



**Philip J. LaTessa**  
**City Auditor**

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**CASH & INVESTMENTS AUDIT**  
**JULY 1, 2006 – SEPTEMBER 30, 2006**

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## **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 July 1, 2006 through September 30, 2006 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 July 1, 2006 through September 30, 2006.

## **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.

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**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 July 1, 2006 through September 30, 2006. For the period examined, the Audit Department determined that the accounts at Key and HSBC Banks were not properly collateralized for the month of September, 2006.

**Auditor's Note:**

On April 9, 2007, the Audit Department issued the cash and investments audit report for the quarterly period from April 1, 2006 through June 30, 2006, covering the fourth quarter of the 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 the 2005/2006 fiscal period. The specific finding pertained to the large compensating balance retained at JP Morgan Chase Bank on behalf of the City of Syracuse. For the Quarter covered by this audit, the Chase balance was \$8 million in July and \$4.5 million for August and September.

In addressing the prior finding, the Finance Department informed the City Auditor that actions had taken to ameliorate the excessively large amount of cash that the City has kept in a non-interest bearing account over the last several years. Specifically, the City had taken steps as follows: The City had taken the initiative to print the 2007 Onondaga County Property Tax bills at the City in order to use larger coupons, similar to the coupons utilized by the City for City and City School District tax bills, which avail themselves to scanning; systems were instituted to allow data to be exchanged between the lockbox processor and the City Information Systems Department via e-mail in formatted text; and, the City had advertised the soliciting of RFQ's

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(Requests for Qualifications) for lockbox services with quotes having been received in early 2007.

**Background:**

In previous audits, findings raised questions as to why the City would leave such large amounts of cash in accounts (as much as \$10 million) 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, predominantly in this instance, the lockbox operation.

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.

For the processing of the tax payments, the City's tax stubs 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 have not included the electronic scanning feature until the 2007 Onondaga County Property Tax bills were printed by the City, using larger payment stubs, to change the situation that had for some time prevented the lockbox processor from scanning both City and County payments. Due to the fact that almost all City and County taxes (two different coupons) are paid by one check, previously, it was not possible to process the City coupon by scanning and the County coupon manually. However, JP Morgan Chase Bank had been charging the lower scanning fee for both City and County coupons, as noted in the information provided by the Finance Department in Number 2 and Number 3, below. The nature of the City Auditor's concern centered on the fact that the situation presented by the smaller County payment stubs, which prevented scanning as an option, limited the potential competition among financial institutions in bidding on the City's business.

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.

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The fees 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. 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.
3. Recognizing the benefits noted in Number 2, 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 which had continued between the City and Chase Bank in his management responses to the last several Cash and Investments audits. The Commissioner has regularly noted that before issuing another Request For Quotes, 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 have recently occurred and the Finance Department has moved to address the situation that had existed from 2003 until the beginning of 2007. In January 2007, the lockbox services were bid out via Request For Qualifications.

Additionally, in the fall of 2005, the City of Syracuse administration, through the efforts of the Commissioner of Finance, began working with the Common Council in order to obtain legislative approval to introduce options for paying property taxes by means of credit card or e-Check via the internet. The Finance Commissioner took the lead role for the City in heading up a consortium of City and Onondaga County personnel in researching the requirements of New York State General Municipal Law, Section 5(b) and in the interviewing of prospective service providers as required by regulations adhered to by the City of Syracuse. The service provider selected, Municipal-Payments.com, an internet site owned and operated by Systems East, Inc. was determined to have the most user-friendly website and was capable of handling the complicated four-payment cycle of the City and County (for City residents) tax bills.

On December 19, 2005, the Common Council approved two ordinances that authorized the electronic payment option. The first ordinance, #601-2005, authorized the Commissioner of Finance to accept payment of property tax bills, including all applicable fees, interest and penalties by Credit Card or e-Check via the internet in accordance with General Municipal Law (GML) Section 5(b). The proposed payment option was seen as a convenient method of payment should taxpayers chose to use the internet and as an enhancement that could reduce the administrative time for processing the over-the-counter and mail-in payments.

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The second ordinance, #602-2005, provided for the waiving of the competitive bidding process for the selection of vendor to be contracted with to be the internet site for the acceptance of real property tax payments by credit card or e-Check for the City of Syracuse. A waiver of the competitive process was requested due to the fact that this undertaking was a collaborative project with Onondaga County and Systems East, Inc. had been able to meet the requirements of the joint property tax collection system. The term of the agreement was established to be for one year, with two one year renewal options exercisable by the City. Ordinance #602 further specifies that any charges associated with the individual transaction are to be paid by the internet user, not the City.

On May 8, 2006, the Common Council took action to extend internet payment capability to include payments for billing originating with the City of Syracuse Water Fund. Ordinances #195 and #196 of 2006 amended the two ordinances previously approved in 2005 to authorize internet payments specifically for water billing with incidental fees being charged back to the water fund.

Finally, on October 9, 2007, the Common Council took further action to expand the utilization of internet payment options to cover parking tickets and related charges. Ordinances #561 and #562 of 2007 opened up the possibility for individuals wishing to use credit cards or e-Check payment options for parking ticket charges and the city is in the process of instituting this new level of service as this audit is being issued. Future extensions of the internet payment option are possible as the city continues to examine the benefits of making such payment options available.

The addition of internet receipts accounts meant that new reconciliations, with the same requirements as all other bank accounts, would need to become part of the monthly bank reconciliation process. Anticipating that the new payment options would create the need for additional levels of coordination, the City's Finance Department put together for internal use a preliminary document that was intended to outline the differences in the operation of these accounts, in contrast to other accounts, and initial solutions to problems that might be, in the early stages of the implementation of electronic payment processes, potential problems that could arise with the expansion of electronic transmissions as a desirable payment option.

Detailed in the preliminary "Internet Account Reconciliation" outline is the following information:

*The structure of the 412 account was set up so that it would collect data on taxpayer-initiated payments made through the Municipal-Payments.com website. This website is operated by the firm awarded the City contract and allows each department that is folded into the internet payment option (Treasury, Water, Parking Tickets, etc.) to run a daily report from the website, prepare a cash report and apply payments to taxpayer accounts. Each department may prepare two separate cash reports: one for credit card and another for e-Check payments. Deposits made to the bank will start at two per day-one for all credit card payments and another for all e-Checks. Note that Systems East does not receive or disburse cash; it only provides the interface through its Municipal-Payments.com website. This website collects payment data and passes the information to the City and to the companies processing credit card and e-Check transactions.*

*Based upon the selection of payment method, the transactions are relayed to the bank by Global Payments (for credit cards) or ACH Direct (for e-Check). Each of these entities makes available an audit trail report which ties to the deposit into the 412 account. The websites are Authorize.net for credit cards and PaymentsGateway.net for e-Checks. Generally, the four cash*

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*reports will tie into the two deposits in the bank. The reconciliation should assure that all deposits reported by Systems East/Municipal-Payments.com have indeed been credited to the City's bank account.*

The Audit Department's initial review of bank reconciliations in the April-June, 2006 quarter, which was the first audited period where internet activity appeared, indicated some discrepancies existed between bank statements and what was appearing in the General Ledger for the 412 account. Subsequent interviews with Finance Department staff suggested some timing issues had been associated with the implementation of the new payment options. It was anticipated by Finance Department staff that later bank reconciliations would become smoother and easier to complete with further attention having been devoted to reconciliation development for internet activity.

Discussions that occurred between the Finance Department and the Office of the City Auditor have included the assertion by Finance that the 412 account is being adequately reconciled. Based on our conversations with Finance Department staff about the particulars of the account, we believe that this is the case; however, the complicated nature of the account has made a third party reconciliation difficult and time consuming. While the review of the information received by the Office of the City Auditor made it possible to determine that the cash and cash equivalent balances were in fact free from "material misstatements", an exact reconciliation was not possible.

The Office of the City Auditor is preparing an audit work plan that will focus exclusively on the 412 account and become an entirely separate audit from the quarterly Cash and Investment Audit program.

**Findings and Recommendations:**

**Finding 1: Investments Held By Key And HSBC Banks Under-Collateralized In September, 2006**

It was found that the collateral provided by Key and HSBC Banks did not reach the required 102 % level and was under funded.

**Recommendation:** The Finance Department should implement closer reviews of the monthly collateral summaries ensuring that all banks are in compliance with the collateralization requirements of the City of Syracuse as mandated by local ordinance.

**Management Response:**

The Department of Finance does review the monthly collateral detail provided by the banks. Occasionally, month-end activity leaves the banks with slightly less than 102% collateral and we address such shortages with the banks.

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**Recommendation 1: City's Reconciliation Of Internet Account Needs Continued Attention And Development**

The preliminary reconciliation document previously quoted quite accurately reflects the complex nature of the internet bank account. Accordingly, the review undertaken of the initial bank reconciliations for the first several months having internet activity to hit the General Ledger and the City's bank account, indicated that there was significant additional work required on the part of the Finance Department to produce an adequate reconciliation report based on the inconsistent timing element combined with the rolling of multiple payments into single deposits, as associated with bank deposit reporting. The Finance Department staff recognized the lack of clarity and has moved forward with plans to stream payments received for taxes, water billing, and eventually parking tickets into three separate accounts. This improvement is currently being implemented. In the meantime, the accounting staff is performing their reconciliations with the systems in place and, as stated above, they feel that their reconciliations are adequate and accurate.

**Recommendation:** It is the suggestion of the Office of the City Auditor that the Finance Department of the City of Syracuse conclude the establishing of separate accounts for the different payments flowing through the 412 account as soon as possible. It is anticipated by the Office of the City Auditor that some of the difficulty experienced by that department in verifying e-Check and credit card payments will be improved by the changes made in Finance.

**Management Response:**

The Department of Finance intends to establish separate accounts to facilitate reconciliation of the internet bank activity.

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