

Performance Audit: City Should Strengthen Cash Handling Policies and Procedures

August 2012

City Auditor
City of Lawrence, Kansas

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Members of the City Commission

Cash handling operations are spread throughout the organization, varying in the amount of cash handled and in policies and procedures for handling cash. Cash handling could be strengthened by improving written policies and procedures.

Effective controls over cash handling require developing written policies and procedures, consistently following those procedures, and ensuring managers and staff understand the purpose of the controls. In a decentralized environment – such as city government – strong policies and procedures are especially important.

I made five recommendations to strengthen cash handling policies and procedures and provide training. I provided the City Manager with a draft of this report on July 12. His written response is included.

Michael Eglinski
City Auditor

Performance Audit: Cash Handling

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Performance Audit: Cash Handling

Results in Brief

Cash handling operations are spread throughout the organization. Individuals and businesses pay the city for items and services such as water and sewer, permits, recreation activities, parking, and fines. Some cash handling locations accept a high volume of payments, while others deal with infrequent payments. Cash handling policies and procedures vary among different departments and locations. This performance audit focuses on the city's written policies and procedures for handling cash.

Effective controls over cash handling require developing written policies and procedures, consistently following those procedures, and ensuring that managers and staff understand the purpose of the controls. In a decentralized cash handling environment, strong policies and procedures are especially important.

The performance audit recommends taking steps to strengthen controls over cash handling. Specific recommendations include improving existing written policies and procedures, developing additional policies and procedures, and providing training.

Performance Audit: Cash Handling

Cash Handling Operations Are Spread Throughout the Organization

Cash handling operations are spread through the organization. The city accepts payments for items and services such as utility payments, building permits, parking, entrance to aquatics facilities, golf, recreation programs, business licenses and permits, and fines. Payments are often made in person, through the mail, or online.

Cash includes currency, coins, credit cards and checks

Throughout the report the term “cash” refers to paper currency, coins, credit card payments, and checks. All of these types of cash should be safeguarded and controlled to ensure the city receives all payments, those payments are properly recorded, and all payments are properly deposited.

Cash handling operations range from locations that handle a high volume of cash to locations that handle an occasional check. Some locations deposit cash with the city’s bank directly, while others deliver cash to the Finance Department for deposit. Cash handling locations fit into three general groups based on the volume of transactions and how deposits are made.

Figure 1 Cash handling location summary

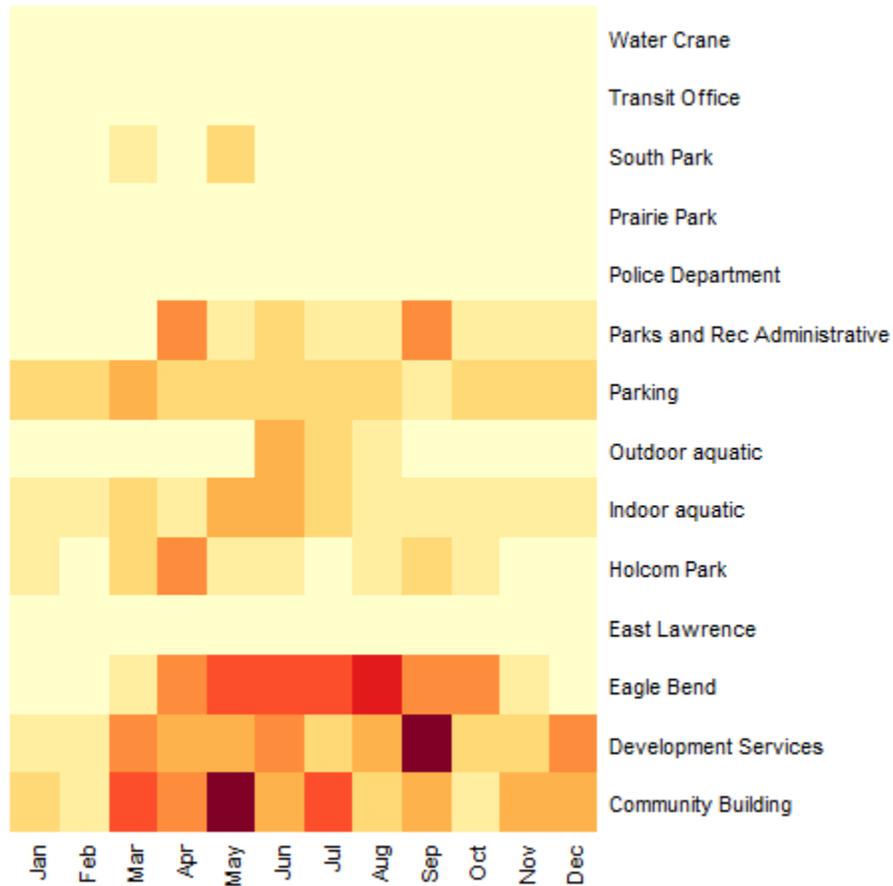
Transactions and deposits	Locations
Very high volume of transactions	Finance Utility Billing Municipal Court Fire-Medical ambulance billing
Moderate volume of transactions, decentralized deposits through individual departments	Parks and Recreation Department locations: <ul style="list-style-type: none"> • Community Building • Eagle Bend Golf Course • East Lawrence Recreation Center • Holcom Park recreation center • Indoor Aquatic Center • Outdoor Aquatic Center • Parks and Recreation administration • South Park Recreation Center • Prairie Park Nature Center Transit office Police Department records office Police Department animal and parking control Planning and Development Services
Moderate/low volume of transactions, centralized deposits through the Finance Department	Information Technology/Public Works – GIS maps City Manager’s Office City Attorney’s Office City Clerk’s Office Public Works – Solid Waste Annex Public Works – Household Hazardous Waste Facility Public Works – Compost Facility

Cash handling practices reflect the need to maintain good customer service and protect city assets. Strong practices protect assets from accidental loss as well as intentional misappropriation. General principles for managing cash call for:

- Organizational structure and sufficient staffing to segregate incompatible responsibilities such as authorizing transactions, recording transactions, maintaining custody of assets, and reconciling assets with records of transactions.
- Work environment conducive to physically safeguarding money.
- Employees well qualified in cash handling techniques.
- Management oversight at a level appropriate for the specific cash handling environment.

Cash handling varies by location and season

Cash handling varies in both the amount and pattern of transactions over the course of a year. The graphic shows currency and credit card transactions by location for locations that handled less than \$1 million in 2011. Darker shades show more cash.



City Should Strengthen Cash Handling Policies and Procedures

The city could improve controls over cash handling by strengthening existing written policies and procedures, developing policies and procedures where they are lacking, and providing training for employees and managers responsible for handling cash. Comparing existing policies and procedures with areas that should be covered identified some gaps. In addition, some locations that handle cash lack written policies and procedures. Effective controls to protect cash require written policies and procedures, consistently following those instructions, and ensuring that managers and staff understand the policies and procedures.

Cash handling policies and procedures vary among different locations

Cash handling policies and procedures vary among locations and departments. City staff provided written policies and procedures for review from the City Attorney's Office, City Manager's Office, Public Works Department, Planning and Development Services Department, Fire/Medical Department, Parks and Recreation Department, and Finance Department.¹ In addition to the department level policies and procedures, the City Code and the city's investment policy provide some guidelines on cash handling.

While location-specific policies and procedures are appropriate to address specific aspects of different operations, written policies and procedures should generally cover the same areas. Regardless of the specific environment, policies and procedures should address:

- Segregating duties
- Physical safeguards
- Processing transactions
- Customer receipts
- Voiding transactions
- Check and credit card transactions
- Balancing and reconciliation
- Access to cash drawers
- Payments by mail
- Deposit process

¹ To identify written policies and procedures, the City Auditor contacted managers in each department by email, followed up when necessary, reviewed revenue reports in the city's accounting system, interviewed staff, and reviewed deposit information.

Effective controls over cash handling require developing written policies and procedures, consistently following those procedures, and ensuring that managers and staff understand the purposes of the controls. In a decentralized cash handling environment, strong policies and procedures are especially important.

Existing written policies and procedures could be strengthened

Existing written policies and procedures could be strengthened by including additional guidance. In particular, city policies and procedures could more consistently and completely address how to handle voided transactions, requirements for separate cash drawers and alternative control approaches for shared cash drawers, and handling payments received by mail.

The City Auditor reviewed seven written policies and procedures provided by management in response to inquiries and compared them to elements of cash handling controls. The comparison identified areas of stronger or weaker policy and procedural coverage.

Figure 2 Completeness of existing written policies and procedures

Policy and procedure element	Coverage
Segregate duties or establish alternative controls	More complete
Address physical safeguards over cash	
Require receipts	
Address handling of check and credit card transactions	
Establish a deposit frequency and process	
Explain how to process a normal transaction	Less complete
Require balancing and reconciliation	
Address voided transactions	
Require separate cash drawers	
Address payments received in the mail	

In addition to addressing general elements, written policies and procedures should address the specific requirements in the City Code for depositing payments. The City Code requires that cash for copying and fingerprinting be paid to the City Treasurer on a daily basis.² It appears that many, but not all, of the transactions related to copying for records

² City Code of Lawrence, Chapter 1, Administration, Article 9, Public Records.

requests and fingerprinting would be through the Police Department. Department staff said that the department has not written policies and procedures for cash handling.

Some cash handling locations have minimal or no written policies and procedures; written guidelines strengthen controls with minimal costs

Several cash handling locations described informal processes for handling cash in response to audit requests for written policies and procedures. Some of these locations handle cash infrequently. Developing policies and procedures for all cash handling locations and for those locations that handle cash infrequently would strengthen controls at minimal cost. Effective controls over cash handling require written policies and procedures, consistently following those procedures, and ensuring that managers and staff understand the purposes of the controls.

The Police Department hasn't established written cash handling procedures. The records unit handles cash related to fingerprinting, records requests, and other services. The records unit handles a comparatively small amount of cash throughout the year. The parking control operations collect meter and lot payments and collect over \$500,000 a year. Management has not established written policies and procedures for either operation, though both described established informal procedures. Management should write policies and procedures for cash handling and ensure managers and staff understands and follows the policies and procedures.

Several city locations, including the City Manager's Office, City Attorney's Office, Information Technology Department, and Police Department-ITC handle cash infrequently and lack written policies and procedures. Writing simple policies and procedures for handling occasional payments would help ensure consistency and establish controls to reduce the chances of loss.

Controls help protect against losses

A worldwide survey of people knowledgeable about occupational fraud highlighted different types of losses, how those losses were identified, and weaknesses that contributed to the losses. Among the common losses were:

- Accepting payment but not recording the transaction
- Taking cash and checks before they could be deposited
- Accepting a payment and inappropriately voiding the transaction

Tips from employees, customers, and anonymous sources provided the most common way that problems were identified. In addition, reviews by management and internal audits identified problems.

Lack of controls, overriding existing controls, and a lack of review by managers contributed to many of the losses.

Source: *Report to the Nations on Occupational Fraud and Abuse: 2012 Global Fraud Study*, Association of Certified Fraud Examiners, 2012.

Current policies and procedures conflict with cash management portion of city's investment policy

Current policies and procedures conflict with the city's investment policy which requires that "no [cash] receipts will be held overnight at any location for any reason."³ Existing cash handling policies and procedures often allow for cash to be held overnight and describe safeguards for security over that cash, such as the use of a safe. The city's policies and practices should be consistent. The Finance Department prepared draft cash handling guidelines that would allow maintaining cash overnight in specific circumstances, but implementing the guidelines would still be in conflict with the city's investment policy. It may be appropriate to revise the investment policy if the draft cash handling guidelines are implemented.

Strengthening reporting requirements would improve control over cash

Only two of the seven written policies and procedures reviewed require reporting of cash losses. The Finance Department-Utility Billing procedure requires that employees immediately report any single shortage of \$50 or more to the Finance Director. The Municipal Court policy and procedure requires reporting shortages to the Court Manager. Specific guidance on when and how to report losses would be appropriate.

³ *City of Lawrence, Kansas, Investment and Cash Management Policy*, June 26, 2012.

Currently, the city's employee handbook provides some guidance by requiring employees to report any fraud, theft or misuse of city assets, including cash, to appropriate city officials. More specific guidelines on when and how to report cash-related losses would be appropriate.

Review of daily deposit documentation for decentralized cash handling locations identified a few issues

The City Auditor reviewed the daily deposit documentation for 13 days in August 2011. Documentation generally appeared complete and consistent, however several issues were noted:

- Documentation from two daily deposits included notes with full credit card numbers. Retaining full credit card numbers shouldn't be necessary to process transactions and potentially exposes a credit card number to inappropriate use. In both cases, it appears the transactions were handled by someone other than a regular cash handler.
- A number of daily balance sheets were not signed off as reviewed by a second person at the department level. In some cases, balancing sheets were not signed off by preparers. Balancing a cash drawer provides a daily accounting of funds received by a cash handler. Independent review acts as a second control over cash. Reviews also help managers fulfill their responsibility to monitor controls over cash.

Management should consider periodic training for employees involved in cash handling

Periodic training for cash handlers could help ensure consistency and emphasize sound controls. Currently, some cash handlers receive training at the department-level. The city provides some organization-wide training such as work place diversity, performance management, and purchasing processes, but does not provide organization wide training on cash handling.

Other Issues

Completing the work for this performance audit identified areas to consider for future audit work:

- Review the city's controls for complying with payment card industry data security standards. Because the city accepts credit card payments, the city should comply with these standards designed to maintain a secure environment. Performance audit work could involve assessing management's controls to ensure compliance with the standards.
- Conduct unannounced cash counts which could include reviews of change funds and petty cash. Unannounced reviews of cash can act as a control to encourage strong controls. During the course of the work for this performance audit, petty cash was identified as an area that could warrant additional work.

Recommendations

The City Auditor recommends that the City Manager:

1. Create and update cash handling policies and procedures. The Finance Department's draft guidelines provide a framework for policies and procedures. New and updated policies and procedures should address the key elements of cash handling summarized in Figure 2.
2. Develop policies and procedures to ensure locations that accept payments for copying related to records requests and fingerprinting pay those fees to the City Treasurer on a daily basis as required by city code.
3. Create simple cash handling guidelines for employees who infrequently handle cash, such as staff who may receive occasional checks in the mail.
4. Resolve the conflict between current cash handling practices and the city's investment policy.
5. Develop training for employees and managers responsible for handling cash.

Performance Audit: Cash Handling

Scope, methods and objectives

Management is responsible for establishing a system to control cash. Controls should be designed to protect assets from loss, theft or misuse and to provide reasonable assurance that these objectives are met. The cost of controls should not exceed the likely benefits. Management uses judgment to estimate both the costs and benefits.

This performance audit focuses on written policies and procedures related to cash handling across the city. Written policies and procedures are one type of control over cash. The performance audit focused on:

- Have managers established written policies and procedures for city operations that handle cash?
- If so, are those written policies and procedures complete?

The performance audit work did not involve cash counts or reviews of cash handling operations. Individual reviews of cash handling operations and unannounced cash counts, including petty cash, will be considered for future performance audit work.

The City Auditor reviewed relevant literature on cash handling to develop a list of key elements to cover in written policies and procedures. Among literature reviewed was the Municipal Treasurers' Association's *Model Cash Handling Training Manual*, cash handling policies and procedures from other jurisdictions, and audit reports from other jurisdictions.

The City Auditor identified cash handling locations and existing written policies and procedures by contacting managers in each city department and requesting any written policies and procedures related to cash handling (See figure 3). The auditor also reviewed revenue reports from the city's accounting system, interviewed staff, and reviewed daily deposit documentation.

Figure 3 Policy and procedures provided by management

Operation	Document
City Clerk's Office of the City Manager's Office	City Clerk's Office Cash Handling Policy and Procedures
City Attorney's Office - Municipal Court	Lawrence Municipal Court Financial Policies and Procedures
Public Works - Waste Reduction and Recycling	City of Lawrence Waste Reduction and Recycling Division Cash Handling and Deposit Procedures
Parks and Recreation Department	Lawrence Parks & Recreation Department Balancing, Deposit Procedures and Closing Procedures
Police Department - Animal & Parking Control	Memo: Audit Procedures-Meter Collections
Planning and Development Services Department - Development Services	Development Services Cash Handling Procedures
Fire-Medical Department	Cash Management
Finance Department- Utility Billing	Cash Handling Procedures
Planning and Development Services Department - Planning	Email description of process
City Attorney's Office - records requests	Email description of process
Utilities Department	Email description of process
Information Technology Department	Email description of process
City Manager's Office - transit	Email description of process
Police Department - Records	Email description of process
City Manager's Office	Email description of process

The City Auditor provided the City Manager with written information on three minor issues based on reviewing specific cash handling policies and procedures. The auditor determined that the issues were not significant given the performance audit objectives, but worth sharing with management for information.

The City Auditor compiled data on cash handling by location using a spreadsheet of bank statements maintained by the Finance Department. To assess the reliability of the data, the auditor interviewed accounting staff, compared some of the data with daily deposit records, and reviewed the data itself. The auditor concluded that the data were reliable for illustrating differences in the amounts and timing of transactions for 2011.

The City Auditor reviewed daily direct deposit documentation maintained by the Finance Department for 13 days in August 2011.

The City Auditor conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require planning and performing the audit to obtain sufficient and appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives. The City Auditor believes that the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objectives.

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Management's Response



City of Lawrence

CITY MANAGER'S OFFICE

DAVID L. CORLISS
CITY MANAGER

City Offices
PO Box 708 66044-0708
www.lawrenceks.org

6 East 6th St
785-832-3000
FAX 785-832-3405

CITY COMMISSION

MAYOR
ROBERT J. SCHUMM

COMMISSIONERS
MICHAEL DEVER
HUGH CARTER
MIKE AMYX
ARON E. CROMWELL

August 7, 2012

Mr. Michael Eglinski
City Auditor
City of Lawrence, Kansas

Re: Performance Audit: Cash Handling Policies and Procedures

Dear Michael:

Thank you for your work in preparing the performance audit concerning cash handling policies and procedures. I agree that improvements to our existing policies can be made. I am pleased that your review did not identify any discrepancies in city accounts relating to cash.

As you note, the Finance Department has prepared draft cash handling guidelines. In the coming weeks, Finance Department staff will review the key elements of cash handling included in your audit to ensure they are included in these draft guidelines. Then, each existing departmental policy will be reviewed and revised in order to strengthen these policies. Where policies do not currently exist, draft policies will be developed by the department. Finance Department staff will provide guidance to departments in creating these policies.

The City's Investment Policy will also be updated to reflect the Cash Handling Policy in terms of timing of receipt of cash. As indicated, departments should be required to receipt cash on a daily basis.

The Finance Department will also, by the end of the year, develop a training program for employees and managers which will incorporate training on cash management as well as credit card compliance with existing state and federal laws (PCI compliance). Training will begin after the first of the year.

Additionally, it should be noted that on-going implementation of our Innoprise Centralized Cash Receipts program should allow for better standardization of cash handling procedures throughout the organization. This implementation will also provide better data collection, providing better information for review by managers and additional training opportunities for staff who handle cash as a part of daily business.

Sincerely,

David L. Corliss
City Manager

