



OFFICE OF THE COMPTROLLER
CITY OF ST. LOUIS



FILE COPY

DARLENE GREEN
Comptroller

Internal Audit Section

Carnahan Courthouse Building
1114 Market St., Room 642
St. Louis, Missouri 63101
(314) 622-4723
Fax: (314) 613-3004

DR. KENNETH M. STONE, CPA
Internal Audit Executive

July 28, 2009

Honorable Larry C. Williams, Treasurer
City Hall
1200 Market Street, Room 220
St. Louis, MO 63103-2806

RE: Payroll Check Printing Process (Project #2009-28)

Dear Mr. Williams:

Enclosed is the Internal Audit Section's report on the special review of the City of St. Louis Payroll Check Printing Process.

The objectives of the review were as to determine:

- The basic procedures used in the process of printing City payroll checks.
- The type and adequacy of controls in place to prevent the occurrence of check fraud resulting in loss of City funds or public confidence.

Particular attention was paid to controls designed to safeguard against the following risks.

- Creation and successful negotiation of counterfeit payroll checks using the City's format.
- Unauthorized printing and negotiation of payroll checks from the City's payroll system.

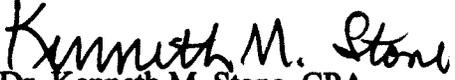
Our fieldwork was completed on March 7, 2009. Management's responses to the noted observations and recommendations were received on July 21, 2009 and have been incorporated into the report.

This review was made under authorization contained in Section 2, Article XV of the Charter, City of St. Louis, as revised, and has been conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing*.

July 28, 2009
Project #2009-28
Page 2

If you have any questions, please contact the Internal Audit Section at (314) 622-4723.

Respectfully,


Dr. Kenneth M. Stone, CPA
Internal Audit Executive

Enclosure

Cc: Jacqueline Adams, Assistant Treasurer
Judy Montgomery, Chief of Staff - Treasury Operations
Michael Green, Director of Administrative Support Services, Treasurer's Office



CITY OF ST. LOUIS

TREASURER'S OFFICE

PAYROLL CHECK PRINTING PROCESS

SPECIAL REVIEW

PROJECT #2009-28

DATE ISSUED: July 28, 2009

**Prepared by:
The Internal Audit Section**



OFFICE OF THE COMPTROLLER

HONORABLE DARLENE GREEN, COMPTROLLER

**CITY OF ST. LOUIS
OFFICE OF THE COMPTROLLER
TREASURER'S OFFICE
REVIEW OF PAYROLL CHECK PRINTING PROCESS
SPECIAL REVIEW
NOVEMBER 2008 – FEBRUARY 2009**

EXECUTIVE SUMMARY

Purpose

The audit objectives of the review were to determine:

- The basic procedures used in the process of printing City payroll checks.
- The type and adequacy of controls in place to prevent the occurrence of check fraud resulting in loss of City funds or public confidence.

Particular attention was paid to controls designed to safeguard against the following risks.

- Creation and successful negotiation of counterfeit payroll checks using the City's format.
- Unauthorized printing and negotiation of payroll checks from the City's payroll system.

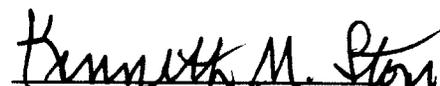
Conclusion

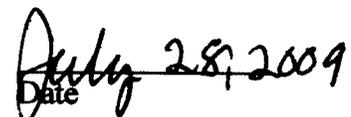
The opportunity exists for the Treasurer's Office to make certain improvements in controls over the payroll check printing process. The following are observations resulting from our review:

1. Opportunity to fully document payroll check printing policies and procedures
2. Opportunity to resolve difficulties in printing and sealing of paychecks
3. Opportunity to improve control over supplies of check forms
4. Opportunity for independent review of check printing activity

Each of these observations is discussed in more details in the *Detailed Observations, Recommendations and Management's Responses* section of this report.

This review was made under authorization contained in Section 2, Article XV of the Charter, City of St. Louis, as revised and has been conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing*.


Dr. Kenneth M. Stone, CPA
Internal Audit Executive


Date

**CITY OF ST. LOUIS
OFFICE OF THE COMPTROLLER
TREASURER'S OFFICE
REVIEW OF PAYROLL CHECK PRINTING PROCESS
SPECIAL REVIEW
NOVEMBER 2008 – FEBRUARY 2009**

TABLE OF CONTENTS

<u>Description</u>	<u>Page(s)</u>
INTRODUCTION	
Background	1
Purpose	1
Scope and Methodology	1
Exit Conference	1
Management's Responses	1
OBSERVATIONS	
Status of Prior Observations	2
Summary of Current Observations	2
DETAILED OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT'S RESPONSES	3-7

INTRODUCTION

Background

In August of 2007, the Treasurer's Office assumed the responsibility for printing the City's payroll checks, using a laser printing system controlled by a computer program.

[Note: remittance advices for employees paid by direct deposit are separately printed by the City's Information Technology Service Agency (ITSA)].

During a payroll distribution observation conducted on October 30, 2008, the Internal Audit Section (IAS) found six (6) blank check forms among the printed checks that were to be distributed. The Treasurer's Office informed IAS that the blank checks were due to a printer problem, which had not yet been resolved. The potential for inadvertent distribution of blank check stock indicated a risk that had not been adequately controlled.

Purpose

The purposes of the review were to determine:

- The basic procedures used in the process of printing City payroll checks.
- The type and adequacy of controls in place to prevent the occurrence of check fraud resulting in loss of City funds or public confidence.

Particular attention was paid to controls designed to safeguard against the following risks.

- Creation and successful negotiation of counterfeit payroll checks using the City's format.
- Unauthorized printing and negotiation of payroll checks from the City's payroll system.

Scope and Methodology

The review procedures included documentation of operating procedures, observation, and inquiries to determine the adequacy of internal controls over the payroll check printing process.

Exit Conference

An exit conference was conducted at the Treasurer's Office on June 29, 2009. The Treasurer's Office was represented by Larry A. Williams, Treasurer; Jacqueline Adams, Assistant Treasurer - Management Services; Judy Montgomery, Chief of Staff - Treasury Operations; Edward Reck, Director of Fiscal Services; and Michael Green, Director of Administrative Support Services.

The Internal Audit Section was represented by Dr. Kenneth Stone, Internal Audit Executive; Ishmael Ikpeama, Internal Audit Supervisor; and Don Curby, Auditor-in Charge.

Management's Responses

Management's responses were received on July 21, 2009 and have been incorporated into the report.

OBSERVATIONS

Status of Prior Observations

There were no prior observations.

Summary of Current Observations

The opportunity exists for the Treasurer's Office to make certain improvements to internal controls over payroll check printing activities. The following are observations resulting from our review:

1. Opportunity to fully document payroll check printing policies and procedures
2. Opportunity to resolve difficulties in printing and sealing of paychecks
3. Opportunity to improve control over supplies of check forms
4. Opportunity for independent review of check printing activity

Each of these observations is discussed in more detail in the *Detailed Observations and Recommendations* section of this report.

**DETAILED OBSERVATIONS, RECOMMENDATIONS
AND MANAGEMENT'S RESPONSES**

1. Opportunity to Fully Document Payroll Check Printing Policies & Procedures

The Treasurer's Office had not fully documented the process of printing the City's payroll checks. The documentation should define the level of authority and responsibilities for all significant activities and related controls of the check printing process. The office's written procedures did not include the following:

- Review and approval of the payroll information received from the City's Information Technology Service Agency (ITSA)
- Cancellation and re-printing of checks
- Manual printing of checks when necessary
- Review of the bank's dishonored check reports if necessary
- Independent review of check printing activity
- Control of blank check stock

Written policies and procedures clarify management's criteria for executing an organization's operations. They document business processes, personal responsibilities, and departmental operations; and promote uniformity in executing and recording transactions. Thorough policies and procedures also serve as effective training tools for employees.

If written policies and procedures do not exist, are inaccurate, incomplete, or simply not current the following could occur:

- Inconsistent practice among employees
- Processing errors because of a lack of knowledge

Recommendation

It is recommended the Treasurer's Office develop written policies and procedures that document all significant activities and related controls of the check printing process. The policies and procedures, with the applicable levels of authority and responsibility indicated, should include but not be limited to the following:

- Review and approval of the payroll information received from the City's Information Technology Service Agency (ITSA)
- Cancellation and re-printing of checks
- Manual printing of checks when necessary
- Review of the bank's dishonored check reports if necessary
- Independent review of check printing activity
- Control of blank check stock

Management's Response

The Treasurer's Office will amend the current procedures to include management's:

**DETAILED OBSERVATIONS, RECOMMENDATIONS
AND MANAGEMENT'S RESPONSES**

1. Continued...

- *Review and approval of the payroll check information received from the City's ITSA;*
- *Cancellation and re-printing of checks;*
- *Printing of manual checks;*
- *Review of dishonored checks;*
- *Independent review of the check printing activity; and*
- *Control of blank check stock*

2. Opportunity to Resolve Difficulties in Printing and Sealing of Paychecks

IAS observed the printing of City payroll checks by the Treasurer's Office for the pay date February 6, 2009, on February 4, 2009. The following conditions were noted:

- a. A Treasurer's Office employee, while sorting the checks by department, inspected each document and removed any unprinted blank forms. A total of 155 unprinted forms were found and counted from a total printing run of 2,265 checks (a 6.8% error rate).

Accidental distribution of blank check forms along with actual paychecks (which bear the fully printed check layout) may increase the risk that someone could successfully counterfeit City paychecks. A person with knowledge of the City's payroll distribution process, plus access to the check design and appropriate check stock, might be able to produce convincing fraudulent checks with modern copying and laser printing technology.

- b. It was also noted that the office's folder-sealer machine jammed at least seven times while sealing printed pay checks and at least twice while sealing the direct deposit advices that were delivered from ITSA.

The problems encountered with the printers and the jamming of the folding and sealing machine have the potential to increase operating costs for materials usage (blank forms and MICR ink) and decrease efficiency in use of staff time.

Information technology and related peripheral functions such as printing of reports, checks, etc. generally are more effectively carried out in a climate-controlled environment (according to discussions held with City information technology and Multigraph printing managers).

The Treasurer's Office Chief of Staff - Treasury Operations (CSTO) confirmed that the Treasurer's Office was certain the printer skipping and sealer machine jamming were due to printing room environment. The CSTO indicated the office planned to remedy the room environment but did not give a timetable. Monetary constraints were cited as a limiting factor in determining the expected timing for a full resolution.

Recommendation

It is recommended the Treasurer's Office:

**DETAILED OBSERVATIONS, RECOMMENDATIONS
AND MANAGEMENT'S RESPONSES**

2. Continued...

1. Continue inspecting all batches of printed checks for the presence of blanks before releasing them to the applicable departments for distribution.
2. As soon as it is economically feasible, make arrangements to air condition and restrict access to the room where the check printing is performed and the area where the check forms are stored.

Management's Response

We concur.

3. Opportunity to Improve Control over Supplies (Stock) of Check Forms

As indicated by the concerns noted in Observation #2, blank check stock should be isolated and controlled to prevent it from being stolen and used fraudulently. A perpetual inventory should be maintained by recording and tracking actual quantities of forms purchased, and quantities used. Using sequentially pre-numbered forms would facilitate that process. The forms currently used do not contain any such control numbers.

The remittance advices for employees paid by direct deposit are printed by the ITSA Operations Section, using blank check forms obtained from the Treasurer's Office. During a tour of the ITSA computer room, IAS noted that boxes of the blank forms were stored next to the printer used to print the advices. The Operations Section's manager said they routinely kept some of the forms in the computer room between printings. Neither ITSA Operations nor the Treasurer's Office maintained records on the number of blank forms obtained from the Treasurer's Office, and ITSA did not keep records of the number of forms used in printing the advices. The ITSA manager also confirmed that the advices are only printed on Wednesday mornings after receiving approval from the Treasurer's Office.

Better control could be achieved by keeping all check stock locked in the Treasurer's Office storage area until needed for printing. The number of forms released to ITSA for printing direct deposit advices, or to the Treasurer's Office Paymaster for check printing, could be recorded by the custodian of the check forms and agreed to by the signature of the recipient. After printing, both the ITSA blank forms user and the Paymaster could record their actual numbers of forms used and unused, and return that data along with the unused forms to the Treasurer's Office check forms custodian. The quantity of check stock on hand in the Treasurer's Office should be periodically inventoried and compared to its perpetual inventory.

Recommendation

It is recommended the Treasurer's Office:

**DETAILED OBSERVATIONS, RECOMMENDATIONS
AND MANAGEMENT'S RESPONSES**

3. Continued...

1. Consider adding sequential pre-numbering as a feature of its blank check forms.
2. Limit the ITSA Operations Section's acquisition of blank forms from their storage area to the morning of the scheduled printing. The number of forms obtained should be limited to the number (including a reasonable "spoilage" allowance) likely to be required to print the direct deposit advices for the pay date.
3. Have the person(s) designated to maintain custody over the check forms:
 - a. Record the number of forms released to ITSA for printing direct deposit advices, and to the Treasurer's Office Paymaster for check printing; and
 - b. Obtain the signature of the recipient in agreement with the recorded number of forms released.
4. Have each user of the check forms record the actual numbers of forms used and unused, and return the usage data and unused forms to the check forms custodian.
5. Maintain a perpetual inventory of the check stock - determined by recording and tracking actual quantities purchased, and quantities used for checks and direct deposit advices per payroll printing date.
6. Take periodic physical inventories of the quantity of check stock on hand and compare to the perpetual inventory quantity. An explanation should be obtained for any significant differences noted. (e.g., more than 10 forms.)

Management's Response

We concur.

4. Opportunity for Independent Review of Check Printing Activity

Check printing data files such as "system logs, laser check printing system logs and check image files should be compared to ensure that extra print runs were not made, additional check images were not added to print files, check numbers are sequential (gaps in numbers do not exist or numbers are not repeated), etc." (Source: Information Systems Control Journal, Volume 4, 2002 - "Laser Check Printing--How It Affects the Internal Control System" by Janice Gorgoglione, CIA, and Gilbert W. Joseph, Ph.D., CISA, CPA)

The Secure32 check printing system has the capacity to generate activity reports, but it did not appear any periodic reports were being generated for independent review and comparison to other relevant information sources. Without an independent review and comparison to other

**DETAILED OBSERVATIONS, RECOMMENDATIONS
AND MANAGEMENT'S RESPONSES**

4. Continued...

relevant information sources, there is a greater risk that improper extra print runs could be made and not be detected.

Recommendation

It is recommended the Treasurer's Office arrange with ITSA to have activity reports generated each pay period indicating, at minimum, the number and contents of each check printing run.

It is further recommended the reports be reviewed and compared to the approved Payroll Register by someone independent of the pay check approval and/or printing activities. The reviewer should ensure appropriate explanatory documentation is available for any duplicated (reprinted) checks noted on the report.

Management's Response

We concur.