



**INTERNAL AUDIT DEPARTMENT
COUNTY OF ORANGE**

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**AUDIT OF THE COUNTY'S
NON-SUFFICIENT FUND (NSF) CHECK
NOTIFICATION PROCESS**

As of April 30, 2006

AUDIT NUMBER: 2576

REPORT DATE: JUNE 29, 2006

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**Audit of the County's
Non-Sufficient Fund Check Notification Process**

As of April 30, 2006

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Transmittal Letter

Audit No. 2576

June 29, 2006

TO: John M.W. Moorlach, Treasurer-Tax Collector
David E. Sundstrom, Auditor-Controller

FROM: Peter Hughes, Ph.D., CPA, Director
Internal Audit Department

SUBJECT: Audit of the County's Non-Sufficient Fund Check Notification Process

We have completed an audit of the County's non-sufficient fund (NSF) check notification process as of April 30, 2006. The final **Internal Auditor's Report** is attached. Given the widespread benefits of the lessons learned from this review, we are distributing this report Countywide. **Please note:** this report contains "suggested recommendations" for departments/agencies that receive payments by check to consider. As such, no responses are required from the departments/agencies included in this report, or from any department/agency.

As the Director of Internal Audit, I now submit a monthly audit status report to the Board of Supervisors (BOS) where I detail any material and significant audit findings released in reports during the prior month and the implementation status of audit recommendations as disclosed by our Follow-Up Audits. Accordingly, the results of this audit will be included in a future status report to the BOS.

As always, the Internal Audit Department is available to partner with you so that you can successfully implement or mitigate audit recommendations. Please feel free to call me should you wish to discuss any aspect of our audit report.

Attachment

Other recipients of this report:

Members, Board of Supervisors
Members, Audit Oversight Committee
Thomas G. Mauk, County Executive Officer
Department/Agency Directors
Foreperson, Grand Jury
Darlene J. Bloom, Clerk of the Board of Supervisors



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INTERNAL AUDITOR'S REPORT

Audit No. 2576

June 29, 2006

John M.W. Moorlach, Treasurer-Tax Collector
David E. Sundstrom, Auditor-Controller
12 Civic Center Plaza
Santa Ana, CA 92701

We have completed an audit of the County's non-sufficient fund (NSF) check notification process as of April 30, 2006. Our audit was performed in accordance with professional standards established by the Institute of Internal Auditors.

County department/agency management is responsible for establishing and maintaining a system of internal controls over the NSF check notification process, and for ensuring proper controls and processes are in place to minimize the acceptance of additional NSF checks. The objectives of an internal control system are to provide management with reasonable, but not absolute assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly. County of Orange Accounting Manual No. S-2 – *Internal Control Systems* prescribes the policies and standards the departments/agencies should follow in establishing and maintaining internal control systems. Our review enhances and complements, but does not substitute for, management's continuing emphasis on control activities and self-assessment of control risks.

Because of inherent limitations in any system of internal controls, errors or irregularities may nevertheless occur and not be detected. Specific examples of limitations include, but are not limited to, resource constraints, unintentional errors, management override, circumvention by collusion, and poor judgment. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate. Accordingly, our audit performed for the limited purpose described above would not necessarily disclose all weaknesses in department/agency operating procedures, accounting practices, and compliance with County policy regarding NSF checks.

Based upon our audit, **no material weaknesses or significant issues were identified**. However, we did identify **five suggested recommendations** for all departments/agencies to consider, as applicable, to improve processes and procedures for processing and tracking NSF checks. These are noted in the Suggested Recommendations section of this report.

John M.W. Moorlach, Treasurer-Tax Collector

David E. Sundstrom, Auditor-Controller

June 29, 2006

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While our audit included only selected departments/agencies, **all County departments/agencies should review their NSF check processes and determine if the observations and recommendations contained in this report are applicable, and implement appropriate controls and processes accordingly.** An expectation of the Board of Supervisors is that Departments and Agencies will view this report as a “**lessons learned**” opportunity to guide them in proactively self-assessing similar operations or processes.

Please note: Effective June 26, 2006, the County implemented a new NSF check notification process that will automate and streamline the notification process. County departments/agencies should consider the suggested recommendations made in this report as they implement the new NSF check notification process.

We appreciate the courtesy and cooperation extended to us by the personnel of Auditor-Controller, Treasurer-Tax Collector, Clerk-Recorder, Health Care Agency, Animal Care Services and Integrated Waste Management Department during our audit.

If we can be of further assistance, please contact me directly or Eli Littner, Deputy Director at (714) 834-5899 or Michael Goodwin, Audit Manager at (714) 834-6066.

Respectfully submitted,



Peter Hughes, Ph.D., CPA
Director, Internal Audit

Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

- Members, Board of Supervisors
- Members, Audit Oversight Committee
- Thomas G. Mauk, County Executive Officer
- Department/Agency Directors
- Foreperson, Grand Jury
- Darlene J. Bloom, Clerk of the Board of Supervisors

EXECUTIVE SUMMARY

OBJECTIVES

The Internal Audit Department conducted an audit of the County's non-sufficient fund (NSF) check notification process. The objectives of our audit were to determine if:

1. The County and its departments/agencies receive timely notification of the receipt of NSF checks.
2. Once notified, departments/agencies have processes and controls in place to prevent the further acceptance of subsequent NSF checks from the same individuals.

Additionally, we attended meetings with Auditor-Controller and Treasurer-Tax Collector staff who are in the process of developing enhancements to the NSF check notification process.

BACKGROUND

We initiated this audit based upon an issue identified in a prior audit of internal controls. In that audit, we noted a department that continued to accept a series of NSF checks from the same individuals over an extended period of time. Accordingly, we conducted this audit to determine how timely the County is notified of NSF checks, and what processes and controls are place (in a sample of departments/agencies) to prevent the continued acceptance of NSF checks. Our audit included reviews in the Treasurer-Tax Collector (TTC), the Auditor-Controller (A-C), and selected departments/agencies that receive a large volume of payments by check.

Volume of NSF Checks

The County's financial institution, Wells Fargo Bank (Bank), sends the County "Returned Items" on a daily basis. Returned Items consist primarily of NSF checks, but also includes checks returned for other reasons, such as account closures and checks that have had a "stop payment" applied. Of the Returned Items, the County receives approximately **500 NSF checks per month**. During the months of **December 2004** and **April 2005** (months when property tax payments are due), the County received approximately **\$3 million** in total bank returned items, which consisted mostly of NSF checks.

SCOPE

Our audit was limited to reviewing the processes for NSF check notification as of April 30, 2006. We obtained an understanding of how the County is first notified of the receipt of NSF checks, and subsequently, how departments/agencies receive notification. We reviewed whether, once notified, departments/agencies have controls and processes in place to prevent the further acceptance of subsequent NSF checks. To obtain our understanding, we reviewed processes in the A-C, TTC, Clerk-Recorder's Office, Health Care Agency and Integrated Waste Management Department. Our methodology included inquiry, auditor observation, and examination of relevant documentation. Our audit did not include a review of processes for other types of Returned Items, or include an evaluation of the enhancements being made to the NSF check notification process.



CONCLUSION

No material weaknesses or significant issues were identified. Based on the objectives of our audit, we noted the following:

1. The County (via the TTC) receives daily notices of NSF checks from the Bank. However, the current process has time lags resulting from the time it takes the Bank to identify and notify the TTC of NSF checks, and from using paper documents and the U.S. mail system to send the daily notices. In addition, the A-C processes and distributes notices of NSF checks to departments/agencies daily; however, for larger departments/agencies, it may take additional time for the departments/agencies to notify their specific programs, clinics, and areas where cash receipts are collected.
2. Based on the departments/agencies we reviewed, we determined that each one has unique processes in place depending on the nature of the payment and the ability to pursue collections of NSF checks. We describe each department/agency reviewed in the Detailed Observations section of this report. It is important for departments/agencies to ensure the notification process to their respective cashiers is timely and effective to minimize the acceptance of additional NSF checks from the same individuals.
3. The enhancements currently being considered for the NSF check notification process will shorten the time it takes for departments/agencies to be notified and will make the process more automated with less manual processing. We believe the County is moving forward in the right direction in making these enhancements to the NSF check notification process.

Because we only reviewed selected departments/agencies, this report contains our **general observations** resulting in **five suggested recommendations** that all departments/agencies should review and implement as applicable. These are noted in the Suggested Recommendations section of this report.

On June 26, 2006, the County implemented the new “Returned Items Project,” or what this report refers to as the NSF check notification process. Departments/agencies that receive payments by check should consider the suggested recommendations made in this report as they implement the new notification process.



DETAILED OBSERVATIONS

NSF Check Notification Process

The information in this section reflects the NSF check notification process that was in effect during our audit. On June 26, 2006, the County implemented an enhanced notification process that is more automated and streamlined, which we discuss following this section.

Treasurer- Tax Collector

NSF checks are first identified by the County's financial institution, currently Wells Fargo Bank (Bank). The Bank notifies the County daily via the Treasurer-Tax Collector Office Cash Cage Unit (TTC) by sending them the NSF checks and accompanying bank statements by mail. TTC staff sort the checks by department/agency, input the checks into their "Back Office" system and generate a *Notice of Checks Returned Report* for each department/agency. The NSF checks are separated into Tax Collector checks and non-Tax Collector checks. The "*Notices of Checks Returned Reports*" are then forwarded either to the Tax Collector Division, or to the Auditor-Controller (A-C) on a daily basis for review and distribution to the various departments/agencies.

Auditor-Controller

A-C/Administration processes the NSF checks on the same day received from the TTC. Multiple copies of the *Notice of Checks Returned Report* are generated for specific purposes, including one for distribution to the departments/agencies with the NSF checks attached. Some of these forms are sent directly to the departments/agencies, and some forms are sent directly to A-C Collections. A-C Collections notifies the departments/agencies of the NSF checks upon receipt of the *Notice of Checks Returned Report*. A-C/General Ledger processes a Journal Voucher to account for the NSF checks for each department/agency.

Departments/Agencies

The following section briefly describes the department/agency processes we reviewed:

Health Care Agency (HCA)

HCA receives payments by check in several of its divisions and programs, including **Animal Care Services, Birth and Death Registration, Environmental Health, Drug Abuse Services, Immunizations, and Emergency Services**. An individual in HCA Accounting receives (via PONY) the *Notice of Checks Returned Report* and the accompanying NSF checks. The individual sorts the reports and NSF checks and generally distributes them to the respective sections within a day or two. In response to the newly implemented NSF check notification process, we noted that HCA Accounting developed written procedures.

We selected **Animal Care Services (ACS)** to review the processes for minimizing the acceptance of subsequent NSF checks. ACS receives NSF items in batches from HCA Accounting, usually two or three per month. Upon receipt, the NSF information is entered into the cashiering software system (Chameleon) within a day or two. If a customer who has previously written an NSF check makes another payment, the system notifies the cashier of the prior NSF check, and the cashiers are instructed not to accept payments by check. However, the system does not prevent one from paying by check again.



Clerk-Recorder (C-R)

The C-R receives payment from the public for providing copies of public records (marriage certificates, birth certificates, death certificates, etc.). The C-R does not maintain customer accounts; instead, the transactions are processed on a similar basis as retail transactions (payment made for the product purchased). Because the C-R does not maintain customer accounts, and due to the high volume of transactions processed, NSF check information is not tracked to prevent subsequent acceptance of NSF checks. The C-R receives notification from the Auditor-Controller (A-C) for NSF checks as they become available. C-R has two different NSF check processes:

- **NSF checks of \$5 or less.** The occurrence of NSF checks in the amount of \$5 or less is rare. C-R staff perform the investigation and collection procedures for these NSF checks. These checks are logged in an *Auditor-NSF Listings* log, which is updated as amounts are collected.
- **NSF checks of over \$5.** A-C/Collections performs the investigation and collection of NSF checks over \$5.00. These NSF checks are recorded in the *Auditor-NSF Listings* log and are updated as the collection process is performed.

Treasurer-Tax Collector (TTC)

The **Tax Collector Division** of the TTC receives payments from the public for property taxes. A majority of property tax payments are made by check. The Remittance Processing Section of Tax Collector receives notification of NSF returned checks from the TTC Cashiering Section on the same day they are notified by Wells Fargo Bank.

When a property tax check is identified as NSF, staff update the Assessment Tax System (ATS) to research and identify the property details, and to remove and cancel the recorded payment from the system. A \$30.00 NSF service charge is added to the account in ATS, and the account shows the NSF status until the payment is made. A *Notice of Tax Payment Cancellation* is mailed to the client, which indicates the service charge has been assessed and that the individual may be subject to treble damages pursuant to Civil Code.

Integrated Waste Management Department (IWMD)

IWMD receives payments by check for disposal fees charged to landfill customers. IWMD Accounting was receiving notification of NSF checks from A-C/Administration in the form of faxes of *Notice of Checks Returned Reports* and NSF returned checks. IWMD Accounting staff now picks up the *Notice of Checks Returned Reports* and NSF returned checks from A-C Administration. IWMD Accounting records the NSF returned check information (e.g. customer name, address, phone number, bank name, bank routing number, checking account number, check number, date and amount) into IWMD's Landfill Site software system, CompuWeigh, makes a copy of the NSF checks and returns them to A-C/Administration. This procedure is usually performed shortly after information is received by IWMD.

Once recorded, this NSF information is updated instantly in CompuWeigh and is accessible to all the landfills immediately. At the landfills, checks received are scanned by a machine that records the checking account number on the check. If an NSF marked customer at any of the landfills tries to submit another check with the same checking account, CompuWeigh flags the customer as previously submitting an NSF check and the cashier requests another form of payment from the customer.



OVERVIEW OF ENHANCEMENTS TO NSF CHECK NOTIFICATION PROCESS

Effective June 26, 2006, the TTC and the A-C implemented the following enhancements to the NSF check notification process. These enhancements will decrease the time it takes to receive notification of NSF checks from the Bank. We believe that the County is moving forward in the right direction in making these enhancements to the NSF check notification process.

As indicated below in our Suggested Recommendations, departments/agencies should modify their procedures accordingly for the new process, and periodically monitor their NSF process for efficiency and effectiveness.

The goal of the new process is to streamline the returned items/NSF check notification process. The new process will electronically deliver the returned check information on a next-day basis. The A-C Information Technology section designed an automated process to notify departments/agencies, post to the County's General Ledger, and create required reports. Overall, it is expected to **reduce the entire process by 4-5 business days**, and will allow collection efforts to begin sooner. The following is an overview of the enhancements:

- The A-C will receive daily electronic files listing NSF checks from the Bank. This will eliminate the current manual process of the TTC of receiving NSF paper documents by mail and inputting the information in their "Back Office" system.
- Upon receipt of daily electronic files, the A-C will update its financial system (CAPS) through an automated Journal Voucher process, and will notify the departments/agencies of the receipt of NSF checks via email. The A-C will work with the TTC Cash Manager to resolve any discrepancies in item counts, dollar amounts and account coding.
- The Bank will mail copies of NSF checks directly to the applicable department/agency. This will eliminate the A-C and TTC having to sort and distribute the NSF checks to department/agencies and will shorten the time for notifying departments/agencies.



SUGGESTED RECOMMENDATIONS

The following suggested recommendations (#1 through #4) should be considered for immediate implementation in applicable departments/agencies. Recommendation #5 pertains to the new NSF check notification process enhancements.

1. Departments/agencies that have satellite locations responsible for receiving checks should **ensure that the satellite locations are immediately notified** of the receipt of NSF checks as soon as they receive notification from the Auditor-Controller. We noted instances when the department/agency prepared NSF check notifications in batches (after several were received) before sending them to satellite locations. This practice delays notifying the cashiers of prior NSF checks and can result in additional NSF checks being accepted from the same customer.
2. Departments/agencies that input NSF check information into electronic form, such as a cashiering software system or spreadsheet, should have **supervisory reviews** in place to ensure the completeness and accuracy of NSF check information (e.g. customer names, bank account numbers). We noted instances when data input errors in customer names and bank accounts resulted in the continued acceptance of NSF checks from the same customers.
3. Departments/agencies should **review their current policies and procedures** for tracking NSF checks to ensure efforts in this area are aligned with overall business objectives. We noted an instance when a department was only tracking NSF checks for amounts of \$50.00 or more. Upon further review of the policy, the department modified their policy to include and track all NSF checks regardless of amount.
4. Departments/agencies should **provide periodic training or reminders to staff** on the importance of processing and tracking of payments made by check. We noted that although there are computerized systems that flag customer accounts with prior NSF check data, the systems do not necessarily prevent another payment by check, which can generally be at the discretion of the cashier.
5. As noted above, the Treasurer-Tax Collector and the Auditor-Controller implemented enhancements in the way the County and applicable departments/agencies are notified of NSF checks. These enhancements will decrease the time it takes to receive notification of NSF checks. Departments/agencies should **incorporate these enhancements into their existing procedures**, and establish periodic monitoring of the process to ensure efficiency, effectiveness, and accomplishment of intended objectives.

