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May 4, 2007

Assignment 10160

To: Distribution List

Subject: Internal Audit Report – Bank Accounts’ Positive Pay Usage

We have completed an audit of the bank accounts’ positive pay usage. We conducted the audit in January 2007 for the open bank accounts existing on December 31, 2006.

We thank the Controller-Treasurer’s staff for their cooperation. Specifically, we want to thank the Treasurer/Investment Division who expended a significant research effort on key details. Their assistance contributed significantly to the successful completion of the audit.

Respectfully submitted,

(signature on file)

Bill Perrone, CIA  
Supervising Internal Auditor

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# COUNTY OF SANTA CLARA

## CONTROLLER-TREASURER DEPARTMENT - INTERNAL AUDIT DIVISION

### INTERNAL AUDIT REPORT

#### Bank Accounts' Positive Pay Usage



Assignment 10160  
May 4, 2007

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## **Executive Summary**

**Conclusion**      The positive pay method is not being applied to all bank accounts linked to the County's main concentration account. For the County of Santa Clara, this is an important feature as there are 33 bank accounts that withdraw funds from the County's main concentration account.

For the 27 bank accounts under the direct control of the County, all have the positive pay feature. Of the six bank accounts under the direct control of special districts or joint powers authorities, six do not have positive pay based on the "bank analysis statement." Based on additional input from the bank and users, five of these six bank accounts have positive pay and it is being used. There is agreement that the one bank account with the 12 special districts does not have positive pay.

One of these bank accounts has 12 special districts, with 18 checkbooks, drawing funds from the commingled pool, which links to the County's main concentration account. While still being permitted to invest any surplus funds in the commingled pool, the 12 special districts should obtain their own bank accounts apart from the County's banking relationship.

To minimize the risk of unauthorized withdrawals, the Controller-Treasurer should obtain the positive pay feature for all accounts drawing down from the County's main concentration account.

The Controller-Treasurer is in agreement with all our findings and recommendations contained in this report

**Audit Objective**      The audit objective is to assure that the positive pay method is applied to all bank accounts linked to the County's main concentration bank account.

**Audit Scope**      The scope of the audit included:

- Identifying all bank accounts within the County's banking relationship
- Identifying those accounts with the positive pay feature
- Analyzing those accounts without positive pay to determine the appropriateness of their lack of this feature.
- Analyzing the risks associated with maintaining a unique bank account for certain special districts.
- Identifying any warrants paid by the bank but not listed on any issuance reports sent to the bank.

**Audit Background**      Positive pay is a method used by a bank to detect fraudulent checks. The bank customer transmits check issued information to the bank; the bank matches checks presented for payment against this information and notifies the customer of any checks presented for payment that are not on any previously submitted issuance record.

This audit is the result of an observation noted in an audit being performed concurrently. Since the observation's nature was outside the other audit's scope, the Internal Audit Division opened this audit to address the concern.

Details about our findings and recommendations are provided below.

(signatures on file)

Bill Perrone, CIA  
Supervising Internal Auditor

Brian P. Mark, CIA  
Senior Internal Auditor

## **Findings and Recommendations**

### **Finding 1                      Certain special districts can inappropriately withdraw cash from the commingled fund.**

There is one bank account whereby certain special districts can draw upon the County's main concentration account. This bank account should, but does not have, the positive pay feature. The current cash handling policy does not require positive pay be a feature of bank accounts that draw upon the County's main concentration account. In our audit of the opening and reconciliation of bank accounts, we recommended the Controller-Treasurer update its cash handling policies and procedures manual to include modern practices such as positive pay.

The County cannot withhold a check or warrant payment drawn on any of these specific bank accounts because the County does not become aware of these payments until after these accounts' checks or warrants clear the bank. Additional control weaknesses noted with these bank accounts include:

- With one exception, the Controller-Treasurer is not a signatory on the checks or warrants issued through these bank accounts.
- Employees with access to the check or warrant stock are not County employees thus are not obliged to comply with the County's or the Controller-Treasurer's policies.
- The County has no control over the physical security of the check or warrant stock.
- The Controller-Treasurer does not receive copies of checks or warrants issued by the joint powers entities.
- The Controller-Treasurer does not receive the bank statements for these entities' accounts.
- The phrase, "County of Santa Clara Warrant" is imprinted on each warrant issued by the special districts. Misuse of these warrants could implicate the County.
- The Investment Division's cash forecasting can be undermined since these districts' checking account activities are not known in advance.

By requiring the positive pay feature be attached to all bank accounts drawing from the County's main concentration account, the County can minimize the risk of districts withdrawing more than their commingled pool contribution. Without this feature, the County's non-invested cash

balance is at risk of inappropriate withdrawals.

**Recommendation 1.1** The County should immediately require the positive pay feature be attached to all bank accounts drawing from the County's main concentration account. [Priority 1]

**Recommendation 1.2** The County should prohibit any check or warrant to be imprinted with the words, "County of Santa Clara Warrant" or "Santa Clara County Warrant" unless the County has control over the usage, access and issuance of the particular checks or warrants. [Priority 1]

**Finding 2** **There are 12 special districts maintaining checking accounts all under one County bank account.**

Twelve special districts, none that are blended districts for the Comprehensive Annual Financial Report (CAFR) purposes, are issuing checks from 18 checkbooks all under one bank account. This bank account is within the County of Santa Clara's bank relationship with the Bank of the West which means that the checks draw down the County's funds without any preventive controls such as positive pay. The Controller-Treasurer is not an authorized signatory on the account; the signatories are not County employees.

These special districts should still be permitted to invest surplus cash in the commingled pool.

**Recommendation 2.1** The special districts should be instructed to obtain bank accounts that do not link to the County's main concentration account. The special districts should be permitted to replenish their cash from their contributions to the commingled pool via a request through e-mail or some other acceptable communication method. [Priority 1]

**Recommendation 2.2** Upon Completion of Recommendation 2.1, the Controller-Treasurer should close this bank account. [Priority 1]

## County of Santa Clara

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### Response to Positive Pay Audit (Investment's Division)

**Recommendation 1.1** Historically, with the exception of account 216, all accounts that exist as sub-accounts to the County's depository account has had the benefit of protection from positive pay protocol. Given that account 216, is shared by a number of entities, positive pay could not be efficiently and effectively implemented. However, it is important to note, unlike other sub-accounts, a designated staff person from the County's General Accounting Unit reconciles account 216 daily and individually inspects each paid check. Clearly, the benefit of fraud protection extended by positive pay is highly desirable; nevertheless, account 216 did receive review and was monitored for aberrational activity.

**Recommendation 1.2** Based on my current knowledge, those bank account users who are not subject to the control of the County and who also draw upon checks with the "County of Santa Clara Warrant" imprinted upon them is a contained group and is limited to account 216. It is my expectation that with the closure of account 216, access and use of County warrant check stock by such entities should cease.

**Recommendation 2.2** Upon our instructions, Bank of the West can close account 216 within a 48-hour time frame.

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### Response to the Internal Audit of Bank Accounts' Positive Pay Usage (Accounting Division)

#### Recommendation 2.1

The Controller-Treasurer will immediately work with each special district to impose the positive pay requirement on the bank accounts and/or obtain new bank accounts. We anticipate completing the implementation of this recommendation by the end of August.