




## ADMINISTRATION

---

### MEMORANDUM

**TO:** City Council

**FROM:** Joe Felz, City Manager 

**SUBJECT:** City Practices on Wire Transfers and Cash Management

**DATE:** April 19, 2016

In response to the embezzlement of \$4.3 million last week by a Placentia employee, Director of Administrative Services Julia James has issued the attached memo outlining best practice guidelines recommended by the State of California and professional accounting organizations. The City is in full compliance with these recommended internal controls established for municipalities.




## **ADMINISTRATIVE SERVICES DEPARTMENT**

### **MEMORANDUM**

DATE: April 19, 2016

TO: Joe Felz, City Manager

FROM: Julia James, Director of Administrative Services  
Kriste M. Saldaña, Fiscal Services Manager 

SUBJECT: Internal Controls

---

Last week it was reported that the Finance Services Manager of Placentia had embezzled \$4.3 million over the past year by wiring the funds to his and others' personal bank accounts. In 2014, an employee of the City of Pasadena embezzled over \$6 million by writing fraudulent checks to a business he owned. As these incidents raise concerns that this type of fraud could happen in other agencies, including Fullerton, I am issuing this memo to alleviate fears by addressing the internal controls currently in place to prevent such action.

While the City of Placentia claimed that it had been issued a "clean" audit for the 2014-15 fiscal year, their auditors were quick to issue the following statement:

*"Our audit for the period ending June 30, 2015 did identify several material weaknesses and significant deficiencies in internal controls and instances of noncompliance. It was not a "clean" audit."*

Internal controls are a system of checks and balances implemented to ensure that adequate oversight is given to all financial procedures and are one of the primary focuses of the annual audit process conducted by our independent auditors. In the case of Pasadena and Placentia, a lack of internal controls was to blame.

The State of California has worked with the California Society of Certified Public Accountants to develop internal control guidelines for municipalities based on best practices adopted by the American Institute of Certified Public Accountants. This memo highlights some of the key areas of these recommendations (highlighted in bold) and the City's current practice.

#### **Cash Deposits**

- **Wire transfers should involve two people (one to initiate and one to approve), to prevent misappropriation of assets**
  - Wire transfers are used for transactions such as investments, payroll (taxes, PERS, etc.) and to pay certain vendors such as the Water District. When a wire transfer is requested by a department, it is first reviewed and approved by the Department Head and Director of Administrative Services. It is then routed to

the Revenue Specialist, who initiates the wire online with the Bank. The Bank will not release the wire until it has been reviewed by a second, authorized individual (usually the Revenue Manager or Utility Services Supervisor) who will then release the wire. The wire transfer documentation is then forwarded to the Accounting division for book entry and eventual reconciliation with the bank statement.

- ***Bank reconciliations are an effective tool to detect mistakes, errors, or embezzlements if they are prepared timely, reviewed in detail, and approved by a second person***
  - Bank reconciliations are the most effective tool in the oversight of cash management as bank statements will reflect all activity in and out of the account. When bank accounts are not reconciled regularly it is easy to overlook key transactions affecting cash. The City's accounting staff reconciles bank statements monthly, which upon completion are then reviewed by the Accounting Supervisor. It is rumored that the employee in Placentia was downloading an electronic copy of the bank statement and converting it to Excel, which enabled him to manipulate the data. While all bank statements are available online, the City also receives a hard copy in the mail which can be compared to the online copy.
  
- ***To ensure proper segregation of duties, the person involved with the bank reconciliation should be prohibited from performing collection of cash receipts in any form, deposits of cash, disbursements, or be an authorized signer on the account***
  - The City's Accountant prepares the bank reconciliation and does not perform or have access to any of the prohibited functions outlined above.

### **Investments**

- ***The purchase and sale of investments should require authorization prior to execution, to ensure the transactions are in compliance with the City's investment policy and the Government Code***
  - City investments are initiated by the City's third party investment firm, Public Trust Advisors, and approved by the Administrative Services Director. The City maintains an Investment Policy in compliance with the State Government Code.
  
- ***An investment safe keeper should be utilized to safeguard investments***
  - The City contracts with Bank of the West for safe keeping services. All investment transactions are handled through the safekeeping division. The City receives monthly safekeeping statements which are reconciled to the general ledger on a monthly basis.

- ***Performance of the investment portfolio should be reviewed periodically to ensure it is meeting the objectives and expectations of the City of Fullerton***
  - The City's Investment Advisory Committee meets and reviews the portfolio on a quarterly basis with the City Treasurer and Public Trust Advisors. The Treasurer's Report is reviewed and approved by the City Council quarterly.

### ***Accounts Payable***

- ***Invoices should be checked for mathematical accuracy and approved for payment prior to processing***
  - Invoices are entered directly into the financial system by the corresponding department, where they are then routed to the Department Manager and the Fiscal Services Manager for dual approval prior to processing for payment. All invoices are checked for accuracy in the amount prior to payment.
- ***Check registers should be reviewed for accuracy by a person independent from the accounts payable process and approved prior to finalization***
  - Upon completion of the Accounts Payable process, a check register is generated which lists all entries made in the system since the last processing period. The check register is then reviewed by the Fiscal Services Manager prior to the release of the payments.
- ***Positive pay, or similar procedure, should be employed***
  - Accounts Payable Clerks do not have access to check stock. An Account Clerk with no access to the A/P system is in charge of handling the check stock from the beginning to end of the print process. Two A/P Clerks are also present when the checks are printed. For greater efficiency, vendors are encouraged to enroll in ACH (automated clearinghouse) payments in-lieu of receiving checks which reduce the opportunity for fraud against City checks. The City also utilizes Positive Pay through the bank, by providing check information (name, check number, amount) which is verified by the Bank before the check is paid.

The City's adherence to the importance of the segregation of duties as outlined above set a foundation for strong internal controls. As more specific details of the Placentia fraud and embezzlement case become available, we will analyze how Placentia's internal controls were compromised and continually monitor the City's practices to assess the effectiveness on ever changing operations.