



Office of the City Auditor

**Report to the City Council
City of San José**

AUDIT OF DECENTRALIZED CASH HANDLING

**Internal Controls Over Cash Handling At
Selected Sites Were Generally Sufficient
But Some Citywide Cash Handling
Procedures Need Updating**

**Report 10-04
February 2010**

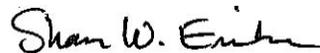
February 10, 2010

Honorable Mayor and Members
of the City Council
200 East Santa Clara Street
San Jose, CA 95113

Transmitted herewith is the report *Audit of Decentralized Cash Handling*. This report is in accordance with City Charter Section 805. An Executive Summary is presented on the blue pages in the front of this report. The City Administration's response is shown on the yellow pages before Appendix A.

This report will be presented at the February 18, 2010 meeting of the *Public Safety, Finance & Strategic Support Committee*. If you need any additional information, please let me know. The City Auditor's staff members who participated in the preparation of this report are Steve Hendrickson and Robin Opheim.

Respectfully submitted,



Sharon W. Erickson
City Auditor

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Office of the City Auditor

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City of San José**

**AUDIT OF
DECENTRALIZED CASH
HANDLING**

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Executive Summary

In accordance with the City Auditor's 2009-10 Audit Workplan, we have completed an Audit of Decentralized Cash Handling. 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 and 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. We limited our work to those areas specified in the "Audit Objective, Scope, and Methodology" section of this report.

The City Auditor's Office thanks the Finance Department, Treasury Division, and City staff in every department in which audit fieldwork was performed, for their time, information, insight, and cooperation during the audit process.

Finding I Internal Controls Over Cash Handling At Selected Sites Were Generally Sufficient But Some Citywide Cash Handling Procedures Need Updating

Our review found internal controls over cash handling at selected sites were generally sufficient and only a few exceptions were noted. However, some Citywide cash handling procedures are outdated, and compliance with the Payment Card Industry Data Security Standards (PCI/DSS) can be enhanced by (1) requiring vendors providing credit card processing software and services be pre-certified for PCI compliance, and that they submit quarterly or annual certifications of compliance and (2) developing Citywide policies and procedures to periodically assess PCI compliance at all distributed cash handling sites accepting credit cards. Furthermore, the City should ensure periodic spot audits of petty cash and change funds are conducted, and should update its 1986 cash shortage/overage procedure to increase the reporting threshold from \$50 to \$100 while implementing a reporting form on the Finance Department's intranet website to allow departments to easily file cash shortage/overage reports. In two related matters, we found that cash collections for bicycle licenses do not justify continuation of the program, and that the San José Police Department has a backlog of false alarm incident reports that have not been billed.

RECOMMENDATIONS

We recommend that the Finance Department:

Recommendation #1 Complete the update of Finance Administrative Manual Sections 4.0 through 4.6 procedures governing cash handling and revenue collection. (Priority 3)

To further strengthen controls over credit card payments, we recommend that the City Administration:

Recommendation #2 Develop Citywide policies and procedures to require and periodically assess Payment Card Industry compliance at all distributed cash handling sites accepting credit cards. (Priority 3)

Recommendation #3 Require vendors providing credit card processing software and services be pre-certified for Payment Card Industry compliance, and submit quarterly or annual Payment Card Industry certifications of compliance to the City's Information Technology Chief Security Officer and department contract managers. (Priority 3)

In our opinion, the Finance Department should:

Recommendation #4 Complete the update of procedures for conducting spot audits of petty cash and change funds, and clarify roles and responsibilities for conducting the audits. (Priority 3)

Recommendation #5 Complete the update of the 1986 cash shortage/overage procedure to increase the reporting threshold from \$50 to \$100, and implement a reporting form on the Finance Department's intranet website to allow departments to easily file cash shortage/overage reports. (Priority 3)

We recommend that City Administration:

Recommendation #6 Either enforce the ordinance the City Council enacted requiring bicycle licensing, or recommend the City Council repeal the ordinance. (Priority 3)

Further, we recommend that Fire Administration should:

Recommendation #7 If fire stations continue to collect fees for bicycle licenses, obtain locked cashboxes for fire stations. (Priority 3)

We recommend that the San José Police Department:

Recommendation #8 **Ensure system software is fully implemented and enter false alarm incident reports into the database to bill for false alarm fines on a timely basis. (Priority 3)**

Introduction

In accordance with the City Auditor's 2009-10 Audit Workplan, we have completed an Audit of Decentralized Cash Handling. 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 and 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. We limited our work to those areas specified in the "Audit Objective, Scope, and Methodology" section of this report.

The City Auditor's Office thanks the Finance Department, Treasury Division, and City staff in every department in which audit fieldwork was performed, for their time, information, insight, and cooperation during the audit process.

Background

Throughout the City, departments accept cash, checks, and credit cards as payment for items such as permits; parking citations; recreation classes; library fines; garbage, water, and recycling; animal licenses and adoptions; and facility rentals. Payments may be made in person, by mail, or online. In some cases, third party vendors process credit card payments or provide software to City departments for credit card payment processing.

Deposits

Each City site collecting payments is responsible for preparing a daily deposit. The City contracts with an armored car courier service to collect deposits according to a weekly schedule and deliver them to the bank.

Current Technology Provides Increased Security

Computerized cash registers and online registration systems add to the safety and security of the cash handling process. During our site visits we noted that:

- Cash register tapes, records, and reports record each transaction by type and amount and the operator who performed an individual transaction;
- Computer-generated end-of-day pay-in summaries ensure that cash, checks, and credit card payments total and match to the daily register tapes, and also ensure that payments are credited to the correct City funds and FMS visible codes;

- Magnetic ‘swipe’ access cards assigned to personnel establish supervisory access and authorization levels and limit staff access to computer system menus and modules and to certain cash register operations – i.e., using the “No Sale” key to open the cash drawer; and
- Online systems processing credit card payments are subject to daily log-off and shut down procedures.

The City’s Banking Agreement With Wells Fargo Bank

Union Bank of California (UBOC) provided City of San José banking services beginning in March 2000 through May 2009. On February 28, 2008, a Request for Proposal (RFP) was issued through the City’s e-procurement system for Financial Services which included the City’s General Banking Services, Merchant Card Processing, Lockbox Services, and Securities Custody Services. On May 5, 2009, the City Council approved a new banking agreement with Wells Fargo Bank that went into effect on June 1, 2009.

According to the Finance Department, the agreement with Wells Fargo Bank will provide a variety of enhanced services at a reduced cost. It also:

- Eliminates the need to create paper checks when processing accounts payable or payroll by using the Automated Clearing House (ACH) Service. ACH also reduces the ability for someone to create a fraudulent check using old check stock.
- Offers Desktop Deposit Services, benefitting the City with (1) less time preparing and transporting checks, (2) checks clearing the system sooner, and (3) earlier access to funds. Because checks are not physically presented, the digital document becomes the check, lessening the chance of payments being lost or stolen in transit. According to the Finance Department, physical checks that are received are held for seven days and then destroyed.

Cash Handling Policy and Management Principles

According to Finance Administrative Manual Section Number 4.0 – General Guidelines for Cash Handling Procedures:

- 4.0.2 *The basic administrative policy in cash handling is to adhere to a system of internal controls which will safeguard City funds, promote accuracy and reliability in accounting and operating records, and promote the efficiency of operations. A satisfactory system of internal controls segregates the performance of tasks necessary to accomplish a complete business transaction among several individuals so that no one performs all the tasks. Additionally, an internal control system utilizes procedural controls which govern the flow of transactions through a system.*

4.0.3 *In order to achieve an effective system of internal controls, it is necessary to utilize the following principles for good management of cash generating functions:*

- A. *The organization structure should provide for segregation of functional responsibilities such as invoicing, receiving payments, and record keeping.*
- B. *The work environment must be conducive to safeguarding money. This includes proper office layout with counters, safes, cash registers, cashier cages, etc.*
- C. *Well qualified employees trained in cash handling techniques must be employed.*
- D. *There must be sufficient staff to permit designation of a limited number of persons to have access to cash and responsibility for cash handling duties.*
- E. *Sound practices and procedures must be established and followed in the performance of department functions.*
- F. *Where a work unit is not large enough to allow for the desirable segregation of duties or if the work environment does not permit the optimal physical facilities, the extent of management oversight must be increased commensurately.*

Audit Objective, Scope, and Methodology

The objective of our audit was to determine if the City of San José has an adequate and effective system of internal controls over the cash handling process. The genesis of this audit was a concern expressed by the City Manager regarding controls over the City's decentralized cash handling process.

To achieve our audit objective we reviewed other jurisdictions' audit reports and cash handling practices, and prior City of San José cash audit reports. We reviewed Citywide and departmental cash handling procedures. In order to test the City's internal control system over the cash handling process, we developed a checklist of audit tests based on the Cash Handling Management Principles listed above and best practices.

We selected a sample of 27 collection sites to visit and observe cash handling practices. The sample included:

- At least one site represented by each City department that handles cash;
- Those sites with the largest total deposits for the week of July 7-11, 2008; and
- Over 95 percent of that week's total deposit amount.

Decentralized Cash Handling

The list of selected sample sites is shown below.

1	Finance-Treasury-A/R
2	Finance-Cashiering
3	UBS-San Jose Water
4	Building
5	Airport-In House
6	DOT-Parking Citations
7	Finance-Payment Processing
8	UBS-General UBS Deposit
9	Building Permits-IDTS
10	Sports Program
11	Police Fiscal
12	Main Library
13	Berryessa Branch Library
14	Biblioteca Branch Library
15	Public Works
16	Berryessa Community Center
17	DPW Development Services
18	Lake Cunningham Park
19	GSA-Animal Services
20	Almaden/Woz Parking Lot
21	Housing
22	ESD-Muni Water
23	Convention Center Garage
24	Block 8 Parking Lot
25	Fire Administration
26	Fire Station 10
27	Fire Station 29

We interviewed personnel and performed 'checklist' tests at each of the above sites between July 13, 2009 and November 3, 2009; we also observed transactions, cash reconciliations, and deposit preparations at these sites. In addition, we reviewed Finance Department (1) results of spot audits of petty cash and change funds performed at selected sites in February 2009 and (2) draft procedures regarding reporting cash shortages and overages. Finally, we:

- Reviewed the City's RFP and subsequent Master Agreement with Wells Fargo Bank for new banking services;

- Reviewed agreements with vendors processing or providing the City software to process online payments; and
- Reviewed cash shortage reports for July 2004 through January 2009.

Audit Checklist, Testing, and Results

At each of the 27 City cash collection sites, we used the checklist to evaluate the adequacy of internal controls over the cash handling process, for example:

- Current written desk procedures on site?
- Secure location and limited access?
 - Locked safe?
 - Locked cashbox in locked drawer?
 - Keyed entry or limited access entry to cash handling areas?
- Protected counter areas with adequate security, including an alarm button and/or camera or video monitor?
- Organization structure provides for segregation of functional responsibilities?
- Proper and sufficient supervisory oversight and approval?
- Numbered controlled receipt for every payment?
- Receipts reconciled and deposits prepared daily and accurately?
- Secure credit card processing and transaction reporting?

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Finding I Internal Controls Over Cash Handling At Selected Sites Were Generally Sufficient But Some Citywide Cash Handling Procedures Need Updating

Our review found internal controls over cash handling at selected sites were generally sufficient and only a few exceptions were noted. However, some Citywide cash handling procedures are outdated, and compliance with the Payment Card Industry Data Security Standards (PCI/DSS) can be enhanced by (1) requiring vendors providing credit card processing software and services be pre-certified for PCI compliance, and that they submit quarterly or annual certifications of compliance and (2) developing Citywide policies and procedures to periodically assess PCI compliance at all distributed cash handling sites accepting credit cards. Furthermore, the City should ensure periodic spot audits of petty cash and change funds are conducted, and should update its 1986 cash shortage/overage procedure to increase the reporting threshold from \$50 to \$100 while implementing a reporting form on the Finance Department's intranet website to allow departments to easily file cash shortage/overage reports. In two related matters, we found that cash collections for bicycle licenses do not justify continuation of the program, and that the San José Police Department has a backlog of false alarm incident reports that have not been billed.

Sufficiency of Controls Over Cash Handling

Our review revealed that the internal controls over cash handling at the sites we tested were generally sufficient and only a few exceptions were noted. Specifically,

- Current written desk procedures for cash handling were present at 25 of 27 sites. The two sites lacking current desk procedures handle minimal amounts of cash (see page 14 of this report).
- Cash was kept in a secure location with limited access at every site – safes were locked; doors to areas containing safes were locked and only designated staff possessed keys to those areas; and cashboxes and/or deposit bags kept within safes were locked. However, we did find two sites that lacked locked cashboxes and we recommend they obtain cashboxes that may be securely locked (see page 15).
- Each site with a counter area had various combinations of cameras, video monitors, and alarm buttons as security measures. Furthermore, counter placement and width at most sites limited public access to the cash handling areas.

- Only 1 of 27 sites lacked an organization structure large enough to provide for segregation of duties and also to allow for proper supervision. A large portion of the services at that site have been moved to City Hall, and the Administration is considering moving the rest of this function to City Hall as well.
- The use of computer systems and computerized cash registers ensures that numbered and controlled receipts are issued for every payment transaction.
- At 1 of 27 sites we found that receipt reconciliation and deposit preparation was not performed on a daily basis. Specifically, staff at this site had a backlog of approximately a week's worth of receipts. The Finance Department sent one Payment Processor to this site for one week to help them clear the backlog, and they are now current.
- At all sites accepting credit card payments staff followed departmental desk procedures for payment processing.

Appendix B shows the results of our observations and testing, with all exceptions noted.

Some Citywide Cash Handling Procedures Are Outdated

Our review revealed that some general Citywide procedures for cash handling and revenue collection are outdated and do not consistently and accurately describe current systems and practices. Sections 4.0 through 4.6 in the Finance Administrative Manual address general cash management principles, accounts receivable, check processing, collection and safeguarding of revenue, revenue recording, cash overages and shortages, and miscellaneous receivables. The effective date shown on each these procedures is April 1986, except for the section pertaining to accounts receivable. Although the accounts receivable section was revised in July 1999, it will soon become outdated as well, as it refers to entering revenues into the City's VAX billing system, which is currently being phased out.

Some of the outdated practices in the procedures include:

- Section 4.6 "Miscellaneous Receivables" requires the Finance Department, upon being informed and receiving documentation regarding a new receivable, to prepare a manual index card for the receivable and post payments received on the card. Current practice is to enter this information into a computer system.
- Section 4.4 "Revenue Recording" requires that the Treasury Division receives all revenues for reconciliation which are then stored for armored car pickup the following day. Current practice is that the

armored car service collects prepared deposits from most individual sites according to a weekly schedule and delivers the deposits directly to the bank.

In our opinion, in order to ensure the City receives, safeguards, and deposits all revenues to which it is entitled, policies and procedures should reflect and accurately describe current processes, practices, and requirements for payment processing and cash handling.

According to the Director of Finance, the department has already begun updating payment processing and cash handling procedures.

We recommend that the Finance Department:

Recommendation #1

Complete the update of Finance Administrative Manual Sections 4.0 through 4.6 procedures governing cash handling and revenue collection. (Priority 3)

Compliance With Payment Card Industry Data Security Standards

According to the Payment Card Industry Security Standards Council, the Payment Card Industry (PCI) Data Security Standards (DSS) were developed to encourage and enhance cardholder data security and facilitate the broad adoption of consistent data security measures globally. The basic standards are to:

- Build and Maintain a Secure Network
- Protect Cardholder Data
- Maintain a Vulnerability Management Program
- Implement Strong Access Control Measures
- Regularly Monitor and Test Networks
- Maintain an Information Security Policy

Desk Procedures Were Followed At Sites Processing Credit Card Payments

Staff at four of the sites in our sample handled credit card transactions. Parks, Recreation, and Neighborhood Services (PRNS) accepts credit cards for class registrations and facility rentals. The Office of Parking Violations customer service representatives accept credit card payments from both walk-in customers and over the telephone. The Building Permits section staff accept credit cards for all types of permits. Airport vendors accept credit cards for food and beverages and concessions. At each of the sites we tested we found that:

- Current desk procedures for the system were located at each site for credit card payment processing; and
- Unique passwords had been created for each person with computer access.

Although we found desk procedures for processing credit card payments were located at each site, we also found that Citywide policies and procedures requiring PCI compliance at sites accepting credit cards have not been developed.

The City Has Contracted with Vendors to Process or Provide Software to Process Credit Card Payments

The City has contracted with several vendors to process or develop software to process payments for those City sites accepting credit cards. ActiveNet/ PaymentTech, CyberSource, and Rocky Mountain Bankcard System provide services to PRNS, the Building Permits section, and the Airport, respectively. Turbo Data Systems, Inc., processes the City's parking citations.

PCI/DSS standards require vendor and software compliance. This includes installing and maintaining firewall configurations to protect cardholder data; encrypting transmission of cardholder data across open, public networks; developing and maintaining secure systems and applications; and regularly testing security systems and processes. In April 2008, the City entered into an agreement with VeriSign to perform an information security audit and by September 2008 the Information Technology Department drafted a Security Framework document. Further, the City underwent a thorough review by Wells Fargo Bank before entering into the new banking relationship in June 2009.

To further strengthen controls over credit card payments, we recommend that the City Administration:

Recommendation #2
Develop Citywide policies and procedures to require and periodically assess Payment Card Industry compliance at all distributed cash handling sites accepting credit cards. (Priority 3)

Recommendation #3
Require vendors providing credit card processing software and services be pre-certified for Payment Card Industry compliance, and submit quarterly or annual Payment Card Industry certifications of compliance to the City's Information Technology Chief Security Officer and department contract managers. (Priority 3)

Spot Audits of Petty Cash and Change Funds

The Finance Administrative Manual requires departments to provide for periodic spot audits of all cash handling locations and field collections. An employee in the department's administrative fiscal unit could perform such an audit. The results of these audits must be reported to the Department Director. Major exceptions must be reported to the Director of Finance and the City Auditor.

Prior audit reports the City Auditor issued between 1998 and 2002 found that spot audits were not routinely conducted and recommended that they be performed. Specifically, in June 1998, the City Auditor audited the PRNS Petty Cash and Change funds, found that spot audits were not being performed in that department, and recommended the spot audits be completed. Since that time, PRNS has been performing and documenting audits of cash funds, safes, and safe logs at their community centers. The audits are conducted annually, by either PRNS fiscal staff or community center supervisors, using a 'checklist approach'. For example, some items on PRNS' checklist include: verifying sites have a procedures manual, proper forms, safe combination acknowledgment forms, and the current fiscal year signature log; checking that the safe is locked; and, if the site has a cash register, that it is balanced and emptied daily.

The Finance Department drafted task lists and fieldwork procedures for conducting petty cash and change fund audits, and conducted spot audits of selected petty cash and change funds in February 2009. Minor exceptions were noted; departments took corrective actions and informed Finance in writing by July 2009.

In our opinion, the Finance Department should:

Recommendation #4

Complete the update of procedures for conducting spot audits of petty cash and change funds, and clarify roles and responsibilities for conducting the audits. (Priority 3)

The City's 1986 Finance Procedure That Requires Investigating and Reporting Cash Shortages of \$50 or More Has Never Been Revised

A Finance procedure written in 1986 requires City staff, when there is a shortage of \$50 or more, to give verbal notification immediately to the Department Director and to the Director of Finance. Further, within three working days, the affected department must prepare a written report describing the occurrence to the Director of Finance with copies to the City Manager and the City Auditor. Finally, if theft is suspected in a cash shortage of \$50 or more, the department must file a police report.

We reviewed the 19 cash shortage memoranda reporting shortages of more than \$50 from 2004-05 to the present. During that five year period, 12 of the shortages over \$50 occurred in PRNS. According to PRNS, several staff must devote significant time to report on and investigate cash shortages over \$50. Staff from the fiscal unit, visit the site where the shortage occurred to conduct interviews, investigate, and re-train staff, if necessary. Staff at the site of the shortage spend time investigating the shortage and filing police reports when appropriate. Additional time is spent writing a formal cash shortage report. Our review of those reports revealed they are quite lengthy, may undergo multiple revisions at several department levels, and sometimes result in additional follow-up reports as well.

In our opinion, although any amount of public funds lost is of concern, changing the procedure to increase the cash shortage threshold above \$50 would decrease the amount of time PRNS staff, and staff in other City departments where shortages might occur, would need to devote to reporting and investigating shortages.

The \$50 Reporting Threshold Should be Increased to Reflect the Rate of Inflation

The Consumer Pricing Index (CPI) measures the change in the price of goods over time and the change in the index is referred to as the rate of inflation. According to the Federal Bureau of Labor Statistics CPI calculator, \$50 in 1986 equals nearly \$99 in 2009 – close to a 100 percent increase. Based on the fact that the CPI has doubled from 1986 - when the City's procedure was put in place - to 2009, in our opinion it is appropriate to increase the cash shortage reporting threshold from \$50 to \$100. Doing so could reduce the amount of time that PRNS and other departments spend preparing memoranda for and investigating cash shortages. In addition, implementing a form to report cash shortages could reduce the length of cash shortage reports as well as the staff time spent to produce them.

The Finance Department Should Consider Implementing a Form and Simplified Process to Report Cash Shortages

The Finance Department has drafted updated procedures and a simplified form to report cash shortages and overages. While every cash overage and shortage is reported, as discussed above, our review found that writing detailed cash shortage reports when theft is not suspected consumes the time of multiple staff, primarily in PRNS. In addition, the cash shortage reports can be quite lengthy, often devoting four or more pages to describing the situation where \$50 was missing, lost, or stolen.

We recommend that the Finance Department:

Recommendation #5

Complete the update of the 1986 cash shortage/overage procedure to increase the reporting threshold from \$50 to \$100, and implement a reporting form on the Finance Department's intranet website to allow departments to easily file cash shortage/overage reports. (Priority 3)

Cash Collections for Bicycle Licenses Do Not Justify Continuation of the Program

City of San José Municipal Code Requires Bicycle Licenses

The State of California Department of Motor Vehicles (DMV) Vehicle Code (VC) allows counties and cities to regulate the registration of bicycles operated within their jurisdictions. Accordingly, in September 1974, the City Council adopted an ordinance to add a section to the San José Municipal Code to regulate bicycle licensing. Section 11.72.020 (formerly Section 3401) reads as follows:

No resident of the city shall operate any bicycle upon any street, road, highway or other public property within the jurisdiction of the city unless such bicycle is licensed in accordance with the provisions of this chapter.

Additionally, Section 11.72.030 authorizes both the San José Police Department and Fire Department to license bicycles and collect license fees. Section 11.72.040 states

The fee for bicycle licenses shall be as set forth in the schedule of Fees established by resolution of Council.

A series of ordinances the City Council adopted between 1975 and 1980 established and then either increased or decreased fees. Fees established when the City Council adopted Ordinance 19976 in February 1980 remain the same today. Specifically, bicycle licenses may be purchased for periods of one, two, or three years for \$2, \$4, and \$6, respectively, and a 3-year renewal license is \$3.

However, our review revealed that the San José Police Department no longer licenses bicycles. Instead, the Police Department Permits Division obtains registration forms and bicycle license stickers from the DMV and distributes these materials to fire stations upon request. The Permits Division provides only 25 forms and stickers annually to each fire station requesting them.

Bicycle Records Database

The primary reason for licensing bicycles is to facilitate recovery of lost or stolen bicycles. The DMV Vehicle Code instructs jurisdictions that license bicycles to develop and maintain a database of bicycle owners and license numbers for this purpose. According to the Permits Division, the SJPJ Juvenile Division was supposed to create a database several years ago to enter all the licensing information to facilitate recovery of stolen bicycles. The fire stations were supposed to remit their documentation to SJPJ for input into the database. However, the SJPJ never created the database, citing lack of staffing as the reason.

Fire Administration Site Visit

One of the sites selected for our sample was Fire Administration, but when we performed the site visit we found that Fire Administration staff do not handle cash. However, we were informed that cash was collected at fire stations when citizens came in to license their bicycles. Fire Administration also mentioned that the department had not set up cash boxes at the stations for bicycle license sales because requests to register bicycles were so infrequent and minimal amounts of cash were handled. In order to review Fire Department controls over cash handling, we included two fire stations in our sample of sites reviewed.

Site Visits to Station 10 and Station 29

Site visits to Station 10 and Station 29 were conducted and we found, as Fire Administration reported, neither station had a locked cash box. Both stations kept logs of bicycle license registrations – in 2008-09, Station 10 sold 1 license and Station 29 sold 8 licenses.

Fire Department personnel at both stations believe the reason so few bicycles are registered and licensed is because citizens are not aware of the requirement to do so. In fact, during 2008-09, the City received only \$636 in bicycle license fees. If the population of San José was aware of requirements and properly registered bicycles they purchased, the City's General Fund could receive additional revenue.

Approximately 22,000 Bicycles Sold in San José in 2008

According to a study by the Coffrin Group, a San José-based business consultant to bicycle and electric vehicle industries, 34 retail firms selling bicycles in San José reported sales on average of 650 bicycles in 2008, approximately 22,000 total. If the \$6 licensing fee had been collected for each bicycle sold, the City would have received approximately \$132,000.

According to Staff, Creating a Database is Not Cost Effective

The SJPD would need to create a database of bicycle sales information to be able to collect license fees and facilitate recovery of lost or stolen bicycles. However, SJPD staff informed us that the cost to create and maintain such a database would cost much more than the City could realize in bicycle license fee revenue.

We recommend that City Administration:

Recommendation #6

Either enforce the ordinance the City Council enacted requiring bicycle licensing, or recommend the City Council repeal the ordinance. (Priority 3)

Further, we recommend that Fire Administration should:

Recommendation #7

If fire stations continue to collect fees for bicycle licenses, obtain locked cashboxes for fire stations. (Priority 3)

The San José Police Department Has a Backlog of False Alarm Incident Reports That Have Not Been Billed**The False Alarm Incident Report Program**

The San José Police Department (SJPD) cites residents or business owners for responses to false alarms. In 2009-10, the schedule of fines was increased. According to the SJPD, the restructuring of the false alarm fine schedule is expected to generate \$661,000 in new revenue to the General Fund, with ongoing revenue of \$881,000.

False Alarm Incident Report Backlog

The False Alarm Incident Report Program (FAIR) located in the Permits Division of the SJPD receives the false alarm incident reports and enters them into a database for billing and collection. When we performed our site visit at the Permits Division we noted that, as of October 2009, false alarm incident reports the FAIR Program received since April 2009 had not been entered into the database. According to the FAIR Program coordinator, the absence of one of three staff members performing data entry was one cause of the backlog.

The San José Police Department is Implementing Updated Software for False Alarm Tracking and Billing

The SJPD applied for grant funds to update software to track and bill for false alarm fines and expected full implementation by October 2009 when the grant was approved and the software was fully implemented. However, software updates have been delayed and the department has suspended entering false alarm incident reports into the current database pending full implementation in February 2010.

We recommend that the San José Police Department:

Recommendation #8

Ensure system software is fully implemented and enter false alarm incident reports into the database to bill for false alarm fines on a timely basis. (Priority 3)

Memorandum

TO: Sharon Winslow Erickson
City Auditor

FROM: Scott P. Johnson
Director of Finance

**SUBJECT: ADMINISTRATIONS RESPONSE
TO "DECENTRALIZED CASH
HANDLING AUDIT"**

DATE: February 10, 2010

Approved



Date

2/10/10

BACKGROUND

The Administration has reviewed "*Decentralized Cash Handling Audit*" (the Audit) and is in agreement with the findings and recommendations made by the City Auditor's Office.

In accordance with the City Auditor's 2009-10 Audit Workplan, a citywide Audit of Decentralized Cash Handling was completed. The Administration appreciates the analysis, observations and recommendations from the City Auditor.

The Finance Department, as the primary department responsible for implementing and monitoring internal controls and procedures to safeguard the City's assets is in agreement with the City Auditor that the proper safeguarding and reporting of monies is of critical importance to the organization and we are encouraged that the Audit revealed internal controls over cash handling at selected sites were generally sufficient.

The City is a complex organization with a multitude of revenue streams and a variety of payment methods. The City Administration, in conjunction with balancing City operating budgets over the past eight years with appropriate controls and procedures in place to mitigate risks has consistently developed processes and procedures that streamline operations and improve operational efficiencies. A recent action approved by the City Council on May 5, 2009 was the City's new banking agreement with Wells Fargo Bank effective on June 1, 2009. The new banking relationship brought enhanced Treasury technology to the City which will not only create cash handling efficiencies and process improvements, but also increase transparency and enhance security in the City's cash handling processes, city-wide.

It should also note that the Finance Administrative Manual was the primary document used to centralize citywide financial policies and procedures. However, in recent years the Finance



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Department has been transitioning the posting of updates of Finance policies from the Finance Administrative Manual to the Finance intranet site that hosts the City's Policy Manual (available on the Office of Employee Relations intranet site) as appropriate. The Finance intranet site and City Policy Manual provides a better platform for the widespread dissemination throughout the organization of citywide policies and procedures. In this effort, over the past several years the The Finance Department has made great strides in updating a number of City-wide Finance policies such as Employee Travel Policy, Procurement Card Policy, Meals and the Reimbursement Policy for inclusion in the City Policy Manual.

In addition, prior to this audit and in conformance with a recent governmental accounting pronouncement, the Finance Department, retained the consulting services of the Government Finance Officers Association (GFOA) to review the Finance Department's documented desk procedures and related policies and procedures and to make recommendation on best practices of Finance related functions in an effort to update the Department's comprehensive desk procedures manual and related finance policies and procedures. The GFOA should be concluding its review and distribution of the comprehensive manual to the Finance Department in the spring of 2010.

The Administration will continue to ensure that cash handling practices citywide evolve with the introduction of new technologies, reflect the best practices of a modern Treasury management practices, and are documented and incorporated into the City's Policy Manual as appropriate and the necessary training is providing to the organization to ensure appropriate internal controls, polices and procedures are followed to safeguard the City's assets.

Below is a discussion on each specific recommendation:

Recommendation # 1: Complete the update of Finance Administrative Manual Sections 4.0 through 4.6 procedures governing cash handling and revenue collection. (Priority 3)

The Administration agrees with this recommendation. In order to ensure the City receives, safeguards, and deposits all revenues to which it is entitled, Finance staff will continue the recent project with the GFOA as noted above to update and improve, policies and procedures that reflect the City's new banking relationship and treasury best practices.

The City's new bank provider will be performing an "ethnographic" study. This study consists of bank product subject matter experts observing, on site, the way city staff interfaces with and functions on a day-to-day basis with the new banking technologies and products. At the end of the evaluation period the bank will provide the Finance Department with recommendations to adapt safeguards specific to their bank product mix. In addition, Finance staff will ensure that as cash handling desk procedures are updated they are incorporated into either the Finance Administrative Manual or the City Policy Manual as appropriate.

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Recommendation #2: Develop citywide policies and procedures to require and periodically assess Payment Card Industry compliance at all distributed cash handling sites accepting credit cards. (Priority 3)

The Administration agrees with this recommendation and has already begun working on a citywide security policy. The policy is currently in draft form and the draft policy has been sent to City stakeholders for review and approval. In addition, several credit card systems are being reviewed internally by the Information Technology (IT) Department and the system owner departments. IT anticipates performing another 3rd party audit at the end of the internal review. As part of IT's security review, funds have already been appropriated for the 3rd party audit.

Recommendation #3: Require vendors providing credit card processing software and services be pre-certified for Payment Card Industry compliance, and submit quarterly or annual Payment Card Industry certifications of compliance to the City's Information Technology Chief Security Officer and department contract managers. (Priority 3)

The Administration agrees with this recommendation. The IT Department, working in conjunction with Finance, has already begun requiring that new credit card processing systems provide appropriate proof of PCI compliance prior to award of contract. The IT and Finance Departments will continue to work together in reviewing existing contracts and developing an on-going compliance review on a periodic basis. The required reporting frequency will be defined by the Payment Card Industry (PCI) Council auditing requirements. The IT department will require reporting from vendors to the City on a scheduled basis as defined by the PCI Council.

Recommendation #4: Complete the update of procedures for conducting spot audits of petty cash and change funds, and clarify roles and responsibilities for conducting the audits. (Priority 3)

The Administration agrees with this recommendation. In order to ensure the City safeguards all monies distributed to approved City departments, Finance staff will continue the recent project to update, and improve, policies and procedures that reflect best practices. In addition, as cash handling desk procedures are updated, Finance staff will ensure that they are incorporated into either the Finance Administrative Manual or the City Policy Manual as appropriate.

It should be noted that prior to this audit the Finance Department initiated updating the petty cash procedure and shared its draft with the City Auditor. Finance believes that input from the City

Auditor, in conjunction with the proposed draft procedure, will result in enhanced cash handling service delivery.

Recommendation #5: Complete the update of the 1986 cash shortage/overage procedure to increase the reporting threshold from \$50 to \$100, and implement a reporting form on the Finance Department's intranet website to allow departments to easily file cash shortage/overage reports. (Priority 3)

The Administration agrees with this recommendation. In order to ensure that City monies are properly accounted for, and any loss of monies thoroughly investigated, Finance staff will continue recent projects to update, and improve, policies and procedures that reflect best practices yet don't unnecessarily burden reporting departments.

It should be noted that prior to this audit the Finance Department initiated updating the cash overage/shortage procedure and shared its drafts with the City Auditor. Finance believes that input from the City Auditor, in conjunction with the proposed draft procedure, will result in enhanced cash handling service delivery.

Recommendation #6: Either enforce the ordinance the City Council enacted requiring bicycle licensing, or recommend the City Council repeal the ordinance. (Priority 3)

The Administration agrees with this recommendation. The City Administration understands, and agrees, that any ordinance enacted by the City Council should be implemented; however, implementation can be impacted by the amount of resources dedicated to support directives, competing priorities, established procedures, and/or level of training provided to staff. In this instance, it appears that the lack of proper implementation for bicycle licensing is multi-faceted (e.g., outreach/awareness, procedures, resources, etc.). As noted in Recommendation #7, locked cashboxes have been provided to all Fire Stations with the exception of Fire Station 20. This enabled improved process for the collection of fees; however, it does not address the low volume of bicycle licenses that were noted in the Audit. In our changing environment, largely impacted by the City's fiscal condition, the City Council should consider repealing the Ordinance since it is very likely that other priorities will weigh more heavily than increasing the volume of bicycle licensing.

Recommendation #7: If fire stations continue to collect fees for bicycle licenses, obtain locked cashboxes for fire stations. (Priority 3)

The Administration agrees with this recommendation. Locked cashboxes have been provided to all Fire Stations with the exception of Fire Station 20. Fire Station 20 is located at the Airport, and does not issue bicycle licenses or receive cash.

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Recommendation #8: Ensure system software is fully implemented and enter false alarm incident reports into the database to bill for false alarm fines on a timely basis. (Priority 3)

The Administration agrees with this recommendation. The Police Department concurs with the recommendations pertaining to false alarms. Several department members have been reassigned to the project as part of a team effort to achieve billing. Team members are verifying addresses, creating a new false alarm citation and trouble shooting procedural issues which have been identified and are contributing to the backlog. The new citation is being created this week in order to start billing within the next seven days. Billing will be coordinated with the Finance Department.

COORDINATION

This report was prepared by the Finance Department and in coordination with the departments of Parks Recreation and Neighborhood Services, Information Technology, Fire, Police, and the City Manager's Office.

CONCLUSION

The Audit has surfaced valid areas for improvement and the recommendations address the need for revising and improving our practices and procedures with respect to cash handling citywide. Proactive action will be taken to thoroughly address the above recommendations over the coming months. The Administration would like to thank the City Auditor's Office for the depth and thoroughness in conducting this audit.


SCOTT P. JOHNSON
Director of Finance



APPENDIX A

DEFINITIONS OF PRIORITY 1, 2, AND 3 AUDIT RECOMMENDATIONS

The City of San Jose's City Policy Manual (6.1.2) defines the classification scheme applicable to audit recommendations and the appropriate corrective actions as follows:

Priority Class¹	Description	Implementation Category	Implementation Action³
1	Fraud or serious violations are being committed, significant fiscal or equivalent non-fiscal losses are occurring. ²	Priority	Immediate
2	A potential for incurring significant fiscal or equivalent fiscal or equivalent non-fiscal losses exists. ²	Priority	Within 60 days
3	Operation or administrative process will be improved.	General	60 days to one year

¹ The City Auditor is responsible for assigning audit recommendation priority class numbers. A recommendation which clearly fits the description for more than one priority class shall be assigned the higher number.

² For an audit recommendation to be considered related to a significant fiscal loss, it will usually be necessary for an actual loss of \$50,000 or more to be involved or for a potential loss (including unrealized revenue increases) of \$100,000 to be involved. Equivalent non-fiscal losses would include, but not be limited to, omission or commission of acts by or on behalf of the City which would be likely to expose the City to adverse criticism in the eyes of its citizens.

³ The implementation time frame indicated for each priority class is intended as a guideline for establishing implementation target dates. While prioritizing recommendations is the responsibility of the City Auditor, determining implementation dates is the responsibility of the City Administration.

APPENDIX B

Results of Site Visit Observation and Testing

SELECTED SITES	Current written desk procedures on site?	Secure location and limited access?			Protected counter areas with adequate security, may include alarm button and/or camera video monitor?	Organization structure provides for segregation of functional responsibilities?	Proper and sufficient supervisory oversight and approval?	Numbered controlled receipt issued for every payment?	Receipts reconciled and deposits prepared daily and accurately?	Secure credit card processing and transaction reporting?
		Locked Safe?	Locked cashbox in locked drawer?	Keyed/Limited access entry to cash handling areas?						
1 Finance-Treasury-A/R	Y	(2)	(3)	Y (4)	Y	Y	Y	Y	Y	
2 Finance-Cashiering	Y	Y	Y	Y	Y	Y	Y	Y	Y	
3 UBS-San Jose Water	Y	(2)	(3)	Y (4)	Y	Y	Y	Y	Y	
4 Building	Y	Y	Y	Y	Y	Y	Y	Y	Y	
5 Airport-In House	Y	Y	Y	Y	Y	Y	Y	Y	Y	
6 DOT-Parking Citations	Y	Y	Y	Y	Y	Y	Y	Y	Y	
7 Finance-Payment Processing	Y	(2)	(3)	Y (4)	Y	Y	Y	Y	Y	
8 UBS-General UBS Deposit	Y	(2)	(3)	Y (4)	Y	Y	Y	Y	Y	
9 Building Permits-IDITS	Y	(2)	(3)	Y	Y	Y	Y	Y	Y	
10 Sports Program	Y	Y	Y	Y	Y	Y	Y	Y	Y	
11 Police Fiscal	Y	Y	Y	Y	Y	Y	Y	Y	Y	
12 Main Library	Y	Y	Y	Y	Y	Y	Y	Y	Y	
13 Berryessa Branch Library	Y	Y	Y	Y	Y	Y	Y	Y	Y	
14 Biblioteca Branch Library	Y	Y	Y	Y	Y	Y	Y	Y	Y	
15 Public Works	Y	(2)	Y	Y (4)	Y	Y	Y	Y	(5)	
16 Berryessa Community Center	Y	Y	Y	Y	Y	Y	Y	Y	Y	
17 DPW Development Services	Y	Y	Y	Y	Y	Y	Y	Y	Y	
18 Lake Cunningham Park	Y	Y	Y	Y	Y	Y	Y	Y	Y	
19 GSA-Animal Services	Y	Y	Y	Y	Y	Y	Y	N	Y	
20 Almaden/Woz Parking Lot	(1)	(2)	(3)	Y (4)	Y	Y	Y	Y	Y	
21 Housing	Y	(2)	(3)	Y (4)	Y	Y	Y	Y	(5)	
22 ESD-Muni Water	Y	Y	Y	Y	N	N	Y	Y	Y	
23 Convention Center Garage	Y	Y	Y	Y	Y	Y	Y	Y	Y	
24 Block 8 Parking Lot	Y	Y	Y	N*	Y	Y	Y	Y	Y	
25 Fire Administration	Y	Y	Y	Y (4)	Y	Y	Y	Y	(5)	
26 Fire Station 10	N	(2)	N	Y (4)	Y	Y	Y	Y	(5)	
27 Fire Station 29	N	(2)	N	Y (4)	Y	Y	Y	Y	(5)	

(1) Surface parking lot with no operator on duty.
 (2) Safe not needed at this site.
 (3) Cash box not needed at this site.
 (4) Designated counter area not necessary for this site.
 (5) Site does not accept credit cards
 * During peak weekend hours, SJPD provides a presence at this site.