

CITY OF HAMILTON

**CITY MANAGER'S OFFICE
Audit Services Division**

TO: Chair and Members Audit, Finance and Administration Committee	WARD(S) AFFECTED: CITY WIDE
COMMITTEE DATE: December 9, 2013	
SUBJECT/REPORT NO: Performance Audit Report 2013-15 - Cheques (Value for Money Audit) (AUD13034) (City Wide)	
SUBMITTED BY: Ann Pekaruk Director, Audit Services City Manager's Office	PREPARED BY: Ann Pekaruk 905-546-2424 x4469
SIGNATURE:	

RECOMMENDATION

- (a) That the Management Action Plans, as detailed in Appendix "A" of Report AUD13034, be approved; and
- (b) That the Acting General Manager, Finance & Corporate Services be directed to instruct the appropriate staff to have the Management Action Plans (as indicated in attached Appendix "A" to Report AUD13034) implemented.

EXECUTIVE SUMMARY

The 2013 Performance Audit work plan approved by Council included an audit pertaining to City cheques used to pay vendor commitments. The costs incurred by the City to issue a cheque and an electronic fund transfer (EFT) payment were calculated and used to analyze a cheque listing to identify opportunities where it may be more economical and efficient to issue EFT payments. Recommendations were made to identify opportunities for efficiencies and potential cost savings in the City's payment processes.

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The results of this audit are presented in a formal Performance Audit Report (2013-15) containing observations, recommendations and management action plans. Audit Report 2013-15 is attached as Appendix “A” to Report AUD13034.

Alternatives for Consideration – Not Applicable

FINANCIAL / STAFFING / LEGAL IMPLICATIONS (for Recommendation(s) only)

Financial: Cost savings of \$0.86 per payment may be achieved by replacing a cheque with an EFT. The implementation of the recommendations in this report may result in cost savings by reducing the volume of cheque payments issued by the City. Additional investigation and action is required by Accounts Payable before the merits of the recommendations can be measured. As a result, the related cost savings cannot be estimated at this time.

Staffing: None

Legal: None

HISTORICAL BACKGROUND (Chronology of events)

This audit was scheduled as part of the 2013 Performance Audit work plan approved by Council. The audit fieldwork was completed in October 2013. The results of this audit are attached as Appendix “A” of Report AUD13034.

The Audit, Finance and Administration Committee receives and approves value for money audit reports as part of its responsibilities for the oversight of governance.

POLICY IMPLICATIONS/LEGISLATED REQUIREMENTS

None

RELEVANT CONSULTATION

Appendix “A” to Report AUD13034 includes action plans which reflect the responses of management responsible for the administration of the Accounts Payable function, Financial Services Division of Corporate Services.

ANALYSIS / RATIONALE FOR RECOMMENDATION

(include Performance Measurement/Benchmarking Data, if applicable)

It costs the City \$1.41 per cheque and \$0.55 per EFT to disburse these payments to vendors. Savings of \$0.86 per payment may be achieved by replacing a cheque with an EFT. Maximum cost savings of approximately \$23,685 would have been realized if all 27,541 cheque payments from January 1 – September 30, 2013 (payments period selected for the audit) were replaced with EFTs. However, it is not reasonable to assume that all cheque payments can be eliminated. As a result, actual cost savings may be much less than the maximum cost savings.

Although significant cost savings are not likely, the City should strive to reduce the number of cheque payments in order to achieve efficiencies in timing of vendor payments, controlling cash flow and reducing the risk of cheque fraud.

A formal Performance Audit Report (2013-15) containing background information, audit objectives, scope, audit methodology, findings and recommendation was issued. Six recommendations were included in Audit Report 2013-15 (attached as Appendix “A” to Report AUD13034). The recommendations made are as follows:

- Set a minimum payment threshold in PeopleSoft to reduce the quantity of low dollar value cheques.
- Contact vendors who receive high dollar value or high volumes of cheques to determine whether EFTs or other forms of electronic payments are possible.
- Develop a strategy to encourage use of corporate procurement cards to reduce the quantity of vendors with single cheque payments.
- Develop a process to proactively obtain EFT banking information from vendors who sign a corporate contract on a go-forward basis.
- Develop solutions with departmental management to reduce the number of special handling cheques.
- Analyze cheque population data on an annual basis to identify opportunities to streamline payment processes and realize potential savings.

Management agreed to all the recommendations and provided action plans for implementation.

ALTERNATIVES FOR CONSIDERATION

(include Financial, Staffing, Legal and Policy Implications and pros and cons for each alternative)

Not applicable

ALIGNMENT TO THE 2012 – 2015 STRATEGIC PLAN:

Strategic Priority #2

Valued & Sustainable Services

WE deliver high quality services that meet citizen needs and expectations, in a cost effective and responsible manner.

Strategic Objective

2.1 Implement processes to improve services, leverage technology and validate cost effectiveness and efficiencies across the Corporation.

Strategic Priority #3

Leadership & Governance

WE work together to ensure we are a government that is respectful towards each other and that the community has confidence and trust in.

Strategic Objective

3.4 Enhance opportunities for administrative and operational efficiencies.

APPENDICES / SCHEDULES

Appendix “A” to Report AUD13034

ap:ab

APPENDIX "A"
CITY OF HAMILTON
PERFORMANCE AUDIT REPORT 2013-15
CHEQUES

INTRODUCTION

Vendors who conduct business with the City and negotiate transactions in Canadian dollars have the option of being paid by cheque or electronic funds transfer (EFT). Vendors who carry out transactions in US dollars are paid by cheque only. The PeopleSoft Finance System is used to capture the majority of vendor invoices and issue related cheque and EFT payments.

The following chart was compiled from the PeopleSoft Finance System and summarizes the number and value of Canadian and US dollar cheque and EFT payments from January 1 – December 31, 2012 and January 1 – September 30, 2013 (excluding CityHousing Hamilton, Ontario Works, HECFI and long term care homes).

Payment Type	Canadian		American (US)	
	2012	2013 (Jan-Sept)	2012	2013 (Jan-Sept)
Cheques	\$587 million 38,869 63%	\$400 million 27,541 61%	\$1.9 million 437	\$1.8 million 387
EFTs	\$524 million 22,881 37%	\$364 million 17,360 39%	- -	- -
Total	\$1,111 million 61,750	\$764 million 44,901	\$1.9 million 437	\$1.8 million 387

In the 2012 calendar year, the City distributed 61,750 payments amounting to more than \$1.1 billion Canadian. Approximately 63% of these payments were dispersed using cheques. Due to the manual processes associated with cheque payments, it is reasonable to assume that it costs the City more to issue a cheque as compared to an EFT payment. Cost savings may be realized if more payments were made using EFTs rather than cheques.

AUDIT OBJECTIVES AND SCOPE

The purpose of this audit was to calculate how much it costs the City to prepare, distribute and account for a cheque and an EFT payment, analyze a cheque listing to identify opportunities where it may be more efficient to issue EFT payments and calculate the related cost savings.

The audit included all Canadian cheques issued from the PeopleSoft Finance System for the payment period from January 1 – September 30, 2013. All operational areas, except CityHousing Hamilton, Ontario Works and HECFI, were included in the analysis.

A cheque may be accompanied by a payment advice which lists all vendor invoices paid by the one cheque. Printing costs are incurred to generate these payment advices. In addition, cheques with payment advices are folded and stuffed into envelopes by City mail staff rather than the City's contracted service provider. Staff do not track the number of payment advices generated nor is this information readily available from the PeopleSoft Finance System. As a result, the costs associated with payment advices have been excluded from the calculated cost per cheque. They would further increase the difference in the cost of payments made by cheque and those made by EFT.

Cheques assigned a special handling code are picked up or sent back to their respective operational areas before being distributed to vendors. Departments use their discretion as to whether these cheques are couriered, hand delivered, mailed or accompanied and paid at the bank. Employee labour costs and/or courier fees incurred to distribute special handling cheques are absorbed by the department. Due to the varied treatment of special handling cheques across the City, these costs cannot be reasonably estimated and have also been excluded from the calculated cost per cheque. They would further increase the difference in the cost of payments made by cheque and those made by EFT.

METHODOLOGY

The work performed by Audit Services involved:

- A. **Documenting cheque and EFT payment processes** based on employee interviews and observations. Process descriptions include main activities such as initiating the payment cycle, preparing and disbursing payments, resolving exceptions, reconciling bank activity and reissuing payments, where necessary.
- B. **Identifying and quantifying costs associated with cheque and EFT payment processes** by examining documentary evidence, observing processes and corroborating statements with other employees (where possible).
- C. **Calculating the cost per cheque and per EFT payment.**
- D. **Generating a list of cheques issued** from the PeopleSoft Finance System for the sample payment period from January 1 – September 30, 2013.
- E. **Creating and analyzing the following data sets from the information collected in step D. above to identify opportunities where it may be more efficient and economical to issue EFT payments:**
 - **Number of cheques issued by payment amount** – quantifies how many cheques were issued for low and high value payment amounts;
 - **Number of vendors by number of cheque payments** – quantifies how many vendors received low and high volumes of cheque payments;

- **Cheques to vendors with corporate contracts** – quantifies how many vendors on the corporate contract list received a cheque payment; and
- **Cheques with special handling** – quantifies the number of cheques issued using a special handling code.

Audit Services conducted this audit in conformity with the *International Standards for the Professional Practice of Internal Auditing*. Those standards require that Audit Services plan and perform the audit to obtain sufficient, appropriate evidence to support the findings and conclusions based on the audit objectives. Audit Services believes that the work performed provides a reasonable basis for the audit findings and conclusions.

FINDINGS

It costs the City \$1.41 per cheque and \$0.55 per EFT to disburse payments to vendors. Savings of \$0.86 per payment may be achieved by replacing a cheque with an EFT.

Cost savings realized through the adoption of more EFT payments will not be significant. If all 27,541 cheque payments from January 1 – September 30, 2013 were replaced with EFTs, maximum cost savings would amount to approximately \$23,685. However, it is not reasonable to assume that all cheque payments can be eliminated. Circumstances exist where vendors do not accept EFTs or departments require a cheque to generate physical documentation that a vendor received payment. As a result, actual costs savings may be much less than the \$23,685 maximum calculated above.

Although significant cost savings are not likely, the City should strive to reduce the number of cheque payments in order to achieve efficiencies in the following areas:

- **Timing** – Vendors may receive a City cheque 3–6 days after the cheque is printed as compared to 1–2 days for an EFT. More timely payments may improve vendor satisfaction, reduce late fees, increase vendor discounts and decrease the number of payment inquiries posed to Accounts Payable by vendors and operating departments.
- **Cash flow** – EFTs enable predictable cash flow as funds are taken out of the City's bank account immediately. It is more difficult to determine when a cheque will clear the bank as the City cannot control the vendor's actions upon receiving the cheque.
- **Fraud** – Cheque fraud is a common form of financial crime where individuals alter or duplicate printed cheques with the intent of misappropriating funds from the City. Despite preventive controls that are in place, the risk of cheque fraud still exists. Decreasing the number of cheques generated by the City may further reduce the risk of such fraudulent activity.

Based on analyses of cheques distributed to vendors from January 1 – September 30, 2013, Audit Services identified the following areas where opportunities may exist to achieve efficiencies in the City's payment process:

- Low value cheques – Fifteen cheques were written for amounts less than \$1.41, the cost to write a cheque. An additional 121 cheques were written for amounts between \$1.42 and \$10.00. It is not cost efficient to write low dollar-value cheques. Functionality exists in the PeopleSoft Finance System to set a minimum payment amount. Invoices falling below this minimum are held, grouped and paid once the accumulated amount surpasses the minimum payment threshold.
- High value cheques – Eighty-one cheques were written to ten vendors for individual amounts greater than \$1 million. Eleven of these cheques were mailed to vendors using normal postal service. Sending such large-value cheques through the mail presents a significant risk due to the possibility of cheque fraud or cheque loss.
- Low cheque volumes – Single cheque payments were made to 5,010 vendors. The use of corporate procurement cards (Pcards) is a more efficient method to pay single one-time vendors and more Pcard use would increase the City's annual rebate. Although management agrees with Audit Services that Pcards are a viable payment option, the amount of Pcard use has declined steadily over recent years.
- High cheque volumes – Nine vendors received more than 100 cheques payments each from January 1 – September 30, 2013. It is more efficient and timely for vendors who receive a large volume of cheque payments to be paid via EFT.

Audit Services identified three vendors who received 676 cheques payments in total for insurance claim adjustment and collision repair services. The department manually enters payment details from the cheque into a claims tracking system in Risk Management. Although divisional management agrees that these vendors may and should be paid by EFT, testing is needed to ensure payment information downloaded from PeopleSoft into the claims tracking system is accurate before cheque payments can be eliminated.

- Corporate contract payments – Vendors with a corporate contract are paid by EFT unless the vendor receives a single lump sum or the City cannot release the EFT payment. Audit Services identified 38 vendors from the corporate contract listing who received at least one cheque payment from January 1 – September 30, 2013. Eleven vendors received cheques despite having EFT banking information entered into PeopleSoft. The following reasons were provided by management that may explain why these vendors were not paid by EFT:
 - The Accounts Payable Clerk entering an invoice into PeopleSoft has the ability to override the payment method to cheque if requested by the operating department;
 - Banking information may not have been carried over to new address locations set up in the vendor's profile; and
 - Banking information is not always obtained for new vendors in a timely manner before the first invoice is received and payment is due.

- Special handling cheques – 6,471 cheque payments disbursed from January 1 – September 30, 2013 involved special handling. The majority of special handling requests came from Dental Services, Risk Management, Payroll and Finance and Councillors' Offices. Additional costs related to employee labour and/or courier fees are incurred by departments to handle, deliver and/or accompany such cheques to the bank. Although special handling costs could not be quantified, efforts should be made to reduce the number of special handling cheques in order to reduce added costs incurred at the department level. Fewer special handling requests may also contribute to timelier vendor payments and reduce the risk that cheques are mishandled or lost.

RECOMMENDATIONS

The implementation of the following five recommendations may result in opportunities to make City payment processes more efficient by reducing costs, making timelier payments, controlling cash flow and reducing the risk of cheque fraud.

- 1. That Accounts Payable set a minimum payment threshold in the PeopleSoft Finance System to reduce the quantity of low dollar value cheques. This payment process change should be communicated to vendors.**

Management Action Plan:

Agreed. A communication to vendors regarding the new Accounts Payable process of receiving invoices is scheduled for Q2 – 2014. This communication will incorporate a message regarding the minimum payments threshold.

- 2. That Accounts Payable contact vendors who received individual cheques greater than \$1 million or more than 100 cheque payments each in the audit period selected in order to investigate whether EFTs or other forms of electronic payments are available in lieu of cheques.**

Management Action Plan:

Agreed. Vendors are currently being contacted.

- 3. That Accounts Payable develop a strategy to encourage use of corporate procurement cards to reduce the quantity of vendors with single cheque payments.**

Management Action Plan:

Agreed. A project to enhance the Pcard program will be undertaken in Q4 – 2014.

- 4. That Accounts Payable develop a process with Procurement to proactively obtain EFT banking information for vendors who sign a corporate contract on a go-forward basis. Accounts Payable should obtain EFT banking information for existing corporate contract vendors who receive cheque payments and ensure this data is correctly entered in the PeopleSoft Finance System.**

Management Action Plan:

Agreed. Discussion has taken place and additional meetings will take place in order to develop a process by Q1 – 2014.

- 5. That Accounts Payable approach departmental management in areas with high special handling requests to understand issues driving special handling and help develop amicable solutions to reduce the number of special handling cheques.**

Management Action Plan:

Agreed. Discussions will be held in Q1 – 2014 during the implementation of the Accounts Payable Automated Workflow with the goal of reducing special handling.

Audit Services' findings were based on extracting and analyzing cheque data available from the PeopleSoft Finance System. Analyses were focused on low and high value cheques, low and high cheque volumes, corporate contract payments and special handling cheques in order to identify areas where vendor payment distribution efficiencies could be realized.

- 6. That Accounts Payable analyze cheque population data on an annual basis to proactively identify opportunities to work with departments and vendors to streamline the City's payment processes.**

Management Action Plan:

Agreed. This task will be included in the Accounts Payable year end schedule.

CONCLUSION

It costs the City \$1.41 and \$0.55 to issue a cheque and EFT payment, respectively. Savings of \$0.86 per payment may be achieved by replacing a cheque with an EFT. Audit Services identified a number of opportunities to reduce the number of cheque payments and realize efficiencies within the City's payment process. Additional investigations and actions are required by Accounts Payable and departments/divisions before the merits of these opportunities can be measured.