October 28, 2015

Performance Audit

Common Cash Bank Reconciliations

Department of Finance and Administrative Services

Report No. 14-104

**CITY OF ALBUQUERQUE
OFFICE OF INTERNAL AUDIT**

PERFORMANCE AUDIT REPORT
COMMON CASH BANK RECONCILIATIONS
REPORT NO. 14-104

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Common Cash Bank Reconciliations

The purpose of this audit was to review internal controls and processes that ensure the accuracy and timeliness of the City's Common Cash bank reconciliations. The audit was included in the fiscal year (FY) 2014 audit plan.

Summary

The Department of Finance and Administrative Services (DFAS) has made progress in revising its process for the Common Cash Bank Reconciliation. Through FY2015, DFAS used a spreadsheet template that was characterized by external auditors as unnecessarily complex, and which did not produce reconciled balances that readily tied to the general ledger. As a result, the external auditors raised CAFR audit finding 08-16, Bank Reconciliation Process. The Department should dedicate the resources needed to develop a complete understanding of the processes and activities that affect Common Cash, finalize its revision of the Common Cash Bank Reconciliation process, and develop a specific corrective action plan to address CAFR audit finding 08-16.

Accurate and timely reconciliations are essential for ensuring the integrity of the City's Common Cash account. DFAS needs to continue its efforts to develop a true book-to-bank reconciliation and ensure the Common Cash account is in full compliance with Generally Accepted Accounting Principles and State regulations. Until this issue is remedied, erroneous Common Cash activity or unapproved transactions may not be detected and addressed.

DFAS agrees that additional improvements are needed to reduce the complexity of the Common Cash reconciliation. DFAS has taken steps to improve the Common Cash reconciliation and will soon implement software to simplify and aid the Department with the reconciliation process.

Recommendations & Benefits
• • •

Developing a complete understanding of the processes and activities that affect Common Cash, revising business processes, implementing a true monthly book-to-bank Common Cash reconciliation, and resolving reconciling differences will enable DFAS to:

- Improve internal control over Common Cash,

- Ensure that cash records are complete and accurate,

- Produce accurate and timely bank account reconciliations,

- Address deficiencies noted by the external auditors, and

- Eliminate repeat CAFR audit finding 08-16.
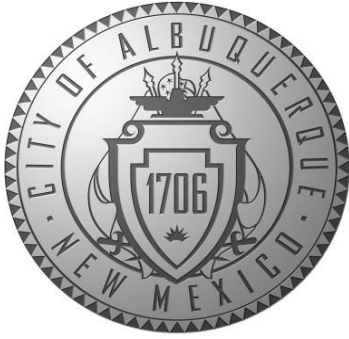
City of Albuquerque

Office of Internal Audit

October 28, 2015

Accountability in Government Oversight Committee
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Audit: Performance
                 DFAS-Common Cash Bank Reconciliations
                 Audit No. 14-104

FINAL

INTRODUCTION

The Office of Internal Audit (OIA) conducted a performance audit of the City's Common Cash Bank Reconciliations process. The audit was included in OIA's fiscal year (FY) 2014 audit plan. The audit objectives, scope and methodology can be found in **Appendix A**.

The audit focused primarily on the monthly Common Cash bank reconciliation performed by Department of Finance and Administrative Services (DFAS) – Accounting Division, the division responsible for the City's accounting and financial reporting. The Accounting Division maintains the City's general ledger system and prepares a variety of reports for various governmental entities, including the Comprehensive Annual Financial Report (CAFR).

Although the Accounting Division prepares the CAFR and the monthly Common Cash reconciliation, the sources and timing of transactions to Common Cash are impacted by accounting information systems and deposit and bank-related business processes that are outside the Accounting Division's direct control. Information system management is the responsibility of the Department of Technology and Innovation's (DTI) ERP Division, while administration of monetary assets is the responsibility of the DFAS – Treasury Division. Due to these dependencies, resolution of Common Cash reconciliation issues will require the cooperation and collaboration of DFAS – Accounting, DFAS – Treasury, and DTI – ERP. Likewise, divisional cooperation and collaboration is a prerequisite for the successful launch of a significant software enhancement scheduled to go live-in in 2016, the ERP "Treasury Remediation," which includes reconciliation functionality.

The audit was prompted by the recurring Common Cash reconciliation audit finding in the annual financial audit of the City of Albuquerque (City). In FY2008, external auditors initially cited audit finding number 08-16 as a *significant deficiency*. The external auditors characterized City bank reconciliations as "unnecessarily complex and cluttered with reconciling items that should have been resolved in previous years." In FY2011, the City's external auditors increased the severity of the audit finding to a *material weakness*. The overall goals of OIA's audit were to gain additional detail on the causes of the repeat finding, provide a fresh perspective on the issue, and provide meaningful recommendations to help eliminate the audit finding.

The following glossary of terms and list of acronyms provide definitions for common terms that are used throughout the report.

Glossary of Terms
General Ledger ("books")
> The City's official book of financial accounts. The general ledger contains the City's asset, liability, fund balance, revenue, and expense accounts and provides the basis for financial statement reporting. The City's general ledger is electronically maintained by Oracle's PeopleSoft ERP system.

Internal Control
> Processes implemented by City leadership which are designed to provide reasonable assurance regarding the achievement of objectives relating to: (1) Effectiveness and efficiency of operations, (2) Reliability of financial reporting, and (3) Compliance with applicable laws and regulations.

List of Acronyms
COSO
> The Committee of Sponsoring Organizations of the Treadway Commission is a joint initiative of five private-sector organizations and "is dedicated to providing thought leadership through the development frameworks and guidance on enterprise risk management, internal control, and fraud deterrence" (source: www.coso.org). The COSO framework is utilized to assess an entity's internal controls.

CAFR
> The Comprehensive Annual Financial Report is a combined presentation of government financial statements, management discussion and analysis, and statistics prepared by state and local governments, including the City of Albuquerque. Preparation of the CAFR is the responsibility of management. The CAFR is audited by an independent public accounting firm (external auditors), which provides an opinion on the conformity of the financial statements with generally accepted accounting principles (GAAP).

ERP
> An Enterprise Resource Planning system is a specialized, integrated software package that

can manage multiple business functions. ERP systems are intended to serve as entity-wide information systems, eliminating the need for multiple information systems in an entity's various departments. The City's ERP system is PeopleSoft, which provides a variety of business applications to assist in the day-to-day execution of citywide business processes, including the Financial, Purchasing, Payroll, and Human Resources.

Financial Control Responsibilities
The City's fiscal year begins on July 1st and ends on June 30th. Following the close of each fiscal year, DFAS prepares the City's CAFR. The financial statements presented in the CAFR are the responsibility of management. Management is also responsible for establishing a system of internal controls over financial reporting, and for ensuring that the system of internal controls is operating effectively.

Government Auditing Standards require the City's external auditors to consider the system of internal controls over financial reporting during the annual audit. In gaining an understanding of the City's internal controls, external auditors may identify deficiencies in internal controls. Deficiencies and their levels of severity have very specific meanings as defined by the Auditing Standards Board (ASB). Codification of Statements on Auditing Standards ASB AU§325 states:

.05   A *deficiency* in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect, and correct misstatements on a timely basis.

.07   A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

.06   A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and resolved, on a timely basis.

External auditors must include any *significant deficiencies* and *material weaknesses* identified during the audit as findings in the CAFR.

Timeline of Audit Finding 08-16, Common Cash Bank Reconciliation Process
Audit finding 08-16 was initially cited by the City's external auditors in FY2008 and was classified as a *significant deficiency*. In FY2011, the severity of the audit finding was increased to a *material weakness*. As shown by the timeline below, issues with the City's bank reconciliation have been included as audit findings in the past seven CAFRs. Per DFAS Management, Common Cash was impacted by underlying systems and business processes. According to DFAS, corrective actions have been taken since CAFR audit finding 08-16 was initially cited. DFAS provided a timeline of corrective actions that affect Common Cash and are included in **Appendix B**.

Timeline and Details for Audit Finding 08-16 – Bank Reconciliation Process

FY2008
- External auditors cite finding 08-16, Bank Reconciliation Process, for the first time.
- Finding is classified a *significant deficiency*.
- External auditors recommend (1) clearing old reconciling items, and (2) implementing bank reconciliation software, in that order.

FY2009
- PeopleSoft ERP system goes live in January 2009.
- Finding is repeated and modified, and remains a significant deficiency.
- External auditors recommend (1) resolving all old reconciling items, and (2) simplifcation and redesign of reconciliation process to maximize use of PeopleSoft.

FY2010
- Finding is repeated and modified, and remains a *significant deficiency*.
- External auditors note some progress in clearing old reconciling items, but note the presence of five reconciling items totaling $52,166 that are more than three years old.
- Finding states that complexity of reconciliation process impacts training of accounting personnel.

FY2011
- The FY2011 audit is performed by a successor accounting firm.
- External auditors repeat the finding, and increase its severity to a *material weakness*.
- External auditors recommend regular book-to-bank reconciliation.

FY2012
- Finding is repeated and modified, and remains a *material weakness*.
- External auditors recommend implementing procedures to regularly reconcile general ledger cash balances to corresponding bank balances (book-to-bank).
- External auditors also recommend timely resolution of reconciling items.

FY2013
- Finding is repeated, and remains a *material weakness*.
- External auditors recommend implementing procedures to regularly reconcile general ledger cash balances to corresponding bank balances (book-to-bank).
- External auditors also recommend timely resolution of reconciling items.

FY2014
- The FY2014 audit is performed by a successor accounting firm.
- The finding remains a *material weakness.*
- External auditors recommend reconciling general ledger cash balances to corresponding bank balances each month.

System Implementation and Limitations
In January 2009, the City implemented an ERP system, which included financial modules that impacted Common Cash. The initial implementation was incomplete and flawed. An independent commission was formed to assess, prioritize, and document all ERP improvement initiatives. In 2010, the commission developed a four-year roadmap to ensure the successful implementation of the ERP system. As the implementation progressed, it was necessary to extend the project into FY2016.

Although the ERP system has functionality to assist with bank reconciliations, implementation of the "Treasury Remediation" is still in process. As a result, the benefits of this reconciliation functionality have not been realized. According to DFAS, the "Treasury Remediation" will greatly enhance their capability to reconcile the City's Common Cash account.

Conceptual Framework for the City's Common Cash Reconciliation
One of the most significant internal controls over an entity's cash assets are regular bank account reconciliations. A bank reconciliation identifies differences between the City's general ledger (book balance) and the bank statement balance, and ultimately provides assurance that both sets of records are correct. Timely book-to-bank reconciliations are important controls for detecting potential fraud and identifying errors, including data entry errors made by the entity as well as errors made by the bank.

Book-to-bank reconciliations are similar to individuals reconciling their personal checking accounts. Throughout the month, individuals utilize manual checkbooks to maintain a written record of all additions (deposits) and subtractions (withdrawals). By calculating the impact of each transaction, the checkbook balance is updated to reflect available cash.

Upon receipt of their monthly bank statements, account holders can *reconcile* their checkbook balances with the banks' records.
1. Checkbook transactions should be matched to activity on the bank statement.
2. Deposits recorded in the checkbook that do not appear on the bank statement are *outstanding deposits* or *deposits in transit*.
3. Checks and other withdrawals recorded in the checkbook that do not appear on the statement are *outstanding withdrawals*.
4. The checkbook should be updated to reflect any deposits or withdrawals appearing on the bank statement that have not been recorded in the checkbook. Examples include interest paid by the bank and fees imposed by the bank.
5. Any errors or unusual items on the statement should be promptly reported to the bank.

Monthly performance of the above steps results in a complete, accurate, and up-to-date checkbook balance.

The City's Common Cash reconciliation process is conceptually the same as an individual's monthly checkbook reconciliation. However, instead of a manual checkbook, the City's book of record for Common Cash is the electronic general ledger. And instead of a small number of transactions each month for items such as paychecks, housing expenses, and utility bills; the City processes thousands of transactions each month including cash deposits from nearly 100 citywide cash sites, automated/manual payments, and various cash adjustments.

FINDINGS

Throughout the audit, potential findings were brought to the attention of DFAS Management. As these issues were presented, DFAS began proactively responding to and addressing many of the findings. Corrective actions implemented to date are included in the following audit findings.

The following findings concern areas that OIA believes could be improved by the implementation of the related recommendations.

1. DFAS SHOULD DEDICATE RESOURCES TO UNDERSTAND THE COMPLEX BUSINESS ACTIVITIES AND PROCESSES AFFECTING COMMON CASH.

    The sources and timing of various Common Cash transactions are not centrally documented or fully understood by DFAS personnel responsible for performing the Common Cash reconciliation. Although DFAS personnel have the knowledge, skills, and ability to fully understand the business activities and processes that affect Common Cash, they should dedicate the time and effort to fully understand the reconciliation process and the reconciling differences.

    The City's external auditors, for the three years ending June 30, 2013, stated in their FY2013 internal control memo, "Those reviewing the bank reconciliation do not fully understand the reconciliation process or the various reconciling items." DFAS management concedes that they do not have a complete understanding of the ERP system and its functionality related to Common Cash, and that the cash reconciliation is an overly complicated and imperfect process, which DFAS began to revamp in March 2015.

    Through FY2015, DFAS continued to use a reconciliation template that was designed in 2006 to work with financial systems that were replaced by the ERP system in January 2009. Under that reconciliation process, one accountant was considered the subject matter expert for the Common Cash reconciliation. However, the accountant did not fully understand the Common Cash reconciliation logic. No other accountants were cross-trained or could immediately perform the reconciliation in the absence of the one accountant who performed the reconciliation. In addition, only one supervisor reviewed the reconciliation, and admitted that he did not understand it, or know how to locate and research the reconciling items.

    The City's Controller stated that other ERP projects needed to be completed prior to implementing the Treasury module and resolving the Common Cash reconciliation issues. In March 2015, the Accounting Division began developing a new reconciliation process for use in FY2016. The process was run parallel with the old reconciliation through June

2015. However, as of September 30, 2015, the July 2015 reconciliation has not been completed.

Through October 2014, the City maintained an excess $2 million cash buffer because the general ledger did not produce an accurate and timely cash position. DFAS – Treasury Division personnel did not rely on the City's general ledger to obtain an accurate Common Cash balance. Instead, reliance was placed on bank data for cash positioning and forecasting.

New Mexico State Auditor Rule, 2.2.2.10 NMAC, requires entities to prepare a specific corrective action plan to address audit findings and must include a timeline, and designation of what employee positions are responsible for meeting the deadlines in the timeline. DFAS needs a corrective action plan specific to the Common Cash reconciliation process. Without a definitive action plan, the City cannot ensure the integrity of the City's Common Cash account and CAFR audit finding 08-16 will remain a material weakness.

The City Controller stated that the Accounting Division has been extremely busy fixing other issues and knew that the Division would be minimally successful in resolving the finding until completion of the Treasury remediation project. Auditing Standard ASB AU§325.20 states that when management is aware of material weaknesses that exist, it "may represent a conscious decision by management or those charged with governance to accept the risk associated with the deficiencies because of cost or other considerations…. The auditor's responsibility to communicate significant deficiencies and material weaknesses exists regardless of management's decisions."

RECOMMENDATIONS

DFAS should:
- Dedicate resources to develop a complete understanding of the processes and activities that affect Common Cash. The department should clearly document the sources and timing of all transactions that post to the Common Cash general ledger and bank accounts, including:
  o Manual cash journals entered by City cash sites and Treasury Division,
  o Automated journals posted by external systems,
  o Journal entries posted by Accounting Division staff, and
  o Any system-generated transactions.
- Cross train accountants and their supervisor on performing and reviewing the Common Cash reconciliation.
- Establish a specific written comprehensive corrective action plan to eliminate audit finding 08-16. The plan should include:
  o Defined milestones leading to an official deadline for resolution of

the audit finding,
- o Designation of what employee position(s) are responsible for meeting the deadlines, and
- o Periodic review and documentation of progress on the plan and adjustment of milestones and deadlines as needed.

RESPONSE FROM DFAS

"Additional resources were added within the Accounting Division during Fiscal Year 2015 to redesign the monthly general ledger to bank reconciliation process. The actions taken to date include:
1. *Identified additional resources to redesign the bank reconciliation process*
2. *Cross trained accountants on the monthly bank reconciliation process*
3. *Documented monthly cash reconciliation process – step by step*
4. *Set up separate bank accounts with the fiscal agent*
5. *Set up separate general ledger accounts for each bank account*
6. *Eliminated double posting of cash and corresponding reversal entries*
7. *Modified the PeopleSoft set-up to use the Intra-Unit Offset account (191300) as the master balancing account.*

"DFAS has taken several steps to reduce the complexity of the information being posted to the general ledger but has had minimal success in clearing timing and unidentifiable differences. DFAS feels that the implementation of an automated bank reconciliation module along with business process redesign will further reduce the complexity and enable the City to complete timely reconciliations, identify all timing differences and clear issues on a monthly basis. A written comprehensive corrective action plan has been developed and is available for review. This plan involves the following major steps:"

ESTIMATED COMPLETION DATE

1. *"Business process review involving deposits*
a.	*Incomplete deposits*	*12/1/2015*
b.	*Timing issues*	*3/31/2016*
c.	*Unidentifiable items*	*6/30/2016*
d.	*NSF process*	*1/31/2016*
e.	*Daily and monthly reconciliation process*	*3/31/2016*
f.	*Allocation of unidentifiable differences*	*6/30/2016*

> 2. ***PeopleSoft Treasury Bank Reconciliation implementation 3/31/2016***
> 3. ***Interface modifications   3/31/2016***
> 4. ***Training   3/31/2016"***

2. <u>DFAS SHOULD ENSURE COMMON CASH RECONCILIATIONS ARE ACCURATE AND COMPLETED AT THE END OF EACH CALENDAR MONTH.</u>

The Common Cash reconciliations should accurately capture the City's complex cash activities, use the City's accounting system to generate cash per book balances, and be completed on a monthly basis. The reconciliation should not include analytical assumptions or contain unidentified reconciling amounts. Reconciliation issues are discussed in the following subsections.

A. **<u>Common Cash Reconciliations Do Not Accurately Capture the City's Complex Cash Activities</u>**

The City's Common Cash business activities add unnecessary complexities to the general ledger account that are not fully captured by the reconciliation. A large volume of activity flows through the general ledger account. Normal Common Cash activity includes manual transactions posted by multiple business units at nearly 100 cash sites, automatic entries from various sub-systems, and automatic bank account replenishment transfers for accounts payable and payroll costs.

Through June 30, 2015, the City's Common Cash account was also designated as PeopleSoft's master balancing account. Due to this configuration, system-generated balancing transactions were posted to the Common Cash account. This introduced additional transactions to Common Cash that were not directly related to cash activity. The presence of balancing entries in the Common Cash account added unnecessary complexity to the general ledger and was not specifically identified in the Common Cash reconciliation.

Standard accounting entries are two-sided, indicating the "to and from" movement of funds. Thus, a single transaction has two components, a plus and the other a minus. The PeopleSoft system is configured so that all City funds are in balance. Because of this balancing requirement, an accounting transaction between funds cannot be completed with just two components; the system adds two additional transactions to the master balancing account in each fund, which in the City's case is the Common Cash account. The accountant recording the entry does not enter the balancing entries. The balancing entries are created by the ERP system and are posted to the Common Cash general ledger account.

Analysis of averages for the three-months ended May 31, 2014, indicates that a significantly higher volume of activity was processed through the City's books than was processed by the bank. In terms of dollar value, the transaction amount is more than five times greater on the City's books than what was actually processed by the bank, as illustrated by the table below.

Transaction Volume and Amount – City's Books versus Bank Statements
Averages for March, April, and May 2014

	Additions/Deposits		Subtractions/Withdrawals	
	Number	**Dollar value**	**Number**	**Dollar value**
Bank records	5,131	$184,754,860	1,431	($186,999,683)
City books	8,570	$1,016,947,114	6,843	($986,469,153)

Source: Bank statements and City books

The sheer volume and variety of transactions flowing through the Common Cash account makes analysis of activity difficult. The variation between the number of transactions on the books and what is actually posted by the bank creates significant obstacles to reconciling the City's books with the bank records. The following conditions contribute to complexity of the City's Common Cash to bank statement reconciliation.

1. Prior to FY2016, the City's Common Cash general ledger account contained activity from four separate bank accounts, as illustrated in the graphic below:
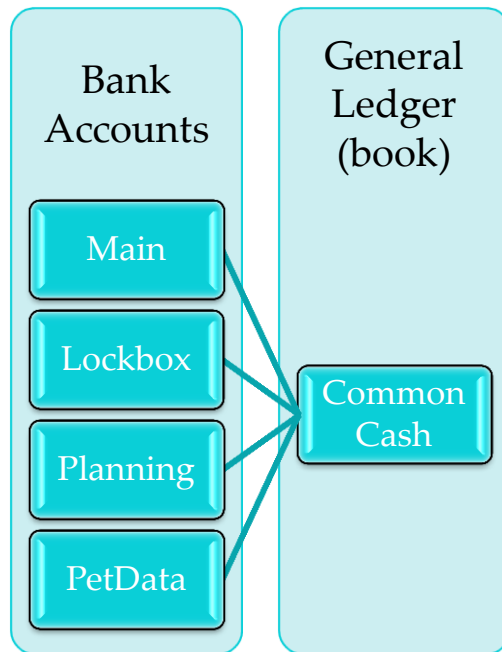
Each bank account had its own characteristics and transaction types. Combining four unique bank accounts into a single book account added unnecessary complexity to the reconciliation process.

Beginning in FY2016, the City transitioned to a new fiscal agent, and DFAS is in the process of creating specific general ledger accounts for each bank account. This will allow DFAS to simplify the reconciliation process by reconciling individual bank accounts to designated general ledger accounts.

2. Prior to FY2016, the main Common Cash bank account processed a large volume of dissimilar transactions that included the following:
   - Deposits from the City's 100 cash sites, segregated by cash and credit card,
   - Wires and other electronic transactions,
   - Transfers to Accounts Payable and Payroll bank accounts,
   - Electronic payment of City purchasing card charges,
   - Investment purchases and redemptions,
   - Daily deposits initiated by the City's Treasury Division (multiple payment types),
   - Debt service payments,
   - Automatic deposits of rent payments from City Airport tenants, and
   - Online retirement contribution payments for City employees.

Beginning in FY2016, DFAS began to simplify the main account by establishing specific bank and general ledger accounts to capture similar activity. For example, separate general ledger and bank accounts were established exclusively for cash site deposits.

3. Complex relationships have been, and continue to be, an impediment to matching specific book transactions to corresponding bank statement transactions. Established business processes and system configurations dictate transaction relationships and hinder the matching of book-to-bank activity. The following examples illustrate some of the complex relationships impacting the City's Common Cash bank reconciliation.

- *One-to-many relationship*: One book transaction corresponds to the sum of several bank transactions. An example is the posting of water meter payments. In November 2014, on the City's books, a single cash transaction was entered for a total of 35 water meter payments. The bank's records however, show individual payments for each meter.

Example: One-to-many relationship

Books		Bank
		Many transactions:
One transaction:		1. $100
$1,000		2. $250
		3. $300
		4. $350
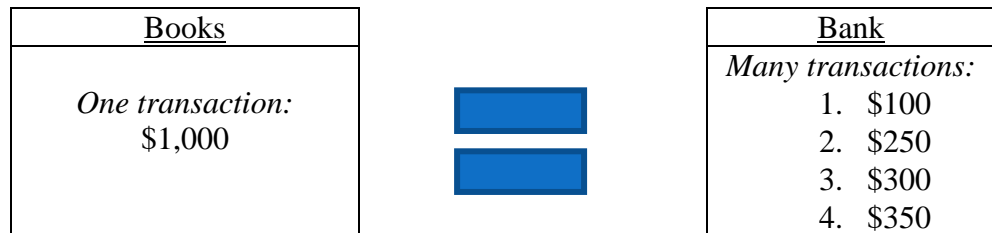
- *Many-to-one relationship*:   The sum of several book transactions corresponds to a single bank transaction. An example is the processing of online payments for parking citations, permits, and alarm fees. On the City's books, separate entries are made for each revenue source. However, on the bank statement, the sum of the deposits appears as a single deposit.

Example: Many-to-one relationship

Books		Bank
Many transactions:		
1. $250		*One transaction:*
2. $300		$1,000
3. $450		

- *Many-to-many relationship*: The sum of several book transactions corresponds to the sum of several bank transactions. Although rare, these transactions are complex because both sets of books contain a different number of transactions that sum to the same amount. This type of transaction requires transaction knowledge and takes time to research and ultimately reconcile. An example is the distribution of expenses for credit card fees to City departments. On the books, such transactions are allocated by activity. On the bank statement, there is a single fee for each individual cash site, resulting in many more transactions. For example, October 2014 credit card fees consisted of 52 book transactions that reconciled to 64 bank deposits.

Example: Many-to-many relationship

Books		Bank
Many transactions:		*Many transactions:*
1. $200		1. $100
2. $200		2. $100
		3. $100
		4. $100

4. Prior to FY2016, the reconciliation process was impacted by double postings to Common Cash. Double postings to Common Cash were a mix of manual entries and automated postings from various subsystems. These transactions caused interim Common Cash balances to be misstated. This required DFAS to post manual reversing journal entries to correct the effects of the double postings. The table below illustrates three business activities that were regularly double posting cash and adding unnecessary complexity to the general ledger.

Pre-FY2016 Double Posted Transactions

Transaction Type	Posting #1	Posting #2
iCart Online Payments	Manual entry	ENVISION subsystem entry
Special Assessment Districts Payments	Manual entry	DFAST subsystem entry
Fleet Fuel Receivables from Other Government Entities	Manual entry	System-generated balancing entry

DFAS discontinued double posting of iCart online payments in September 2014. Accounting management stated that the other two double posts have been

discontinued effective July 1, 2015.

B. **Common Cash Reconciliations Include Assumptions**

Prior to FY2016, the Common Cash reconciliation was a combination of transaction reconciliation and analytical procedures. The Accounting Division applied analytical procedures because they were unable to reconcile all transactions. The reconciliation compared the net change in general ledger activity for the month to the net change in bank balances for the month. The reconciliation assumed that all transactions were accurately recorded in both the City's general ledger and bank accounts. However, the process did not accurately capture all of the City's Common Cash activity and timing differences that a true book-to-bank reconciliation would.

The table below illustrates Common Cash reconciliation assumptions, realities and impacts.

Pre-FY2016 Common Cash Reconciliation Assumptions and Realities

Assumption	Reality	Impact
The reconciliation assumed there were no timing differences between the City's books and the bank.	Timing differences naturally occur and are ordinary components for cash reconciliations. For example, approximately $1.3 million in October 2014 book activity was not recorded at the bank until November 2014.	Monthly reconciliations were not accurate because they did not account for the timing differences between the City's Common Cash account and the bank.
The reconciliation assumed that there was no impact from the designation of Common Cash as the master balancing account.	There were numerous balancing transactions on the City's books that did not have a relationship to a deposit or a withdrawal.	Monthly reconciliations were not accurate because there was no procedure to account for the effect of balancing transactions on the Common Cash general ledger account.
The reconciliation assumed all activity from the Planning and PetData bank accounts were recorded in the City's Common Cash account.	The City's Common Cash account and reconciliation did not capture all the activity from the Planning and PetData bank accounts. March and April 2014 contained returned items and bank adjustments totaling $6,037 that could not be located on the City's books.	Monthly reconciliations were not accurate because they did not capture all the activity from the Planning and PetData bank accounts.

Pre-FY2016 Common Cash Reconciliation Assumptions and Realities

Assumption	Reality	Impact
The reconciliation assumed that returned items and reprocessed transactions from the Main Common Cash bank account were recorded on the City's book	Returned items and reprocessed transactions for insufficient funds were not recorded on the City's books.	Monthly reconciliations were not accurate because the City's books did not capture bank transactions for returned and reprocessed activity.
The reconciliation assumed that running queries on Accounts Receivable activity provided a complete picture of monthly cash deposits.	Deposits are posted to Common Cash from sources other than Accounts Receivable. All deposits posting to Common Cash need to be analyzed.	Monthly reconciliations were not accurate because the analysis of individual bank deposits was not reconciled to all Common Cash book activity.
The reconciliation assumed that all transactions were accurately recorded in both the City's general ledger and bank accounts.	Certain activities double posted transactions to Common Cash. For example, iCart transactions were systematically double posted for 22 months, which required year-end adjustments.	Monthly reconciliations were not accurate because they did not disclose the impact of double postings. Interim cash balances were overstated until year-end adjusting entries were posted.

Source: OIA analysis

DFAS began developing a new reconciliation process in March 2015. The process was run in parallel with the old reconciliation process through the end of FY2015. Beginning in FY2016, the new process will be the only reconciliation performed. According to DFAS, the new process will eliminate the assumptions noted above.

C. **Common Cash Reconciliations Contained Unidentified Reconciling Amounts**
Because the Common Cash reconciliation did not accurately capture the City's cash activity and included assumptions, it contained reconciling net variances. The reconciliation contained a line identified as "Cumulative unidentified diff between posted ARD [Accounts Receivable Deposits] journals and the bank."

Net monthly unidentified differences for February through June 2014 ranged from $460 thousand to negative $2.2 million. The City should accurately identify and account for cash variances to be able to detect fraud and other errors.

(Refer to finding number three for additional details about this issue.)

D. **Common Cash Reconciliations Did Not Begin with the Book Balance from the General Ledger**
Monthly Common Cash reconciliations did not begin with the book balance directly from the City's general ledger, the official book of record for the City. The beginning

balance for each month's reconciliation was obtained from the Accounting Division's prior reconciliation spreadsheet. Common Cash balances contained in spreadsheets are not substitutes for the City's general ledger.

The Accounting Division used monthly transactional data for the reconciliation, but did not use general ledger cash balances. Some of the City's funds are Life-to-Date (LTD), which remain open at fiscal year-end. According to DFAS, the Common Cash ERP system generated book balance is not accurate without adjusting for the LTD funds beginning balances. The table below illustrates the large variances between various sources.

Variances in Common Cash Ending Balances

Month	ERP System General Ledger Ending Balance	DFAS Ending Balance with LTD	Accounting Div. Spreadsheet Ending Balance
February 2014	($95,930,940)	($28,100,592)	$16,907,210
March 2014	($110,577,501)	($16,734,990)	$28,384,654
April 2014	($105,594,846)	($28,009,221)	$17,243,959
May 2014	($28,607,111)	($33,143,846)	$11,853,287
June 2014	($75,772,459)	$18,631,553	$34,026,553
	Source: General Ledger Balance Report	Source: DFAS Accounting Division	Source: DFAS Common Cash Reconciliations

The reconciliation process cannot identify true differences between general ledger book balances and bank activity without using the general ledger cash balance as a starting point. GAAP requires financial reporting to be reliable and timely.

E. Common Cash Reconciliations are not completed timely

Common Cash reconciliations are routinely performed more than 60 days after the end of each calendar month. Twice during the audit, reconciliations took more than 90 days after the end of the calendar month to complete.

Deposit agreements with the City's fiscal agents require that unauthorized transactions be reported no later than 60 days after the statement date. For certain types of errors, the deadlines are shorter. Without timely bank reconciliations, losses due to bank errors or fraud may not be detected within fiscal-agent deadlines for reporting. Should the City find bank errors or fraud after the deadlines, the City would have to absorb any losses.

The above issues were discussed with DFAS Management during the audit. According to DFAS Management, the following changes have been made to the Common Cash general

ledger account:

- At the start of FY2016, DFAS separated the Common Cash account from the master balancing account. Balancing transactions are now recorded in a separate general ledger account and are no longer posted in the Common Cash account. This change reduces the number of transactions in the cash accounts and simplifies the reconciliation process.
- Duplicate sources of double-posted cash entries (see Pre-FY2016 Double Posted Transactions table above) have been eliminated.
- Additional general ledger accounts have been established to serve as unique book accounts for each bank account. This action reduces volume and variability of transactions in each account and simplifies the reconciliation process.

Although DFAS has taken actions to decrease the complexity of the Common Cash bank reconciliation, additional actions are required to produce accurate and timely book-to-bank reconciliations.

RECOMMENDATIONS

After gaining a full understanding of current processes and activities impacting Common Cash, DFAS should:

- Update business processes to simplify and streamline relationships between the general ledger and the bank accounts.
  - Evaluate data quality of each posting source to verify that general ledger entries contain a complete and sufficiently detailed record of the transaction to facilitate matching of all general ledger transactions to corresponding bank statement transactions.
  - Reconcile each bank account on an individual basis to simplify the matching of general ledger transactions to corresponding bank activity.
- Ensure that the revised book-to-bank reconciliation process:
  - Can be used to reconcile all City Common Cash bank accounts,
  - Is modeled on accounting best practices,
  - Ties to the Common Cash book balance every month,
  - Matches general ledger transactions to bank statement deposits, withdrawals, and other transactions (interest, fees, timing differences, returned items, etc.),
  - Individually identifies each reconciliation difference between the City's books and the bank,
  - Discloses outstanding deposits and withdrawals, including the effects of Accounts Payable and Payroll bank accounts on Common Cash, and

- o Accurately reports the City's true Common Cash position at the end of each month.
- Work with the Department of Innovation – ERP Division to develop an ERP system generated general ledger balance report that captures Life-to-Date fund activity.
- Adopt a mandatory deadline for completing the Common Cash bank reconciliation within fiscal agent deadlines for reporting errors, including during months when the Accounting Division is involved in CAFR preparation.
- Document the Common Cash reconciliation procedure in writing. The written procedure should:
  - o Use clear descriptive language,
  - o Contain the sequence of required steps,
  - o Provide information on how to obtain account balances and transactions from the system,
  - o Be updated as processes change, and
  - o Provide sufficient detail so that any Principal Accountant would be able to perform the reconciliation with minimal supervision.

RESPONSE FROM DFAS

"All of the issues described above highlight the issues related to the bank reconciliation process. As of July 1, 2015, a separate master balancing account was set up in the PeopleSoft system to track intra-unit cash transactions. This modification will enable the Accounting division to reconcile intra-unit transactions separate from true cash transactions. The issues created with the interfaces double posting and eliminated through allocations have been resolved. The monthly bank reconciliation process has been redesigned and the process has been documented. The bank reconciliation process brings in general ledger balances monthly instead of carrying forward the balances and bringing in general ledger balances at year end.

"During the fiscal agent transition, additional bank accounts were set up. Separate general ledger accounts were also set up for each new bank account. Reconciling differences remain extremely difficult due to one to many and many to one relationship described above. When the City went live with the new fiscal agent, Treasury mandated that cash-site journals match bank deposits to create a one for one relationship.

"The implementation of PeopleSoft Treasury Cash Management bank

reconciliation implementation has begun and is expected to be completed by March 2016. The benefits of implementing the PeopleSoft Treasury Cash Management Bank Reconciliation module are as follows:

- *Standardized business processes through built in application controls*
- *Standardized reconciliation rules that are built into the system*
- *Standardized training*
- *Eliminate manual reconciliation files contained in excel*
- *Increased automation and reduced manual effort*
- *Business process changes will be identified during the design phase of the implementation in order to minimize the amount of manual reconciliation items required by treasury in the cash book.*

"Accounting will develop deadlines for the CAFR and Non-CAFR season ensuring that the bank reconciliations are completed within acceptable time frames.

"DFAS expects that timing differences will be identifiable once the implementation of the Treasury Cash Management Bank Reconciliation module is complete and, at that time, accounting and treasury will designate additional staff to research outstanding reconciling items."

ESTIMATED COMPLETION DATE

"Estimated Completion Date of implementation is 3/31/2016. Identifying differences will be completed once the implementation is complete. DFAS will attempt to address all outstanding differences by 6/30/2016."

3.   DFAS SHOULD IDENTIFY, INVESTIGATE, AND RESOLVE COMMON CASH RECONCILIATION DIFFERENCES.

The DFAS Accounting Division did not identify, investigate, and resolve reconciliation differences on a timely basis. Each month, Common Cash reconciliations contained unidentified differences. Net differences in one month were carried forward and combined with the next month's unidentified differences. These unidentified differences were essentially monthly plugs for unexplained cash variances. This practice is not consistent with GAAP, which requires financial reporting to be reliable and timely, and Section 6-10-2 NMSA 1978, which requires municipalities to balance the cash record on a daily basis.

The table below illustrates the cumulative net unidentified differences for the last five months of FY2014.

Net Unidentified Cash Differences for the Last Five Months of FY2014

Month	Net Monthly Difference	Net Adjustments	Cumulative Difference
January 31, 2014 Balance			($5,773,926)
February 2014	($68,284)		($5,842,210)
March 2014	($1,967,121)		($7,809,331)
April 2014	$460,837		($7,348,494)
May 2014	($384,139)		($7,732,633)
June 2014	($2,169,332)	$7,976,667*	($1,925,298)

Source: DFAS Cash Reconciliations

*Note: The adjustment was primarily due to deposits of certain online credit card payments,
which were posted to the books twice daily, once by an automated posting and once by a manual
entry. This double posting continued for more than 22 months. The adjustment corrected the
overstatement of deposits for the year ended June 30, 2014.*

Historically, DFAS offset net unidentified Common Cash reconciliation amounts with
investment income at fiscal year-end. DFAS processed accounting entries between
Common Cash and investment income to align the City's general ledger with the Common
Cash bank balances. This practice was discontinued in FY2013. Since then, unidentified
differences have been carried forward and DFAS is working towards identification and
resolution of the unidentified Common Cash differences.

As noted above, net monthly unidentified differences for February through June 2014
ranged from $460 thousand to negative $2.2 million. Because the sources of the
differences have not all been identified, DFAS can only account for the net monthly
difference and does not know how large the true variances are. Until this issue is
remedied, erroneous Common Cash activity or unapproved transactions may not be
detected and addressed.

RECOMMENDATIONS

DFAS should:
- Identify all monthly reconciling differences on an individual basis on the
  reconciliation report, instead of combining such differences as a net plug.
- Investigate each reconciliation difference by tracing the transaction to its
  source.
- Develop a process to research, investigate, and correct individual
  reconciling differences each month. Set short-term target dates for
  resolution of each reconciling difference.
- Disclose unidentified balances in a manner consistent with GAAP, and do
  not offset or write-off unidentified balances against investment income or

other accounts.
- Develop a plan to research and permanently resolve all reconciling differences remaining from past fiscal years.

RESPONSE FROM DFAS

"Many differences are due to the one to many and many to one relationship created by business processes and by the set-up of certain interfaces. These issues will be explored during the discovery phase of the PeopleSoft Treasury Bank Reconciliation implementation. The goal is to create as many one to one relationships as possible so the auto-bank reconciliation process can clear them. If some of the deposits cannot be cleared, business processes will be developed to address exceptions and manually clear the deposits in the cash book system if necessary.

"Once the implementation is complete unidentifiable differences will become apparent and accounting and treasury will designate additional staff to research and clear outstanding reconciling items. DFAS will design a method to allocate true unidentifiable differences to each fund. DFAS hasn't allocated unidentifiable differences to funds using investment income since Fiscal Year 2013. Refer to action plan."

ESTIMATED COMPLETION DATE

"Estimated Completion Date of implementation is 3/31/2016. Identifying differences will be completed once the implementation is complete. DFAS will attempt to address all outstanding differences by 6/30/2016."

4. DFAS SHOULD ESTABLISH INTERNAL CONTROLS OVER SPREADSHEETS USED IN FINANCIAL REPORTING.

The Common Cash bank reconciliation is performed on a user-developed Microsoft Excel spreadsheet. This spreadsheet contains significant financial reporting information that is used in the City's CAFR. The spreadsheet has a complex structure, containing many arithmetic functions, summations, and control totals. For end-user applications such as spreadsheets which are significant to financial reporting, COSO Principle 11 recommends that management select and develop:
  (1) **Technology infrastructure controls**, designed and implemented to help ensure the *completeness, accuracy, and availability* of technology processing, and
  (2) **Security management process controls**, designed to restrict technology access rights to authorized users commensurate with their job responsibilities and to

protect the entity's assets from external threats.

The reconciliation spreadsheets are stored in a shared folder on the City's network. This shared workspace is accessible to all members of the Accounting Division, approximately 25 people.

Because DFAS has not established controls over spreadsheet access, design and revision control, and formulaic integrity tests, any Accounting Division staff member could access the spreadsheets and make intentional or unintentional unauthorized changes. The lack of individual accountability makes it possible that a change could remain undetected, impact the financial reporting information produced by the spreadsheets, and ultimately introduce errors or misstatements to the CAFR.

RECOMMENDATIONS

DFAS should establish internal controls over key spreadsheets used in financial reporting. For example,
- Access controls should restrict spreadsheet changes to authorized users.
- Input controls should be established to ensure that input data is consistent with source data.
- Version controls should be established to ensure that only current and approved versions of spreadsheets are used.
- Calculation testing should be performed to ensure accuracy of formulas and summations following changes to spreadsheet templates.

RESPONSE FROM DFAS

"DFAS agrees with the recommendation and will implement spreadsheet controls on the files used to reconcile cash."

ESTIMATED COMPLETION DATE

"12/31/2015"

CONCLUSION

DFAS should dedicate the additional resources needed to accomplish accurate and timely reconciliations. Accurate and timely bank account reconciliations are essential internal controls to ensure that cash records are complete and accurate, and that data entry errors, bank errors, and potential fraud are detected and resolved in a timely manner.

DFAS must first develop a complete understanding of the processes and activities that affect Common Cash. Once the department fully understands how various transactions affect Common Cash, it can implement business process improvements to resolve the complex account structure. Process improvements should also ensure general ledger data is sufficient to facilitate the matching of book transactions to bank statement activity.

Gaining a full understanding of all cash transactions, revising business processes, completing the revised monthly book-to-bank Common Cash reconciliation, and resolving reconciling differences will enable DFAS to improve internal control over Common Cash, address the deficiencies noted by the external auditors, and eliminate CAFR audit finding 08-16.

We greatly appreciate the assistance and cooperation of the Department of Finance and Administrative Services during the course of the audit.

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Senior Information Systems Auditor

REVIEWED:

_____

Internal Audit Manager

APPROVED: APPROVED FOR PUBLICATION**:**

_____   _____

Debra Yoshimura, CPA, CIA, CGAP   Chairperson, Accountability in
Director, Office of Internal Audit   Government Oversight Committee

OBJECTIVES

The audit objectives are:

- Are Department of Finance & Administrative Services (DFAS) internal controls and processes adequate to ensure Common Cash Reconciliations are timely and accurate?
- Are DFAS internal controls and processes adequate to ensure the accurate tracking and resolution of reconciling items?
- What has DFAS done to correct and remediate CAFR finding 08-16, Bank Reconciliation Process?

SCOPE

Our audit did not include an examination of all functions and activities related to the City's Common Cash bank account reconciliation processes. Our scope was limited to the objectives above.

This report and its conclusions are based on information taken from a sample of transactions and do not represent an examination of all related transactions and activities. The audit report is based on our examination of activities through the completion of fieldwork on September 10, 2015 and does not reflect events or accounting entries after that date.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

METHODOLOGY

Methodologies used to accomplish the audit objectives include but are not limited to the following.

- Reviewed City Ordinances, Administrative Instructions, and State laws applicable to cash recordkeeping and bank account reconciliation.
- Researched best practices and accounting principles related to reconciliation of cash

accounts.
- Gained an understanding of internal controls over City bank accounts.
- Gathered and reviewed background information, internal control documentation, and policies and procedures pertaining to bank account reconciliation processes.
- Interviewed DFAS management and staff in the Accounting, Treasury, and ERP Divisions.
- Gained an understanding of current reconciliation practices for the City's Common Cash accounts and compared actual process to documented procedures and to best practices.
- Observed the daily reconciliation of the Common Cash account performed by the Treasury Division.
- Reviewed bank statements for the Common Cash, Common Cash Lockbox, Planning Department Trade Payments, Animal Welfare PetData, Accounts Payable, and Payroll accounts.
- Reviewed and analyzed monthly reconciliation spreadsheets for the Common Cash bank reconciliation.
- Re-performed key steps and calculations in the Common Cash bank reconciliation process.
- Developed an understanding of City information systems queries used to reconcile Common Cash.
- Analyzed timing differences between the City's Common Cash general ledger records and the bank.
- Traced bank deposits and withdrawals through posting to the City's Common Cash general ledger records.

<div align="right">**APPENDIX B**</div>

Improvements to Underlying Control Activities Impacting the Common Cash Reconciliation

The following information was provided by DFAS Management and describes the actions taken to address the underlying system and business process issues impacting the Common Cash reconciliation.

2009-2010
- Implemented controls to reduce chartfield errors
- Worked on resolving conversion errors
- Project costing reconversion
- Remediate day-to-day business processes
- Created the online journal review process
- Developed a monthly close process
- Created over 100 queries to monitor the close process
- Develop new interest allocation process
- Implemented GASBS 45

2010-2011
- Remediated the set-up of the inventory receiving and sales process.
- Updated the online journal review process
- Developed various training documents
- Created the grant reconciliation process
- Initiated grant reconciliations
- Launched remediation of the general ledger
- Implemented GASBS 54
- Developed an indirect overhead process

2011-2012
- Cleaned up chartfield errors
- Developed additional combo edits
- Implemented new annual closing process
- Remediated interest allocation process
- Continued training documentation efforts

- Developed processes to facilitate arbitrage calculations
- Implemented GASBS 60, 61 and 63
- Process improvement for external interfaces to PeopleSoft, eliminating the need for a translation table
- Payroll clean-up related to payroll customization for grants and projects

2012-2013
- Continue chartfield error clean-up
- Reconciled a major portion of the operating grants fund balance
- Continued development of training documentation
- Modified Trial Balance structure
- Created uniform set of grouping codes in PeopleSoft to facilitate financial reporting
- Standardized the fund preparation and review process
- Developed the project close process
- Reconciled and closed over 2000 project activities
- Implemented GASBS 65
- Implemented integration broker
- Fully implemented the PeopleSoft Accounts Receivable Module
- Implemented the PeopleSoft Grants Management Module
- Implemented the PeopleSoft Asset Management Module
- Implemented PeopleSoft Commitment Accounting Module
- Completed the remediation of the payroll processes and timekeeping module

2013-2014
- Developed business processes for PeopleSoft Grants Management Module
- Developed business processes for PeopleSoft Asset Management Module
- Developed business processes for PeopleSoft Commitment Accounting Module
- Eliminated customization of payroll as related to grants and projects and perform final clean-up
- Updated Trial Balance to include new Asset Management ledger
- Fully reconciled the operating grants fund balance
- Closed remaining qualified projects and activities in the operating grants fund
- Implemented GASB 53
- Participated in the PeopleSoft Upgrade to 9.2
- Implemented workflow for Journal Entry

- Built live (current year) Trial Balance table
- Developed exception reporting
- OPEB Trust established for City
- Continue training documentation development

2014-2015
- Modified the Trial Balance to include the life-to-date entry for project funds eliminating a time consuming process at year-end
- Developed Fixed Asset table in DSS
- Revamped Cognos reports
- Developed two DSS tables strictly for cash accounts
- Corrected combination edit errors in Commitment Control module
- Reconciled and cleaned up additional conversion issues in project funds
- Identified and adjusted amounts related to cash and clearing accounts
- Modified business processes related to clearing accounts, grants management, accounts receivable, and deposits
- Implemented the PeopleSoft Travel Module
- Implemented GASB 68
- Continue training documentation development
- Develop year end "Round-up" document for distribution to all departments
- Redesign WIP schedules
- Closed 900 CIP projects
- Analyzed capital IDOH processes
- Modified the cash reconciliation process
    - Brought in the monthly book balances
    - Created additional queries to identify differences clearing more deposits
    - Eliminated double postings and the allocations that reverse them.
    - Established additional bank accounts
    - Established unique general ledger accounts for each bank account.
    - Documented the new reconciliation procedures
    - Began cross training accountants in the accounting division on the bank reconciliation process
    - Modified the PeopleSoft setup eliminating cash as the master balancing account
    - Added more resources to help research incomplete deposits and outstanding items in the bank reconciliation

      o   Require departments to create deposits that match the bank deposit

Findings that have been cleared are as follows:

Fiscal Year	Total # of findings	Total # of findings related to the City	Material Weaknesses related to the City	Significant Deficiencies related to the City	Other Matters related to the City
FY2009	43	39	0	35	4
FY2010	34	27	0	16	11
FY2011 *	41	36	4	6	26
FY2012	35	28	4	8	16
FY2013	20	16	4	7	5
FY2014 *	20	11	1	3	7

* Change of auditors

Fiscal Year	CAFR completion date	Time available before next CAFR season
2009-2010	09 completed 10/10	0
2010-2011	10 completed 6/11	20 days
2011-2012	11 completed 3/12	4 months
2012-2013	12 completed 2/13	4 months
2013-2014	13 completed 3/14	5 months
2014-2015*	scheduled to be on time	