



Lexington-Fayette Urban County Government
OFFICE OF INTERNAL AUDIT

Jim Newberry
Mayor

Joe Kelly
Senior Advisor for Management

INTERNAL AUDIT REPORT

DATE: September 17, 2010

TO: Jim Newberry, Mayor

CC: Joe Kelly, Senior Advisor for Management
Linda Rumpke, Commissioner of Finance & Administration
Kim Bryan, Acting Director of Accounting
Susan Straub, Communications Director
Urban County Council Members
Internal Audit Board Members

FROM: Bruce Sahli, Director of Internal Audit

RE: ACH & Wire Transfer Audit

Background

The LFUCG utilizes both the ACH (Automatic Clearing House) and Wire Transfer functions to receive various collections and pay various debts. ACH is an electronic network for financial transactions in the United States, and processes large volumes of credit and debit transactions in batches. ACH credit transfers include direct deposit payroll and vendor payments. A wire transfer is a method of transferring money from one person or institution to another, and can be made from one bank account to another bank account. Bank wire transfers are often the most expedient method for transferring funds between bank accounts.

At the LFUCG, ACH is primarily used for payroll related expenses, while wire transfers are primarily used for debt service related expenditures. The LFUCG also receives substantial revenue via wire transfer from a number of different sources. The LFUCG paid

\$259,670,070 via ACH for FY 2007 through FY 2009. The LFUCG received \$96,426,921 via wire transfers in FY 2008 and FY 2009.

Scope and Objectives

The general control objectives for the audit were to provide reasonable assurance that:

- ACH & Wire Transfer transactions were properly posted into the PeopleSoft financials
- ACH & Wire Transfer transaction duties were properly segregated
- ACH & Wire Transfer transactions were properly reviewed and approved

The scope of our audit included financial transactions for the period Fiscal Year 2007 through Fiscal Year 2009 for ACH and Fiscal Year 2008 and Fiscal Year 2009 for Wire Transfers.

Statement of Auditing Standards

We conducted our audit in accordance with the International Standards for the Professional Practice of Internal Auditing. Those standards require that we plan and perform the audit to afford a reasonable basis for our judgments and conclusions regarding the organization, program, activity or function under audit. An audit also includes assessments of applicable internal controls and compliance with requirements of laws and regulations when necessary to satisfy the audit objectives. We believe that our audit provides a reasonable basis for our conclusions.

Audit Opinion

In our opinion, the controls and procedures did not provide reasonable assurance that the general control objectives were being met. Opportunities to improve controls are included in the Summary of Audit Findings.

Priority Rating Process

To assist management in its evaluation, the findings have been assigned a qualitative assessment of the need for corrective action. Each item is assessed a high, moderate, or low priority as follows:

High - Represents a finding requiring immediate action by management to mitigate risks and/or costs associated with the process being audited.

Moderate – Represents a finding requiring timely action by management to mitigate risks and/or costs associated with the process being audited.

Low - Represents a finding for consideration by management for correction or implementation associated with the process being audited.

SUMMARY OF AUDIT FINDINGS

Finding #1. Segregation of Duties & Management Oversight Issues

Priority Rating: High

Condition:

Several issues regarding segregation of duties and a related absence of management oversight were identified during the audit, as noted below.

The Director of Accounting served as the sole account administrator for the ACH and wire transfer program for nearly two years. It was also noted that a Department of Finance employee was able to create and approve wire transfer templates without any oversight. We noted that there was no indication of management review and approval regarding the creation of 35 of the 65 ACH & wire transfer templates examined during the audit.

In 45 of 59 ACH & wire transfer transactions tested, we noted that the same employee who created the transaction's supporting documentation also approved the transaction. ACH transactions are financial transactions often having a significant dollar impact (Up to \$10 Million per transaction was allowed by the ACH System in place during the audit) and should be approved by someone other than the requestor.

The Investment Analyst has the ability to invest funds into short-term certificates of deposits and money market investments without any management oversight. Although a monthly reconciliation of these investments is subsequently performed by another employee, the potential financial impact of these investments dictates that prior approval by management is warranted.

Effect:

The absence of prior management approval of templates designed to conduct electronic financial transactions, and the absence of review and approval from the next level of management on documentation designed to support electronic financial transactions or significant investment activity, represents a significant weakness in financial controls designed to prevent erroneous or inappropriate financial transactions.

Recommendation:

The Commissioner of Finance & Administration should become template co-administrator backup with the ability to monitor templates created by the Director of Accounting (however, since the Commissioner of Finance & Administration would be the reviewer, she should not have template creation capability). Documentation authorizing ACH and wire transfers should require management approval separate from the document's creator before the transaction is processed by the Department of Finance. The Director of Accounting or Commissioner of Finance & Administration should provide final approval for all ACH and wire transfer activity, and should review and approve investment activity prior to its occurrence.

Acting Director of Accounting Response:

Sub Finding 1

Due to the unforeseen staffing issues (death of employee & retirements) in the Finance Department and the reconciliation duties that are assigned to various accounting staff, the staffing for dual administrators was not feasible. With the additional hiring of 2 Finance & Administration positions (currently posted), this will be addressed. There will be 2 assigned account administrators and 1 security data administrator. This will address the control issue in this area. We expect the positions to be filled by November 1, 2010.

Sub Finding 2

With the conversion from National City Bank to PNC Bank the procedures for creating and submitting wire and ACH templates and payments have changed. All electronic payments either ACH or Wires are submitted by one manager, reviewed and approved by another. No one person can create a template for a payment and also approve the payment. This allows for better oversight of all electronic transactions.

Sub Finding 3

Agreed. Management will approve all investment activities in a manner that will provide oversight while still allowing for the purchase and selling of investments in a timely method.

Insuring timeliness will allow the Finance staff to take advantage of sudden changes in the investment markets.

Commissioner of Finance & Administration Response: I concur with the responses provided by the Finance & Administration team and will insure that the recommendations are implemented in a timely fashion. Hiring for the vacant positions is currently underway and will alleviate many of the control items addressed in the ACH audit.

Finding #2. Banking Services Need to be Consolidated
Priority Rating: High

Condition:

A substantial amount of revenue is received at LFUCG's Central Bank Lockbox and must be manually transferred to National City Bank via wire transfer. During the audit, we noted that this transfer was performed a couple of times per week by a Department of Finance employee.

Effect:

Failure to perform this function daily results in significant amounts of cash temporarily residing in a non-interesting bearing account, thereby preventing the LFUCG from maximizing short term money management and investments.

Recommendation:

The LFUCG should consider having all banking functions provided by one bank to ensure economies of scale and maximize short term money management and investment opportunities, including having the Lockbox set up as a Zero Balance Account (ZBA) which could be automatically swept daily to maximize cash management.

Acting Director of Accounting Response: Due to the fact that the Lockbox reporting system operates on a prior day basis and that all ACH's initiated do not show up on the report until 2 days after the ACH is initiated it is not feasible to transfer funds on a daily basis without the risk of overdrawing both accounts. The Lock box accounts and their set up will be included as part of the next RFP for banking services. This will allow for the opportunity to consolidate and possibly convert to ZBA accounts with the financial institution that is chosen to provide banking services to LFUCG.

Commissioner of Finance & Administration Response: I concur with the responses provided by the Finance & Administration team and will insure that the recommendations are implemented in a timely fashion.

Finding #3. Procedures Manual Needs Updated

Priority Rating: High

Condition:

The ACH & Wire Transfer Procedures manual needs to be updated. For example, the procedures manual states a Form 211-5 will be used as supporting documentation for ACH transactions. The Division of Accounting now employs a different type of supporting documentation (during the audit, we noted that 36 of 59 transactions testing used this new form of documentation).

Effect:

Outdated written procedures could result in Finance personnel being inconsistent in the proper processing of ACH & Wire Transfer transactions, and in complying with management's performance expectations. Outdated procedures also make it more difficult to train employees and hold them accountable for proper implementation of training.

Recommendation:

The procedures manual should be updated as needed.

Acting Director of Accounting Response: Agreed. With the conversion of the payroll system from the Mainframe to PeopleSoft and several months later the conversion from National City Bank to PNC bank the Procedures Manual for the most part became outdated twice in a six month period. Now that both systems are fully in place, our focus will be placed on getting the Procedures Manual updated to reflect the changes that have occurred. This will be a top priority for the new Administrative Officer being hired for the Finance & Administration Department.

Commissioner of Finance & Administration Response: I concur with the responses provided by the Finance & Administration team and will insure that the recommendations are implemented in a timely fashion. Hiring for the vacant positions is currently underway and will alleviate many of the control items addressed in the ACH audit.

Finding #4. Timely Posting of ACH Transactions Needed

Priority Rating: High

Condition:

We noted that 27 of 50 ACH transactions tested during the audit were entered into the PeopleSoft financials three or more business days after the ACH transaction date,

including seven that were posted ten or more business days late. We noted that all ACH transactions are next day transactions and the reporting system is based on a prior day basis for these transactions, indicating that there will be a two day delay from the date that the ACH is initiated. We also noted that in order to ensure that the ACH transactions are successful before posting to PeopleSoft, a report is printed that confirms the completion of the transaction, and this cannot be done in the current PNC Bank nor could it be done in the prior NCB banking platform until the day after completion of the transaction. Taken together, this indicates a minimum of three business days is typically needed to post ACH transactions in PeopleSoft.

Effect:

ACH transactions can be for very large dollar amounts, and therefore the PeopleSoft Financials regarding such transactions should be updated as soon as possible. Otherwise, the real-time budget information in PeopleSoft is not accurate, creating the risk of over-spending in a budget category.

Recommendation:

A policy should be developed to require the posting of ACH transactions (as well as wire transfer transactions) into the PeopleSoft financials within three business days. This policy should be reviewed with Accounting staff, and a backup employee should be available to post the transactions in the absence of the employee regularly assigned this duty.

Acting Director of Accounting Response: We will develop a procedure that requires all ACH and wire transfers be posted to the PeopleSoft financial within three business days for the date the ACH or wire transfer transaction is initiated.

Commissioner of Finance & Administration Response: I concur with the responses provided by the Finance & Administration team and will insure that the recommendations are implemented in a timely fashion. The delay in recording many of the ACH entries occurred during implementation of our new software. We are no longer experiencing these delays and ACH postings have fallen within the proposed 3 business day metric for posting. As indicated, we will immediately implement this metric into our posting process and measure accordingly.

Finding #5. Reconciliations Need Management Review

Priority Rating: High

Condition:

There is no indication of management review of the ACH & wire transfer reconciliation process to ensure it is completed accurately and in a timely manner.

Effect:

Failure to ensure Reconciliations are performed accurately on a timely basis could result in undetected errors or missing funds.

Recommendation:

Management should review and approve the reconciliation for unusual items that may require follow up and to ensure the work is completed timely.

Acting Director of Accounting Response: Currently an Accountant reviews, verifies and reconciles all electronic transactions monthly which are then reviewed by a Sr. Accountant. This will be a priority for the department and addressed in conjunction with the hiring of additional Finance and Accounting. Once hired, incorporation of further Senior level reviews of the reconciliation process will be made.

Commissioner of Finance & Administration Response: I concur with the responses provided by the Finance & Administration team and will insure that the recommendations are implemented in a timely fashion. Hiring for the vacant positions is currently underway and will alleviate many of the control items addressed in the ACH audit.

Finding #6. Monitoring Opportunities Missed

Priority Rating: High

Condition:

Failed login attempts into the ACH & wire transfer system are not being reviewed or evaluated by LFUCG Computer Services personnel. Failed logins provide network security personnel a preliminary indicator of possible efforts to access the system by unauthorized personnel.

In addition, Department of Finance and Division of Computer Services management should request a copy of the bank's annual SAS 70 (Service Organization) audit, which reports on the bank's in-depth audit of its control objectives and activities, including controls over information technology and related processes as a service provider (the bank serves as LFUCG's ACH & wire transfer service provider).

Effect:

The absence of processes to review and evaluate failed login attempts represents a control weakness in preventing and/or detecting ACH & wire transfer technology and transmission problems. The absence of a process to review of the annual SAS 70 audit report represents a missed opportunity to evaluate the ACH & wire transfer service provider's internal control structure.

Recommendation:

Computer Services should develop a process whereby all failed login attempts are logged and evaluated for any evidence of system or procedural control weaknesses. A process should also be developed to ensure an annual review of the bank's SAS 70 audit report by Finance and Computer Services personnel.

Acting Director of Accounting Response: Agreed. The Finance Department will begin dialogue with the Division of Computer Services to develop processes and procedures that will monitor all PNC login attempts. The SAS 70 request should be included as a required annual report in the next Banking RFP.

Commissioner of Finance & Administration Response: I concur with the responses provided by the Finance & Administration team and will insure that the recommendations are implemented in a timely fashion.