



Philip J. LaTessa
City Auditor

CASH & INVESTEMENTS AUDIT
OCTOBER 1, 2005 – DECEMBER 31, 2005

Introduction:

As required under Article V, Section 5-503, of the Charter of the City of Syracuse, the annual audit of the City of Syracuse's cash and cash equivalents activity for the period October 1, 2005 through December 31, 2005 was conducted. The purpose of this audit is to review cash and investment activity as set forth in the City of Syracuse Investment Policy and the City of Syracuse Charter, as adopted by the Common Council. The examination was administered in accordance with the *Generally Accepted Government Auditing Standards*, issued by the Comptroller General of the United States and *Standards for the Professional Practice of Internal Auditing*, as circulated by the Institute of Internal Auditors.

These standards require that we plan and perform the examination to afford a reasonable basis for our judgments and conclusions regarding the organization, program, activity or function under examination. It was not our objective to, and we do not, express an opinion on the financial statements of the City of Syracuse, New York, or provide assurance as to either the City's internal control structure or the extent of its compliance with statutory and regulatory requirements and guidance of the Office of the State Comptroller.

The management of the City of Syracuse, New York, is responsible for the City's financial affairs and for safeguarding its resources. This responsibility includes establishing and maintaining an internal control structure to provide reasonable, but not absolute, assurance that resources are safeguarded against loss from unauthorized use or disposition; that transactions are executed in accordance with management's authorization and are properly recorded; that appropriate financial records are prepared; that applicable laws, rules and regulations are observed; and that appropriate corrective action is taken in response to audit findings.

This report is intended solely for the information of the Mayor and Common Council of the City of Syracuse, New York, yet it is understood to be a matter of public record and its distribution is not limited. Further information regarding this audit is available at the City of Syracuse's Audit Department upon request. The Audit Department would like to thank the personnel who assisted and cooperated with us during the audit.

Scope:

The scope of the examination entailed reviewing the bank statements, collateralized deposit data, general ledger and related records for the period October 1, 2005 through December 31, 2005.

Objectives:

The original objectives of the cash and investment audit were as follows:

1. Determine whether the cash balances represent all cash and cash items on hand, in transit to or in financial institutions and are properly recorded.
2. Determine whether funds are properly collateralized.
3. Assess the cash balances in non-interest bearing accounts.

Methodology:

To reach the assurance that the cash balances represented all cash items on hand, in transit to or in appropriate financial institutions and properly recorded, and that all investments and cash funds are properly collateralized, the Department of Audit tested the City's cash and cash equivalents activity for each month in the audit period. For the liquid asset (cash) accounts belonging to the City departments, the Department of Audit tested the information found on the Bank Reconciliations and Schedules of Collateral to the corresponding bank and collateral statements via the financial institutions. Once the proper figures were determined, they were traced to the general ledger detail to ensure all cash items were properly represented and recorded. The collateralized funds were recalculated to ensure accuracy.

For the City's cash equivalent (investment) accounts, the figures found in the City's general ledger were checked to the appropriate supporting documentation from the financial institution to ensure proper representation and recording.

The Department of Audit interviewed Finance Department staff, including the Systems Accounting Manager, with the purpose of getting a fuller understanding of the influences affecting the timeliness of the reconciliations done as a part of cash management.

Conclusion:

With reasonable assurance, it was determined that the City's cash and cash equivalent balances were free from material misstatements for the period October 1, 2005 through December 31, 2005. Excluding the errors noted below, the Audit Department was also reasonably assured that all city accounts were properly collateralized.

Auditor's Note:

On April 24, 2006, the Audit Department issued the cash and investments audit report for the period from July 1, 2005 through September 30, 2005, covering the first quarter of 2005/06 fiscal year. That audit included mention of a finding reported on other occasions during the auditing of the city's cash and investments for FY 2004/05. The specific finding pertains to the large compensating balance retained at JP Morgan Chase Bank; this finding remains an outstanding issue and continues to raise the same concerns on the part of the Department of Audit as previously stated.

Background:

As noted in the objectives for the cash and investment audit for the period of July 1, 2005, through September 30, 2005, the large and relatively unchanging balance in the city's JP Morgan Chase Bank Account-Chase General Account #99.01.301.01 has been given closer scrutiny due to the substantial size of the balance and the non-interest bearing nature of this particular account. The Chase Bank Account carried a ten million dollar balance in the period from July through September 2005, with no activity affecting the balance. This pattern was repeated in the period from October through December 2005.

Initially, these findings raised questions as to why the City would leave such large amounts of cash in accounts with virtually no activity and not producing any interest earnings for the City. The explanation provided by the Finance Department relates to the fact that this JP Morgan Chase Bank Account is a compensating balance bank account. Compensating balances are balances held

in accounts that generate no interest earnings and are used by the bank in lieu of charging for a specified set of services.

JP Morgan Chase was selected in February 2003, based on a Request For Proposal (RFP) to provide lockbox services to the City relative to the collection of taxes, parking tickets and water billing. The responses received to the RFP, from JP Morgan Chase, M&T and Fleet Banks, were reviewed by a Request For Proposal Committee and a recommendation to select Chase Bank was made to the Mayor, approved by him and was about to be submitted to the Council for approval when the Law Department determined that the Commissioner of Finance had the authority to negotiate the contract and that Council approval was not required. The Commissioner of Finance communicated to JP Morgan Chase Bank the city's intention of retaining the bank for the lockbox services; and although they were already the financial institution providing the services at that time, their response to the RFP was, by far, the lowest. At that time, the City also negotiated the arrangements whereby the lockbox services were to be paid for by using compensating balances to off-set the cost rather than actually charging the city for the various lockbox transactions times the specific per-item fee.

The RFP that was advertised by the City for lockbox services was for a two year period, but our research was unsuccessful in generating a copy of a signed contract between the City of Syracuse and JP Morgan Chase Bank from either the Office of the Corporation Counsel, Office of Budget and Management, Division of Purchase, or the Department of Finance. A communication from the Commissioner of Finance to a Vice President at JP Morgan Chase, dated March 14, 2003, was located which stated that JP Morgan Chase had been awarded the lockbox services contract for a two-year period at the prices quoted in the bid sheet submittal. The city has continued to utilize the services of JP Morgan Chase for lockbox services up to and including the period covered by the audit.

Per the RFP, the estimated number of items to be run through the lockbox was: 196,000 tax payment items, 32,000 parking ticket items and 96,000 water billing items. The pricing submitted by JP Morgan Chase for the handling of payments provided various fees dependent on the need to process manually, using a bar-code and using a bar-code feature plus electronic data interchange.

For the processing of the tax payments, the City's tax stubs do contain a feature permitting electronic scanning (Optical Character Recognition). The tax bills sent out by the City, as the agent for the collection of Onondaga County's taxes do not include the electronic scanning feature. Due to the fact that almost all City and County taxes (two different coupons) are paid by one check, it is not possible to process the City coupon by scanning and the County coupon manually. However, JP Morgan Chase Bank has been charging the lower scanning fee for both City and County coupons.

The water bill stubs are OCR coded and the City is charged the lower rate for the water payments processed through the lockbox. The parking ticket stubs received at the lockbox are manually processed due to the fact that the nature of the instrument (the tickets that are sent in with the associated payments) prohibits electronic scanning, frequently being exposed to elements such as rain, snow, etc, therefore limiting the use of the more advanced technology.

The current fess being charged by the bank is \$0.345 for tax coupons and water stubs, and \$0.74 for parking ticket stubs. The Finance Department personnel interviewed while researching this topic stressed several points regarding the current relationship with JP Morgan Chase and the unusually large amounts retained in the Chase General Account:

1. The large amount that was held in the Chase General Account was a reflection of extremely low interest rates in the market during 2005 compounded by the extremely long time that rates were at these all-time lows. Indeed, at the end of the calendar year 2005, these large balances were still insufficient, per the analysis, to provide adequate coverage of the services. However, JP Morgan Chase waived the difference.

2. The City had experienced several problems with the previous lockbox contract that had caused major problems for the City in tracking and counting for property tax payments. Chase Bank had provided assistance to the City in the middle of these problems and done a lot to correct the difficulties.

3. Chase Bank had operated in a way that was beneficial to the City by using compensating balances as the basis for recovering its cost as opposed to paying interest on the balances and charging the fee provided for by means of the RFP. Since banks are driven by balances rather than a profit/loss statement, it is more in their interest to have the moneys sitting in the account; this benefit translates to a better pricing being made available back to the City.

4. Recognizing the benefits noted in Number 3, Chase Bank was willing to offer the City the benefit of the scanning price for County coupons and waive the insufficient account balances at year-end.

The Finance Commissioner has responded to questions regarding the arrangement between the City and Chase Bank by strongly recommending that before another Request For Quotes is advertised by the City, technological considerations and advancements need to be implemented to provide an environment where true competitive submittals are turned into the City for evaluation. Such prerequisite modifications would include altering the county property tax payment stubs so they could be electronically scanned, and modifying the current system whereby the City supplies JP Morgan Chase Bank, as the lockbox service provider, with the data files to be used for tax collection verification on spool tapes; such antiquated technology has drastically restricted the number of banks with lockbox-processing facilities in the central New York area from responding to the City's solicitation for lockbox services.

Findings and Recommendations:

Finding 1: City Could Have Opportunity To Reduce Compensating Balance Amounts With Investment Made To Upgraded Technology

This is a finding previously reported in several prior audits.

The antiquated technology currently used by the City has restricted the number of banks capable of providing the City with some of the financial services used by the City, which may have created higher costs to local government through the lessening of competition.

Recommendation: It is the conclusion of the Department of Audit that the City of Syracuse would have the potential to benefit from investments made by the City for the improvement of the

technology related to the handling of data and data passed onto external institutions. This type of investment will create a more competitive environment for solicitation of services, the lockbox services being an excellent example, where a larger number of prospective respondents will be able to provide the services being sought by the City.

Management Response: The Finance Department has asked the Department of Information Systems to upgrade the electronic exchange of information to a process of Internet or email transmittal rather than the current antiquated system of tapes. Also, the City is considering printing the County's taxpayer bills at the City to take advantage of the larger coupons, which would avail themselves to scanning.

Finding 2: Investments Held By Key Bank Under-Collateralized In December 2005

It was found that the collateral provided by Key Bank did reach the required 102 % level and was understated by \$247,865. There was no explanation available as to the problem with Key Bank's error and it was noted by the accounting staff that Key bank's failure appeared to be a continuation of the lack of an automated system in determining the City's collateralization amounts.

Recommendation: The Finance Department should implement closer reviews of the monthly collateral summaries to ensure that all banks are in compliance with the collateralization requirements of the City of Syracuse, per local ordinance. With increased scrutiny, the City can work with banks having difficulties meeting the requirements of both the City and New York State Banking Law, which will minimize, and hopefully correct errors in a timely manner.

Management Response: The Finance Department has contacted Key Bank with respect to this finding since banks are also required to comply with municipal collateralization under the New York State Banking Laws

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