as an internal Finance Department decision. As stated to the Auditor, the Finance Department has no disagreement in removing the Deputy Finance Director from signature authority providing there is a way to retain his ability to manage the investment portfolio and to authorize wire transfers needed by other Finance staff.

The Finance Department views the alternative identified in the Auditor's report of having the City Auditor provide the bank authorization as an inefficient process and a possible violation of the preferred "arms-length" distance between the City Auditor and the daily operations of the Finance Department.

Auditor's Response: Although the review may not have identified a manual check issued by a signatory other than the City Auditor or City Manager, it must be remembered that three other people are signatories. Any two of the five signatures can be used to issue a check unless steps are taken to prevented them from doing so. This is a concern because the review found that the current

manual check process does not take sufficient steps to prevent signatories other than the City Auditor and City Manager from issuing a manual check without proper review and approval.

- 1.1B. *The report notes that: There are three (3) City Manager signature stamps with various degrees of availability to various City employees, including most account signatories...it appears that only one signature stamp is warranted. Written procedures which address who has access to the City Manager's stamp, and what purposes they can be used for, are not available.*

While there is no incident of these stamps ever being misused, the Finance Department concurs that written procedures need to be developed to document and clarify where these stamps are located, how they are secured and who has authority to use them.

- 1.1C. *The report states that the City is not in Compliance with City Charter Section 61, Article 10 which requires that the City Auditor sign and the City Manager countersign all checks.*

The Finance Department disagrees with this statement. Since no check has been issued with any signatures other than those of the City Auditor and the City Manager, the City is absolutely in compliance with this section of the Charter. Please refer to our response to 1.1A for further comment on this issue.

Auditor's Response: We believe it is logical to assume that if City Charter Section 61, Article 10 requires the City Auditor to sign and the City Manger counter-sign all City checks, only these individuals should have bank signatory authority to issue a City check. The finding stands as written.

- 1.2 *Procedures are not in place to insure that an employee who is an authorized bank account signatory for the City has this authority removed prior to the last day of employment with the City.*

The Finance Department agrees that procedures are not in place to remove authorized signatures from the bank card upon those employees leaving employment with the City. This has been addressed in part by the newly developed City-wide procedures for Department Head transition.

The report also states that this situation created an "...increased risk that City money could be used for unauthorized purposes." The Finance Department disagrees. Once an employee leaves the City, that employee has no means to request or approve

payment for anything; can not approve the A/P Edit List; does not have access to blank checks; and does not have access to either the City Auditor's or City Manager's signature stamps. It appears that the author of the report is attributing a greater degree of seriousness to an administrative weakness than is warranted. There is no risk to City funds as a result. The Finance Department will draft additional procedures to specifically address the removal and updating of bank signature authority upon employee termination or transfer of responsibilities.

Auditor's Response: Finance Department management considers allowing a former employee to remain as a signatory on 5 City bank accounts (Including the general fund account and payroll account, two large accounts) for 5 months to be an administrative weakness. This is an internal control weakness. One of the fundamental internal control procedures used to provide a reasonable assurance City money will only be used for authorized purposes is to restrict who is a bank account signatory. The finding stands as written.

- 1.3 *Conditions exist which could give some employees in the Finance Department the opportunity to issue a manual check without proper review and approval, or for unauthorized purposes, and to take steps to conceal this activity.*

The report states that the above condition "...results primarily from a lack of a proper segregation of duties." As in all financial systems, controls can definitely be improved. However, the Finance Department disagrees with the opinion of the Auditor that there are ineffective controls over the manual check process. There is no step in the process that does not involve two or more people to complete. Despite the Auditor's implications to the contrary, no single person can accomplish the approval, writing and issuing of a manual check. This current process meets the basic condition of effective accounting controls, specifically a "proper segregation of duties".

In nearly all cases, prior to a manual check being issued, management in three different departments (the requesting department, the Finance Department, and the City Auditor's office) must review the documentation and approve each transaction for payment. In fact the Auditor states in the report that the audit did not identify any "...instances where a manual check was issued for unauthorized purposes..."

The following is a summary of what occurs in the manual check operation:

- i All the transactions are initiated by management personnel in the requesting department; an explanation for an emergency check and the supporting documentation are provided to management personnel in the Finance Department

- ii Finance Department management reviews the supporting documentation and, based on the explanation provided by the management personnel in the requesting department, determines if a manual check is necessary;
- iii The City Auditor is informed that a manual check is being requested and is provided with the details. Often, the management personnel of the requesting department is sent directly to the City Auditor to discuss the request, in order to expedite the process. The City Auditor is provided with and reviews the supporting documentation and signs the check.

This would appear to be a "proper segregation of duties". Again, it must be reiterated that any possibility of fraud under the current system requires collusion of two or more employees in different departments. Even if there was collusion between management personnel in the requesting department and management personnel in the Finance Department, the City Auditor's Office is in a position to prevent every instance of it simply by following the normal process.

The report highlights two concerns (Concern "A" and Concern "B") which identify circumstances under which the author believes that persons can commit an irregularity and then "take steps to conceal it." In reality, any employee can attempt to commit fraud and take steps to conceal it in any system. The control test is whether or not they can be successful at concealing it.

It is the position of the Finance Department that current controls and separation of duties and responsibilities prevent the possible irregularities alluded to in the report from being concealed for any length of time. While the identified irregularities are theoretically possible, their success would require significant collusion to a degree that is highly unlikely.

Auditor's Response: Our report has demonstrated that conditions exist which would allow an employee to issue an unauthorized check without proper review and approval.

Regarding timely detection of such an act, having Finance Department managers who can perform so many manual check issuing and /or processing tasks, and also approve subordinates to perform manual check procedures they have been assigned to perform, unnecessarily increases the risk to the City that a manual check will be issued for an unauthorized purpose and that it will not be detected or timely detected. We are concerned that Finance Department management has not acknowledged the seriousness of this finding.

Subsequent to the completion of this audit (April 8, 1997) it has also come to our attention that most of these same concerns also apply to the issue of unauthorized system generated checks. Of particular concern, one senior manager in Finance has been authorized to perform virtually all tasks required to acquire, to pay and to record a purchase through FUNDS. Some of this employee's FUNDS authorization was removed subsequent to Finance's review of this report.

Internal controls over the safeguarding of assets constitutes a process designed to provide a reasonable assurance for preventing or timely detecting the unauthorized acquisition, use, or disposition of City assets. They are not designed to detect collusion as implied by the Finance Department.

The finding stands as written.

Recommendations

1. *Remove all authorized bank account signatories except the City Auditor and the City Manager.* All bank account signatories other than the City Auditor, the City Manager the Finance Director and the deputy Finance Director have been removed from the account. The Finance Director will be maintained on the bank signature card for emergencies only. The Finance Department will review the Deputy Finance Director as a signatory and develop other alternatives if possible..

Auditor's Response: If all authorized bank account signatories except the City Auditor and the City Manager are not removed as bank account signatories, the City will not be in compliance with City of Berkeley charter, Section 61, Article 10. Additionally, allowing the Acting Finance Director and Deputy Finance Director to continue to be City bank account signatories is a significant internal control weakness because they can perform or authorize so many tasks in the manual check process. A procedure to allow the City to issue checks in an extreme emergency is a good idea. However, such a procedure should include internal controls which provide a reasonable assurance this procedure will not be used unless there is an extreme emergency. Therefore, our recommendations, or an alternative which accomplishes the same results, should be implemented.

2. *The Property Check List form should be used.* The Property check list will be used by the Finance Department. Written procedures will be developed but the Finance Department believes that the arms length distance between the City Auditor and the daily operations of the Finance Department should be protected. Therefore, it is not

recommended that the City Auditor replace Finance Department staff or the City Manager in directing the bank or the daily activities of Departmental employees.

Auditor's Response: Since the bank requires receipt of written authorization from an account signatory for a non-signatory to conduct bank business, the review is recommending procedures be prepared so Finance Department managers who are removed as bank signatories can continue to conduct business with the bank as usual. The only change being recommended is that only the City Manager and City Auditor be authorized check signatories. Since only one signature is required to authorized specific bank account related activities, the City Manager, rather than the City Auditor, could sign such documents if that is preferable to Finance. Our recommendation, or an alternative which accomplishes the same thing, should be implemented.

3. *Physically secure the manual checks.* The box of sequentially-numbered, blank manual checks have been removed from the Treasury office and placed in a locked cabinet under the control of the responsible Accountant II. The Deputy Director of Finance and the Treasury Manager will review the security of the manual checks and develop any additional procedures for improved security if required. Written documentation will be developed.
4. *Implement procedures.* The Finance Department does not believe this is a problem currently as discussed above. However, written procedures will be developed to further clarify the boundaries of authority throughout the manual check writing process.

Auditor's Response: If this recommendation and recommendation 1 (for this finding) are not implemented, some Finance Department managers will continue to have the ability to issue a manual check without proper review and approval, or for unauthorized purposes, and in some cases to take steps to conceal this activity. These recommendations, or alternative recommendations which accomplish the same thing, should be implemented.

5. *Maintain only one City Manager Signature stamp.* The City Manager believes that the maintenance of multiple signature stamps is necessary to effect normal business. The Finance Department, in coordination with the Budget Office and the City Manager, will assist the City Manager and the Budget Office to develop required written documentation regarding the use of the City Manager's signature stamps if requested.
6. *Access to the signature plate should be removed from the Auditor's Office.* This recommendation is directed at the City Auditor, but speaks to Finance developing

written procedures. If the City Auditor chooses to implement this recommendation, the Finance Department will support that move with any requested assistance to prepare written procedures as detailed in the report.

Finding 2: Approval to issue a manual check is not always documented.

Four of the 20 manual checks reviewed were issued without the required written approval of Finance Department management. This is a significant internal control weakness...because this internal control is not functioning properly, manual checks could be issued for unauthorized purposes and go undetected.

It is unclear from the report what written approval was missing. It may be assumed from statements made later in the report that what is referred to are the initials of the reviewing party in Finance. If so, the Finance Department disagrees that the absence of the initials are evidence of a "significant internal weakness". As stated earlier, with or without these authorizing initials, unauthorized checks cannot be issued without significant and highly unlikely collusion between or among several City employees. The report states that the documentation supporting the four (4) checks was adequate and none were duplicated by system checks.

Rather than evidence of "significant internal weaknesses", we concur with the Auditor that this is more likely a demonstration of the need for clear, written documentation and employee training so that existing procedures are consistently followed. The manual check process is by definition a "rush" or emergency operation. That makes clear and well understood procedures of importance.

Auditor's Response: Internal controls over the safeguarding of assets constitutes a process designed to provide a reasonable assurance for prevention or timely detection of unauthorized acquisition, use, or disposition of City assets. They are not designed to detect collusion as implied by the Finance Department. Regarding finding 2, to prevent or timely detect the unauthorized use of City assets by the unauthorized issue of a manual check, one of the current internal control procedures is to have Finance Department management review and authorize each payment to be made by manual check. To insure a manual check is not issued without going through this process, another employee is not to release check stock from inventory until they have received written authorization from management a manual check can be issued. Because 20% of the manual checks reviewed were issued without the written approval of Finance Department management, this internal control is not functioning as intended. The finding stands as written.

Finding 3: Unnecessary risk of double payment.

Internal controls are not in place which would provide a reasonable assurance a vendor will not be paid twice in error.

- 3.1 *Manual check activity is often not timely posted.* The Finance Department agrees with this finding. The Department has established the requirement that each manual check must be recorded in Fund\$ within 24 hours of issuance, and that any exceptions to this are to be reported to Finance Department management at the time that the variance occurs. This will be incorporated into written procedures along with a process for spot checking adherence to the requirement.
- 3.2 *Manual check activity could be improperly processed through FUNDS; and*
- 3.3 *A determination whether or not an invoice has already been paid may not always be made prior to issuing a manual check. Authorization for a manual check was not documented for four of the 20 manual checks reviewed.*

The Finance Department disagrees with this part of the finding and contends that a determination of whether or not the invoice has already been paid is always made prior to issuing a manual check. The issue of "proper authorization" was discussed above.

However, the Finance Department shares the concern with the Auditor related to staff only recording double payments in FUNDS after efforts to have the vendor return the overpayment are not successful. The Department will review the situation and develop appropriate procedures.

In the instance of the example detailed by the report, it is important to note that although two payments were made to the vendor, the City was not at risk because the vendor had provided goods and services and submitted an invoice almost equal to the total of the two payments. The "delay" noted by the report was not an attempt to conceal anything. It resulted from the vendor researching its records and being reluctant to return the money since they provided the City with the goods and services equal to or exceeding the total of both payments; and from the authorizing department's desire to work in cooperation with their vendor to amicably resolve the issue.

Auditor's Response: For 20% of the manual checks reviewed, payment by manual check had not been authorized in writing. This means that in these instances a manual check should not have been issued until written authorization was obtained. Procedure

requires Finance Department management to verify an expense had not already been paid prior to approving payment by manual check. If manual checks are sometimes issued without this written authorization, this internal control (not releasing a manual check without written authorization) is not effective in preventing double payments.

Recommendations

1. Procedures for the 24-hour posting of manual checks are in place currently. They will be properly documented.
2. Double payments will be recorded in FUNDS in a timely fashion and will be properly documented in the vendor file and the manual check records. Procedures will be documented.
3. *Establish internal controls.* Procedure already in place.

Finding 4: Totals in the Accounts Payable Edit report are not checked for accuracy.

The Finance Department agrees with the finding and has implemented the recommendation. Each Accounts Payable clerk now prepares an adding machine tape of all the invoices processed for payment each day; and the Accounts Payable Manager reconciles the tape totals to the total of the Edit Reports.

Finding 5: Many vendors are incorrectly assigned multiple vendor numbers.

- 5.1 *Payment activity under 2 or more vendor numbers must be reviewed to determine if an invoice has been paid prior to issuing a manual check. Having to look at payment history under multiple vendor numbers increases the likelihood an invoice that was paid will be overlooked and paid again by manual check in error.*

Although we acknowledge that there are some vendors that have incorrectly been assigned more than one vendor number, the Auditor's work papers indicate that the Auditor has erroneously concluded that all vendors with more than one vendor number were assigned those numbers in error. This is not the case. In the HTE system, multiple vendor numbers are required in order to process payments for vendors with multiple remittance addresses. We reviewed the list of 11 vendors identified by the Auditor as incorrectly having multiple vendor numbers, and made the following observations:

- (i) None of these vendors were involved in manual check transactions and this particular review was beyond the scope of the review of the manual check process. This is important to note because the Auditor previously indicated that there were between 33 to 36 manual check transactions per year during

the period of time covered, and the reader of this report might reasonably relate the number of exceptions identified by the Auditor (i.e. 11) to the aforementioned 33 to 36 manual check transactions. In reality, the 11 exceptions should be compared to the total universe of over 800 vendors that were in the population of transactions reviewed by the Auditor.

- (ii) We agree with the Auditor that excess code(s) were assigned to these 11 vendors three to five years ago. However, the audit report fails to indicate that a multiple vendor code was actually used for only one of the 11 vendors during the 1996-97 fiscal year and a multiple code hasn't been used for five years or more for seven of the 11 vendors.

While we agree the excess code numbers should not be used, it would be inappropriate to just eliminate them without careful planning because the City will lose the audit trail. The Accounts Payable Manager and Information Systems staff are working on a project to eliminate the excess code numbers but still retain the audit trail. In the meantime, all requests to establish new vendor codes must be approved by the Accounts Payable Manager.

Auditor's Response: During the course of field work, Finance Department employees discussed with the auditor their concerns regarding their difficulties with multiple vendor numbers. It has subsequently become clear that some of these existed because of shortcomings in the HTE software, while others existed because of human error. The auditor looked into this subject in order to document the steps Finance was taking to correct the problem. We concur with Finance that corrective action should be taken with careful and coordinated planning.

- 5.2 *The vendor's correct mailing address is often difficult to determine because it is not uncommon for vendors with multiple vendor numbers to have more than one mailing address. Having a vendor with more than one mailing address increases the chance a manual check will be sent to the wrong address.*

We addressed this issue above. While Finance recognizes the fragility of the current system, multiple mailing addresses for one vendor does not increase the chances a check will be sent to the wrong address because each invoice reviewed and paid generally indicates to which specific address that check should be mailed.

- 5.3 *Multiple vendor numbers will cause the City's automated accounting system to sometimes not report, or incorrectly report, tax information to vendors and to the Internal Revenue Service. This could result in penalties being assessed to the City.*

Finance agrees with finding# 5-3a, but disagrees with 5-3b and 5-3c. Beginning last year(1996), Finance management staff ran a query by alphabetical order and had provided instructions that the Accounts Payable unit combine the individual totals for vendors with multiple code numbers onto one Form 1099. However, they could not implement this procedure and submit the 1099 forms by the deadline. In FY 97/98 (FY 96/97 closing and tax completion), the process will be started earlier so that there is enough time to accomplish the combining of the multiple vendor totals.

We disagree with# 5-3b because the vendor determines where the 1099 form is to be sent by their completion of the information on the initial Form W-9. We disagree with# 5-3c because for 1996 1099 forms, a query was run of all vendor payments in alphabetical order and the Accountant I in Finance-Accounting added the amounts of individual totals to identify all vendors receiving \$600 or more during the year. This list was given to the Accounts Payable Unit. This is now a part of the regular 1099 issuing process.

Auditor's Response: Finance management acknowledges that incorrect use of multiple vendor numbers is resulting in the City's automated accounting system incorrectly reporting tax information. However, they disagree this is a finding because additional work (corrective action) is being performed and these errors are being corrected. As stated in the finding, there is a cost to the City when, in order to avoid incorrect reporting errors, staff must perform additional work to identify and correct 1099 errors. In summary, there is a problem condition that needs to be corrected.

Recommendations.

1. As stated above, Finance has already placed an enhancement request with HTE. Information Systems is aware of this enhancement request and supports it.

Auditor's Response: In Finance management's response to this finding (not the recommendation), they state that the auditor's recommendation has been implemented. However, it appears this activity may not have been documented which was also recommended. Specific documentation of requests to the City's Information Systems Department as well as to the software vendor should improve the quality and timeliness of the response from both. The recommendation stands as written.

2. Finance will strengthen the controls and user training for adding new vendor numbers. These will be documented as departmental written procedures.

Finding 6: Accounting system does not always identify duplicate invoices.

Invoice references are not always entered, or are not always entered in a consistent format. As a result, the accounting system is not always able to warn staff in Finance-AP of duplicate invoices before these invoices are paid again in error.

Finance agrees with this finding. Staff is in the process of developing more comprehensive procedures and a training program for implementation.

Recommendations.

1. The standards will be documented, made part of the improved written departmental procedures, and employee training completed.

Finding 7: Invoices are sometimes paid without written approval from an authorized employee of the department receiving the goods or services.

Invoices are sometimes paid without written approval from an authorized employee of the department receiving the goods or services. Payment could be made to a vendor for goods or services that were not approved for payment, or which did not benefit the City.

In two cases out of 20, the Auditor found that the initials of the "authorized signatory" from the receiving department were missing from an invoice paid by a manual check. From this, the author of the report concluded that the payment did not have proper approval. This relates back to the comments made in this response under Finding #2 (i.e., this is more likely a demonstration of the need for clear, written documentation and employee training so that existing procedures are consistently followed rather than improper payment or even the possibility of improper payment.)

Auditor's Response: For 10% of the manual checks reviewed, payment was processed without the written approval to pay from an authorized employee. This means that in these instances a manual check should not have been issued until written authorization was obtained. The written authorization documents that the invoice or voucher was approved for payment by an authorized signatory. If payments are sometimes processed without this written authorization, this internal control is not effective in preventing the City from paying for unauthorized expenses.

Recommendations.

1. Finance will include the proper review and approval process in the updated written procedures. Employees in requesting departments, the Finance Department and the City Auditor's Office will be trained in the process.
2. Further clarification is required on Recommendation #2 before a response can be formulated.

Finding 9: Incorrect encumbrance balances.

Users too often make incorrect increases or incorrect decreases to encumbrance balances when entering manual check and related void check transactions into GMBA-Account Payable. Efforts to identify and correct incorrect encumbrance balances are performed infrequently.

The Finance Department agrees that mistakes are sometimes made in entering manual checks and related void check transactions. Finance is in the process of developing more comprehensive procedures to assist staff in making the correct entries the first time around. Finance has already implemented procedures to ensure correcting entries are made on a timely basis.

Finance disagrees with the finding that the encumbrance reconciliation was done on an infrequent basis. A reconciliation was done for the quarter ended September 1996, but, due to CAFR time constraints, did not include a summary sheet listing the discrepancies. Even though the summary sheet was not prepared, the reconciliation between P/I and GMBA was completed and adjusting entries were prepared. Another reconciliation for the period ended February 1997 was completed in May 1997, which did include a summary sheet. A third reconciliation begun in late May for the period ended in mid-May 1997 was interrupted by an HTE system problem that prevented P.O. change orders from coming over to GMBA. As of July 2, 1997, this system problem had not been corrected by HTE.

Auditor's Response: At the request of Finance Department management, during July 1997 the auditor again reviewed encumbrance reconciliation records and met with staff that prepared the reconciliation. It reconfirmed that as of April 8, 1997 (date fieldwork completed), the last time an encumbrance reconciliation was completed (and identified errors corrected) was for the period ending May 23, 1996. This is almost a year ago. Finding stands as written.

Recommendations:

1. Written procedures for reducing errors are being developed. Written procedures for timely correction of errors when they do occur are already in place.
2. The encumbrance reconciliation is already done at least quarterly. As soon as the HTE system problem is resolved, that regular schedule will be resumed.

Auditor's Response: The recommendation for Finance to prepare quarterly encumbrance reconciliations and timely correct encumbrance errors identified is not already being done, and stands as written.

Summary

The Auditor has identified some weaknesses in internal controls and made recommendations (some of which have already been implemented) that will improve the City's control over the manual check process. However, the report found no actual instances of irregularities or improprieties.

The report makes strong statements about the Finance Department not having "proper segregation of duties" related to the manual check-issuance process that are, in actuality, not true when viewed from the stated purpose of the report (i.e., to determine whether controls are in place which provide a **reasonable assurance** of proper handling and issuance.)

These statements would seem to be at variance with the results of the City's independent audit (specifically the review of the City's internal control structure) conducted by KPMG Peat Marwick. The conclusion reached by the independent auditors in their recently completed audit of the City's 1995-96 financial year was that the "control risk for the City's procurement and disbursement cycle appears low".

To accomplish the violations which the author notes in the report **may** or **could** occur, significant and improbable collusion would have to occur. No accounting system is ever 100% protected from multiple party collusion. In addition, one of the responsibilities of the Finance Department is to assure that when developing and implementing internal controls, the cost of implementing them does not exceed their expected benefit.

It is assumed that it was not the intent of the City Auditor to class the control weaknesses identified in the manual check process in the as either a reportable condition¹ or a material weakness². Based on that assumption, the Finance Department finds the information provided by this report helpful in improving many systems within the City's financial accounting and management systems. The value of the Auditor's observations is not limited to the relative narrow process of issuing manual checks.

The Finance Department will develop the identified and agreed upon written procedures and provide evidence of responding to the remainder of the appropriate findings as indicated in the body of this report no later than December 31, 1997.

Auditor's Response: KPMG Peat Marwick stated in their 1995-96 report on the Internal Control Structure: "...we assessed control risk in order to determine our auditing procedures for the purpose of expressing our opinion on the general purpose financial statements and not to provide an opinion on the internal control structure. Accordingly, we do not express such an opinion."

The reason such an opinion is not expressed by the external auditor is that the standards for a "financial statement audit" require the auditor "to obtain reasonable assurance about whether the general purpose financial statments are free of material misstatements" and not to express an opinion on the City's internal control structure.

Other types of audits, such as those performed by the Auditor's Office, may be specifically designed to evaluate the efficiency and effectiveness of a system of internal controls over a specific cycle or operation. The manual check review is such an audit.

¹ Reportable conditions are significant deficiencies in the design or operation of the internal control structure which could adversely affect the organization's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

² A material weakness is a reportable condition in which the design or operation of the specific internal control structure elements do not reduce to a relatively low level the risk that errors or irregularities, in amounts that would be significant in relation to the financial statements, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

City of Berkeley



City Manager's Office
 Martin Luther King Jr.
 Civic Center Building
 2180 Milvia Street
 Berkeley, California 94704
 TEL: (510) 644 6580
 FAX: (510) 644 6035
 E-Mail: manager@ci.berkeley.ca.us

RECEIVED


JUL 17 1997

AUDITOR

MEMORANDUM

July 16, 1997

To: Ann-Marie Hogan, City Auditor

From:  Phil Kamlarz, Deputy City Manager

Subject: Review of Manual Check Process

The purpose of this memo is to provide a formal written response to your recommendation to the City Manager's Office regarding the Manual Check Process (specifically, Finding 1.1: "Lack of internal controls over the issuing of manual checks" - Too many employees can sign City checks, greatly increasing the risk that a manual check will be issued for an unauthorized purpose, etc.).

Recommendation 5 suggests that the City Manager's Office do the following:

1. Maintain only one City Manager signature stamp,
2. Generate alternate methods for using such stamp for budget modifications, and
3. Develop written policies and procedures for use of such stamp.

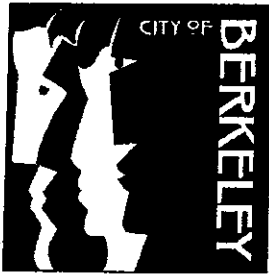
The City Manager's Office disagrees with items 1 and 2.

We find our current practice of utilizing the CM stamp(s) in question to be acceptable practice and therefore respectfully disagree. The signature stamps in question are held in secure environments (one with the City Manager's Secretary and one with the Budget Office staff). There are a number of situations which require the signature of the City Manager other than that of signing checks. To discontinue the use of these stamps would have an impact on the daily flow of information in this office.

We agree with item 3.

Developing written policies and procedures which address what purposes the stamp can be used for, who is authorized to use the stamp, and how access to the stamp will be restricted is both reasonable and practical. Although such procedures have been in place, there is currently no written policy. Staff will develop these into a written document.

cc: Stephanie Lopez, Budget Office




Office of the City Auditor
Ann-Marie Hogan, City Auditor

MEMORANDUM

August 17, 2000

To: Fran David, Director of Finance

From: Grant Bennett, Audit Manager 

Re: Bank Account Signature Authorizations

I reviewed your memo to Bank of the West regarding the change in City management, and requesting an update of authorized signatories. We recommended in our 1998 audit of the manual check process that authorized signatories be limited to the City Manager and the City Auditor only. We also recommended an alternate for each should either become incapacitated. The City Manager concurred with our recommendation and reported to Council that action had been taken to limit signature authority, but to include the Director of Finance. A copy of the July 7, 1998 information item submitted to Council by the City Manager is attached for your reference. Given that the Deputy Director of Finance has general responsibility for all City accounting transactions, I believe that he should not also have authority to sign checks for the City. This is a fairly standard separation of responsibilities control; the basic objective being that no one individual should control all aspects of a financial transaction. I strongly recommend that the control implemented by the City Manager in 1998 be continued. It seems reasonable that an alternate signatory should be appointed in the City Manager's Office, however.

Attachment

Cc: Acting City Manager Weldon Rucker
City Auditor Ann-Marie Hogan ✓

City of Berkeley



City Manager's Office
Martin Luther King Jr.
Civic Center Building
2180 Milvia Street
Berkeley, California 94704

TEL: (510) 644 6580
FAX: (510) 644 6035

E-MAIL: manager@ci.berkeley.ca.us

COUNCIL INFORMATION

July 7, 1998

CR# 97-103

To: Honorable Mayor and
Members of the City Council

From: James ^{JK}Keene, City Manager

Subject: REVIEW OF THE MANUAL CHECK PROCESS - IMPLEMENTATION OF AUDIT
RECOMMENDATIONS

STATUS:

In response to the recommendations made in the Manual Check Process Audit report submitted at the October 7, 1997 Council meeting by the City Auditor, the Finance Department has implemented revised procedures, taken other appropriate corrective action and developed other plans as follows:

Recommendation 1

Too many employees can sign City checks. Currently, the City Auditor, City Manager, Director of Finance, and Deputy Director of Finance are approved to sign checks.

Remove all authorized bank account signatories from Berkeley bank accounts except the City Manager and City Auditor. Have the City Manager or City Auditor submit the signature cards directly to the bank to insure no additional bank account signatories are added.

Make arrangements with the bank to have alternate authorized signatories which would replace that of the City Manager and City Auditor in the event they become incapacitated.

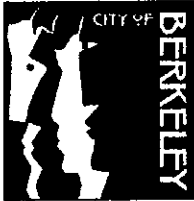
Corrective Action Taken

All authorized bank account signatories have been removed, except for the City Manager, City Auditor and Director of Finance. The Director of Finance is only authorized to sign checks in an extreme emergency during the absence of the City Manager, City Auditor and their authorized signature stamps.

RECEIVED

AUG 16 2000

AUDITOR'S OFFICE



Finance Department
Office of the Director

August 15, 2000

Bank of the West
Cash Management Services
Attn: Louise Sizelove
201 North Civic Drive, Suite 1900
Walnut Creek, CA 94596

Re: All current City of Berkeley Accounts

To Whom It May Concern:

In light of the appointment of a new Acting City Manager, I request that signature cards currently on file for the referenced accounts be removed and signature cards be filed in their place. The new signature cards should bear the signatures of:

Acting City Manager
City Auditor
Director of Finance
Deputy Director of Finance

Weldon Rucker
Ann-Marie Hogan
E. Frances David
Robert Hicks

Thank you for your attention to this matter.

Sincerely,

E. Frances David
Director of Finance

Cc: Mr. Weldon Rucker, Acting City Manager
Ms. Ann-Marie Hogan, City Auditor
Ms. Gail Cabe, Finance/Accounting

City of Berkeley



City Manager's Office
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TEL: (510) 644 6580
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E-MAIL: manager@ci.berkeley.ca.us

COUNCIL INFORMATION

July 7, 1998

CR# 97-103

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Members of the City Council

From: James ^{JK}Keene, City Manager

Subject: **REVIEW OF THE MANUAL CHECK PROCESS - IMPLEMENTATION OF AUDIT
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Make arrangements with the bank to have alternate authorized signatories which would replace that of the City Manager and City Auditor in the event they become incapacitated.

Corrective Action Taken

All authorized bank account signatories have been removed, except for the City Manager, City Auditor and Director of Finance. The Director of Finance is only authorized to sign checks in an extreme emergency during the absence of the City Manager, City Auditor and their authorized signature stamps.

Recommendation 2

The Property Checklist form (Administrative Regulation 2.4 effective February 25, 1997) should be used to insure that each employee's bank signature authority is removed prior to their last day of employment with the City.

Develop a written procedure which would permit the City Manager and/or City Auditor to expeditiously direct the bank (in writing) to give specific employees in the Finance Department authority to conduct specific business with the bank.

Corrective Action Taken

The Finance Department has not had an opportunity to use the Property checklist form to remove employees who have left the employ of the City, since the date of this report. However, the department will use the form for this purpose.

In addition, the Finance Department has developed a draft Administrative Regulation "Establishing Bank Accounts", which authorizes the City Manager and/or City Auditor responsibility for directing the bank(s) in writing to give specific employees in the Finance Department authority to conduct specific business with the bank.

Recommendation 3

Physically secure the manual checks kept in Finance - Treasury from the possibility of access without signature in the manual check inventory log.

Corrective Action Taken

Prior to the submission of the City Auditor's report to the City Council, the partial box of sequentially numbered, blank manual checks were removed from the Treasury office and placed in a locked cabinet under the control of the responsible Accountant II. That individual does not release manual checks without the signature of authorized personnel.

Recommendation 4

Managers with authority to approve issuance of a manual check should not be able to perform the following:

1. Requisition or buy goods, and also approve them for payment.
2. Be an authorized bank account signatory for the general fund account.
3. Have authorization to obtain the signature plate.
4. Have the ability to post both the purchase and the payment of the purchase in FUNDS.

Corrective Action Taken

The Director of Finance significantly restricted Fund\$ system access for the Director of Finance and Deputy Director of Finance pending a comprehensive internal controls vulnerability assessment. When this assessment is completed, each of these employees will be given all the access, and only the access, needed to efficiently and effectively perform their duties and responsibilities.

The vulnerability assessment will primarily include determining the procedures performed, identifying the potential risks involved in performing them and the policies and procedures in effect in the system to act as checks and balances and compensate for the perceived risks.

As of this date, managers in Finance with authority to approve the issuance of a manual check cannot also 1) requisition good/services and approve them for payment; 2) be an authorized bank account signatory (except for the Director of Finance in an extreme emergency during the absence of the City Manager and City Auditor; 3) have authorization to obtain the signature plate; and 4) have the ability to post purchase and/or payment of the purchase in Fund\$.

Recommendation 5

Approval to issue a manual check is not always documented.

Finance should update written procedures for manual checks to:

1. Document staff who can authorize the issue of a manual check.
2. Identify what tasks must be completed before a manual check is authorized. This should include verifying that the invoice has not yet been paid, the payment was authorized by an authorized signatory from the department which received the goods or services, that documentation adequately supports that payment is due, and that funds are available.
3. Prohibit manual checks from being signed out from inventory without the written authorization of appropriate staff. Management should taken necessary steps to insure staff always follow this procedure.

Finance Department management should emphasize to staff the importance of only releasing manual checks from inventory after written authorization and adequate support documentation are received.

Corrective Action Taken

The Finance Department has updated the manual check procedures and discussed them with all staff involved in the process. These procedures (1) document who can authorize the issuance of a manual check (i.e., Director of Finance and Accounts Payable Manager); (2) identify the tasks that must be completed before a manual check is authorized and (3) require that all manual checks issued are signed for by authorized personnel.

Recommendation 6

Require each manual check issued be posted in Fund\$ within 24 hours of the check issue date. Require the accountant who oversees the manual check inventory to report all exceptions to the Deputy Director within 24 hours. The cause for the exception should be identified, and the problem condition corrected so it will not happen again. This procedure should be included in the written policies and procedures for manual checks.

Corrective Action Taken

This recommendation was accepted and has been implemented.

Recommendation 7

Before each Accounts Payable Edit report is approved by the Deputy Director of Finance, totals in the Accounts Payable Edit Report should be reconciled with batch totals obtained from the invoices processed for payment. Any differences should be researched, and corrections made. This procedure should be added to the written policies and procedures.

Corrective Action Taken

This recommendation has been implemented. An adding machine tape of all invoices is prepared and reconciled with the Accounts Payable Edit List prior to submission of the batches to the Deputy Director of Finance for approval. In addition, the written procedures have been revised to reflect the change.

Recommendation 8

Finance should submit a written project request to Information Systems. It should request that Information Systems work with Finance to develop a method or program which can be used to efficiently eliminate instances where a vendor has been assigned more than one vendor number in error. The problem with vendors with multiple vendor numbers should be corrected within 6 months from the date this report is issued.

Corrective Action Taken

It is unnecessary to have Information Systems prepare a program to eliminate the excess vendor code numbers. The ability already exists in the system for staff to merge and eliminate the majority of the excess vendor codes. Before the files can be eliminated and/or merged, a vendor information certification letter must be on file and all vendor taxpayer identification must be recorded. However, a vendor number that has active PO's outstanding cannot be eliminated, but the information can be merged.

During the preparation of the calendar year 1997 1099 forms, every vendor that had activity was sent a vendor information letter and research was done to identify all duplicate numbers; all duplicated vendor tax information was merged and, when possible, the excess numbers were eliminated (except for those with an active P.O.).

Recommendation 9

Only employees who are authorized to add new vendor numbers in GMBA should be given Fund\$ access to perform this task. Employees authorized to add new vendor numbers should receive training, and written procedures, regarding how to correctly perform this task.

Corrective Action Taken

The access to authorize addition of a new vendor is tied to the access for making basic changes such as address, tax I.D. # and telephone # which is the responsibility of Accounts Payable staff. It would be inappropriate to take this access away from Accounts Payable staff. However, all Accounts Payable employees have been instructed that only the Accounts Payable Manager or Senior Accounting Office Assistant are authorized to add new vendors.

Recommendation 10

Finance should develop written procedures which establish standards so invoice reference information is consistently entered in Fund\$. This task should be completed within 6 months from the date of this report is issued.

Corrective Action to be Taken

Finance staff will update the Accounts Payable invoicing procedures to establish standards for consistently entering invoice references in Fund\$. We anticipate these procedures will be updated by June 30, 1998.

Recommendation 11

Prior to Finance Department approval of an invoice for payment by manual check, it must be verified that each invoice is signed by an authorized employee of the department that received the goods or services. Management should ensure that this procedure is always followed. This should be included in the written policies and procedures for issuing manual checks.

Corrective Action Taken

The written policies and procedures have been revised to require that an authorized employee of the paying department initial each invoice to acknowledge approval of the invoice for payment.

Recommendation 12

Develop written procedures which will show staff how to correctly record manual check and void check activity in accounts payable so encumbrance balances and PI and GMBA are correct.

When manual check activity is recorded in GMBA-AP, the encumbrance entry should be reviewed and approved before the entry is posted if possible.

Corrective Action to be Taken

Finance staff will revise the written encumbrance procedures to document how to properly record manual and void check activity, so that encumbrance balances in the Purchasing/Inventory and the

GMBA modules remain in agreement. We expect to complete these revisions by June 30, 1998. Also, training of all appropriate staff will be conducted.

Recommendation 13

Prepare a formal encumbrance reconciliation at least quarterly. It should be prepared within 30 days after the quarter to be reconciled has ended. Encumbrance errors identified by the reconciliation should be corrected within 2 weeks of completion of the reconciliation. This requirement should be incorporated into the written policies and procedures.

Corrective Action Taken

Encumbrance reconciliations have been done on a quarterly basis during the 1997-98 fiscal year, with adjustments made on a timely basis.

FINANCIAL IMPLICATIONS:

None

CONTACT PERSON:

Robert Hicks, Deputy Director of Finance 644-6476
Fran David, Director of Finance 644-6476

Approved by:

Frances David, Director of Finance