

Internal Audit Report 16-01
Citywide Cash
December 2016



City of Sioux Falls
Internal Audit Department
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CITYWIDE CASH INTERNAL AUDIT REPORT 16-01

INTRODUCTION

Internal Audit has performed two audits of citywide cash handling. The first audit was performed in 2007. This audit, like the one performed in 2007, is a high-level audit focusing on basic controls over cash handling. Since 2007, Internal Audit has performed numerous detailed audits of cash handling in specific City departments and agencies receiving cash on the City's behalf. See appendix one of this report for a list of past internal audits of cash handling within City departments. We have also periodically conducted unannounced cash counts of City petty cash and change funds that were not a part of specific audit.

BACKGROUND

Cash is defined, for the purpose of this audit, as coin, currency, checks and credit/debit cards. The City of Sioux Falls has numerous functions and responsibilities that require it to exchange cash with members of the public, receive payments through the mail, and receive online payments. For example, City offices:

- Accept payment for parking tickets and monthly parking leases.
- Accept payment from teams for enrollment in recreation leagues.
- Accept payment for permits and licenses.
- Receive tax receipts from other government agencies.

Finance, Utility Billing, Sanitary Landfill, and Health receive the largest amounts of cash. Finance received over \$180 million¹ in cash in 2015, Utility Billing received \$6.1 million, Sanitary Landfill received \$11.5 million, and Health received \$8.3 million. In order to process cash transactions from citizens and businesses, City departments must maintain sufficient cash levels. To do this, departments maintain change funds which are kept in a cash register or cash drawer to make change when citizens or businesses use cash for a transaction. Additionally, most departments have a separate petty cash fund used to make small purchases for authorized supplies and materials. City departments must protect the cash kept in cash registers and cash drawers as well as any assigned change funds or petty cash funds. As of August 2016, the City had 19 petty cash funds totaling \$2,595 and 38 change funds totaling \$13,448. See appendix two of this report for a list and description of City-owned checking accounts and information on signatories and reconciliation of these accounts.

Risk of Misappropriation

In a 2016 study titled *Report to the Nations on Occupational Fraud and Abuse*, the Association of Certified Fraud Examiners stated that government entities are particularly vulnerable to fraud for a number of reasons such as volume of transactions and number of

¹ This figure includes 1st and 2nd penny sales taxes and property taxes. Sales tax revenue comes via ACH transactions.

employees. Cash is a resource especially at risk of misappropriation. Cash can be taken from an organization at one of three moments:

1. When the cash is being received.
2. When cash is on hand.
3. When the cash is disbursed.

Theft of cash is defined legally in two ways: larceny and skimming. The difference is the timing: larceny is stealing money the organization has already accounted for and skimming is the stealing of money before the organization has had the opportunity to record it. A third way to take cash is through fraudulent disbursements. This audit focused on controls to prevent or detect skimming or larceny. An accounts payable internal audit in 2017 will focus on controls to detect or prevent fraudulent disbursements.

Typical fraud schemes involving cash might include the following:

- An employee accepts a currency payment from a citizen or business then inappropriately voids the transaction and pockets the currency.
- An employee simply pockets a currency payment from a citizen or business without ever putting the money in the cash register and recording the transaction.
- An employee perpetuates a check for cash substitution scheme: Unrecorded revenue checks (no cash receipt issued) are substituted for currency from transactions which were receipted and then laundered through the organization bank deposit.
- An employee or nonemployee knows where the change fund or petty cash drawer is and simply takes the money when nobody is around.
- An employee “borrows” from the petty cash fund. The presence of personal checks or IOUs in the petty cash drawer would be a red flag for auditors or supervisors.

Tips from employees, customers, and anonymous sources provided the most common ways that problems are identified according to the Association of Certified Fraud Examiners. A lack of controls, overriding existing controls, and a lack of review by managers contributed to many of the losses. The City of Sioux Falls maintains a fraud, waste, and abuse hotline for City employees to report tips. The hotline setup allows employees to do this anonymously.

Control Activities

Management is responsible for establishing a system to protect cash from misappropriation. Typical control activities would include:

- Physical barriers to separate cash from customers such as Plexiglas and locked doors.
- Security video cameras to record transactions between employees and customers.
- Written policies and procedures.
- Formal training for those employees assigned cash handling responsibilities.
- Management oversight and review. For example, this might include monitoring actual revenue received over revenue anticipated (budgeted).
- Unannounced cash counts by supervisors or auditors.

- Segregation of duties.

Of all the control activities, the most important is segregation of duties. No one employee should be in a position where they control all aspects of a transaction (receiving, recording, reconciling, and custody of cash). However, due to practical considerations such as a limited number of employees, the “textbook” approach of ideal segregation of duties may not be possible. Since managers are responsible for controls, they must weigh the cost and benefits of control activities. Compensating controls including greater management involvement can be a solution in cases where ideal segregation of duties is not practical.

Limitations of Controls

- Human nature can limit the effectiveness of established controls either by an employee’s unfamiliarity with procedures or through a tendency to cut corners and take shortcuts.
- The collusive activities of two or more individuals can result in control failures. For example, there may be collusion between an employee performing important cash handling procedures and a customer, supplier, or another employee.
- Managers are often in a position to override prescribed policies and procedures with the intent of personal gain or to misrepresent an entity’s financial condition or compliance status.

Payment Card Industry Data Security Standard

Because the City is receiving more and more payments by means of credit and debit cards, we considered it important to determine how the City protects the card information gathered from customers. The Payment Card Industry Data Security Standard (PCI DSS) is a set of requirements designed to ensure that all companies that process, store, or transmit credit card information maintain a secure environment. The Payment Card Industry Security Standards Council (PCI SSC) was launched in 2006 to manage the ongoing evolution of standards. The PCI SSC is an independent body created by the major payment card brands (Visa, MasterCard, American Express, and Discover). Total fees paid by the City for payment card sales in 2015 were \$264,135 or 2.2% of each transaction. See page six of this report for information on the City’s level of compliance with the PCI DSS.

OBJECTIVES

The objectives of this audit were to:

1. Determine the status of audit recommendations related to cash handling from previous internal audits.
2. Determine if City departments have up-to-date written policies and procedures specific to the departments in regard to cash handling.
3. Determine if departments have adequate segregation of duties for cash handling.
4. Determine if deposits in departments are made timely.
5. Determine if there is adequate physical security of cash.

6. Determine the level of compliance with the Payment Card Industry Data Security Standard.

SCOPE AND METHODOLOGY

This audit examined cash handling practices in place during 2016. It included all City departments/divisions that receive and process cash. This was a high-level audit of cash to determine if there any areas of higher risk which were not mitigated by internal controls. As such, we did not perform detailed testing of deposits nor did we perform unannounced cash counts. Information gathered during this audit will allow Internal Audit to prioritize detailed cash handling audits of specific departments and division in future years. Audit methodologies included:

- Distribution of a cash handling questionnaires to City departments. Managers were asked to complete these questionnaires for their area of responsibility. Internal Audit reviewed the answers to these questionnaires and discussed them with management. These questionnaires focused on how much cash is received by each department or division, in what form the cash is received (e.g. percentage of checks compared to currency), for what purposes the cash is received, and the associated controls in place to protect cash.
- Review of prior cash handling audits of City departments and the associated audit recommendations. We reviewed the status of these prior recommendations with management.
- Visits to departments to review the physical security in place to protect cash and to interview front-line employees about cash handling.
- Research into key controls for cash receipts.
- Research into the requirements of the Payment Card Industry Data Security Standard (PCI DSS).
- Interviews with City managers and staff to understand how the City of Sioux Falls complies with the PCI DSS.
- Interview with the Director of Audit Services for the City of Portland, Oregon about the results of their audit of PCI DSS in the City of Portland and lessons learned.
- Review of general ledger records to determine if there is evidence that deposits of cash receipts are made timely.

RESULTS

Noteworthy accomplishments

Based upon internal audits of cash handling performed in various City departments since 2007 and audit work done this year, the following noteworthy accomplishments were identified. See appendix one of this report for list of internal audits performed.

- Improved segregation of duties.
- Elimination of some petty cash funds and a decrease in the authorized amount in other funds. For example, in 2007 the City had 25 petty cash funds totaling

\$3,010. In 2016 there are 19 funds totaling \$2,595. City-issued purchase cards (P-cards) are now used for low-dollar purchases.

- Institution of unannounced cash counts by supervisors in several departments such as the Police department and the Health department.
- Assignment of Business Analysts from the Finance office to specific City departments. Business Analysts monitor actual revenue and expenses against anticipated revenue and expenses as part of their duties. The benefit is that problems can be detected earlier. They also assist departments in reviewing and updating financial policies and procedures.

Prior audit recommendations

All prior recommendations from previous internal audits of cash handling have been implemented.

Written policies and procedures

City departments have up-to-date written policies and procedures specific to their departments for cash handling with one exception. Public Parking is in the process of developing written procedures.

Segregation of duties

City departments receiving and processing cash have adequate segregation of duties. No one employee can do all the steps necessary to receive and process cash payments. In a few departments ideal segregation of duties is not practical. However, compensating controls are in place.

Timeliness of deposits

Cash received by City departments is deposited timely. Cash received by almost all City offices is deposited in the City's bank account within two business days of being received. Cash from rural libraries is deposited every two weeks or monthly depending on the volume of cash. Cash from parking meter money is deposited either weekly or twice weekly depending on volume of cash.

Physical security

There is adequate physical security of cash received and processed by City departments. The level of security varies depending upon the amount of cash handled by departments. When necessary, cash collected in City offices is secured overnight in a locked file cabinet or a safe. Change funds and petty cash funds are always secured to protect from theft.

Payment Card Industry Data Security Standard compliance

The City of Sioux Falls is compliant with the requirements of the Payment Card Industry Data Security Standard. Payment card information from customers is processed by third-party vendors and is not stored on City computer servers. Third-party vendors used by the City to process payments undergo periodic independent security assessments to help ensure they are in compliance with the PCI DSS. Payment card information from customers is entered into the third-party website as it is received by the City employee.

Other observations

While reviewing cash operations in a City department, we became aware of an outside agency that, by contract, receives payments for fees on behalf of the City of Sioux Falls. We discussed the situation with management and will likely be performing an audit of the cash controls at this outside agency as part of our 2017 Annual Audit Plan.

While interviewing City employees who receive and process cash for the City, we determined that employees do not necessarily receive any formal training on cash handling with the exception of pool cashiers at the Parks/Recreation department. Formal training would help ensure consistency across City departments and help emphasize the importance of good control procedures. See recommendation 1 below.

We also noted during the course of this audit that many of the payments that the City receives are in the form of currency or checks. Receiving payments by way of Automated Clearing House (ACH) would be safer and more efficient. ACH transactions are done bank to bank. The City already uses ACH in many cases for both payments received and payments made. We encourage the City to continue this trend. See recommendation 2 below.

RECOMMENDATIONS

We made the following recommendations that address the above referenced results.

- 1) Finance should provide formal training for City employees handling cash. Training could be modified for those employees infrequently handling cash compared to employee frequently handling cash.

Management's Response: We concur with this recommendation and will expand cash handling training to encompass employees at all cash handling points.

Management Representative Responding: Tracy D. Turbak, Finance Director

Date of expected implementation: 2017

- 2) City management should continue to pursue more ACH (bank to bank) transactions for both payments received and payments made by the City.

Management's Response: We concur with this recommendation and will continue to push for greater use of ACH transactions citywide.

Management Representative Responding: Tracy D. Turbak, Finance Director

Date of expected implementation: 2017

CONCLUSION

We appreciate City management's cooperation and courtesy displayed during our audit work. Management has strengthened controls over cash handling.

AUTHORIZATION

The Sioux Falls City Council approved this audit by resolution in January 2016 as part of the 2016 Annual Audit Program. The Internal Audit Division operates under the authority of an Internal Audit Charter adopted by City Council resolution 11-13.

AUDIT STANDARDS

This audit was conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing* issued by the Institute of Internal Auditors.

STATEMENT OF INDEPENDENCE

Internal Audit is administratively and operationally independent of the programs and departments it audits, both in appearance and in fact. The Internal Audit Manager is accountable to an Audit Committee appointed by the City Council per section 32.022 of the Code of Ordinances of Sioux Falls, SD.

DISTRIBUTION OF REPORT

This report is intended for the information and use of the Mayor and City Council, management, and others within the City of Sioux Falls. However, the report is a matter of public record and its distribution is not limited.

PERFORMED BY

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APPENDIX ONE

Cash Handling Audit Areas by Year

2007

Citywide cash

2008

Health
Libraries
Building Services
Sanitary Landfill

2009

Fire Rescue
Parks/Recreation

2010

None

2011

Police
School-based health clinic

2012

Utility Billing

2013

Parks/Recreation
Leaf drop-off
Libraries

2014

None

2015

Sanitary Landfill

2016

Affordable Housing (carried over from 2015 Annual Audit Plan)
Citywide cash

APPENDIX TWO

City of Sioux Falls Checking Accounts

Financial

Institution

Purpose

First Premier	All pooled cash transactions
First National	Contributions for Veteran's Memorial Park
Wells Fargo	CDBG: Affordable Housing Federal grant funds
Wells Fargo	HOME program: Affordable Housing Federal grant funds
Wells Fargo	Single Family Rehab: Affordable Housing Federal grant funds
Wells Fargo	State FLEX: Affordable Housing Federal grant funds
Wells Fargo	General fund: Affordable Housing Federal grant funds

Authorized check signers

First Premier main account: Mayor, Finance Director, Assistant Finance Director, or Chief Accountant

First National account: no checks to be written on this account; purpose is to receive contributions. Money is transferred out to First Premier account on periodic basis.

Wells Fargo: Community Development Director, Affordable Housing Manager, or Public Parking Manager

NOTE: City policy requires two authorized signatures on every check.

Reconciliation of the monthly bank statements

An Accountant in the Finance department reconciles all City of Sioux Falls checking accounts.