

PAPER CHECK PROCESSING

PROGRAM EVALUATION AND AUDIT



METROPOLITAN
C O U N C I L

March 2022

Contents

Highlights.....	3
Summary of Findings.....	4
Introduction.....	5
Background.....	5
Objectives	6
Scope.....	6
Methodology	7
Limitations.....	7
Recognition	7
Observations	8
Conclusions	13
Appendix A.....	14
Distribution List.....	15

The Council should Eliminate Paper Checks

What We Found

What Needs Improvement

The Metropolitan Council has an extensive, inefficient system of controls for processing paper checks. If the Council had issued each check in 2021 by electronic means, it could have saved anywhere from \$12,700 to \$275,900. Additionally, internal estimates indicate that the Council could have saved 60 staff hours by switching to electronic payments.

We also found that staff are not implementing the controls for the check requisition process. This has increased the number of checks that the Council issues.

Additionally, physical controls for printing facilities can be improved.

What We Recommend

The Metropolitan Council should:

- Stop issuing paper checks and require vendors to be paid electronically.
- Create a tightly controlled and documented exceptions process for necessary check payments.
- Consider additional controls for printing facilities.
- Perform an inventory of items in the printing facilities.



Why We Did This Work

In 2021, the Council issued nearly 14,000 physical checks totaling approximately \$118 million. Finance requested that Audit review the controls surrounding the paper check process. Audit reviewed the physical controls to determine their effectiveness. We also reviewed best practices for using paper checks.

What We Reviewed

Audit reviewed Finance's records of check requisitions, check logs, onsite controls, PeopleSoft controls, and industry best practices for processing checks. This review was limited to the processes and controls for issuing paper checks.

How We Did This Work

Audit interviewed finance staff from across the Council to help answer the audit objectives. We also reviewed physical controls at check processing facilities and performed desk reviews of key control records.

Summary of Findings

Number	Description	Recommendation	Follow-up Action	Page
Observation 1	The Council is not following industry best practices for checks.	Eliminate paper check use.	Assess Risk	<u>10</u>
		Create a tightly controlled, documented process for exceptions.	Confirmation	<u>11</u>
Observation 2	Printing facility controls can be improved.	Increase controls at a facility.	Assess Risk	<u>12</u>
		Conduct an inventory of items stored in printing facility.	Confirmation	<u>12</u>

Introduction

Background

For the past 20 years, check usage has declined for point of sales transactions and third-party payments. According to data from The Federal Reserve, between 2015 and 2018, check payments declined 7.2% per year by number; and 4% percent per year by value. These numbers are roughly in line with declines between 2003 and 2012.¹ Compared to electronic payments, checks are much more costly and inefficient to process and handle.

Further, governments have been reducing or eliminating paper checks. In 2010, the United States federal government gradually ceased using paper checks for benefit payments and now requires electronic funds transfers.² The State of Minnesota also requires payments between government agencies to be made using electronic, integrated financial tools.³

The Metropolitan Council issues paper checks to vendors and employees to compensate them for services rendered. Vendors can be contractors, landlords, or other entities to which the Council owes money. Payments are subject to signature authorities and other provisions under the Metropolitan Council's Procurement Procedure.⁴ Check requests can be sent to Finance via an online MetNet form. When possible, purchasing cards (p-cards) are supposed to be used instead, but have specific limitations on their use and the dollars spent.

Council employees can also specifically request payments through the Check Requisitions process.⁵ Specifically, check requisitions are to be used only when appropriate to the individual purchase, such as for training classes, seminars, etc. Payment will be sent directly to vendors and will not be given to employees except in specific situations. The Procurement Procedure specifically approves payments for use on advertising, professional memberships, conferences, seminars, travel, subscriptions, permits, licenses, easements, utilities, taxes, insurance, required charges, and legal settlement payments. Check requisitions are subject to the same documentation requirements as other forms of procurement.

In 2021, the Council issued nearly 13,800 checks totaling approximately \$118 million across four pay cycles. Nearly two-thirds of payments were part of the Accounts Payable pay cycle, which accounted for approximately \$112 million of the total value. The majority of the remaining payments went to landlords and tenants as part of the Housing and Redevelopment Authority (HRA) pay cycle. HRA accounted for 37.7% of the total payments and approximately \$5.3 million of the total value (**Table 1**).

¹ Gerdes et. al. (January 2020). The 2019 Federal Reserve Payments Study. Board of Governors of the Federal Reserve. Retrieved from www.federalreserve.gov: <https://www.federalreserve.gov/paymentsystems/2019-December-The-Federal-Reserve-Payments-Study.htm>

² Bureau of the Fiscal Service (2022). <https://fiscal.treasury.gov/eft/>

³ Minnesota Management & Budget Statewide Operating Policy (April 2015). *Interagency Payments, Policy Number 0805-01*.

⁴ Metropolitan Council. FM 14-1a "Procurement Procedure".

⁵ *ibid*.

Table 1: Payments by Pay Cycle

Pay Cycle	Payments Count	Percent of Total Payments	Total	Percent of Total Value
Accounts Payable	8569	62.1%	\$112,482,059.94	95.5%
Garnishments	12	0.1%	\$31,514.18	0%
Housing and Redevelopment Authority	5204	37.7%	\$5,325,943.21	4.5%
Risk	11	0.1%	\$4,227.28	0.0%
Totals	13796	100%	\$117,843,744.61	100%

Objectives

The audit objectives were to determine if:

- The Council's controls for issuing physical checks are effective and limit check fraud risk.
- There are best practices for using paper checks over electronic forms of payment.

This audit considered the Council's *Thrive MSP 2040* Outcomes and Principles of Stewardship and Accountability. Specifically, it plans to further *stewardship* by reviewing implemented processes to ensure that public resources are protected from check fraud. It addresses *accountability* by reviewing adherence to Council procedures and the desire for accurate financial records.

This work helps address Audit's strategic planning goal of improving the Council's awareness of risks and internal controls with targeted recommendations to management to fill gaps, mitigate risks and improve controls. Specifically, it reviews the information technology general controls for the check requisition process. It also considers Council's reliance on information technology to perform tasks efficiently, quickly, and accurately while protecting the Council against system threats. The audit also reinforces the Council's focus on ensuring public funds have been spent appropriately.

Scope

This audit reviewed the controls, processes, and documentation related to the check issuing process. The time-period for review, if necessary, was January 1, 2021 to January 1, 2022. The audit also reviewed physical controls for the check printers located at Metropolitan Council facilities.

This audit does not cover broader Accounts Payable processes, bank reconciliations, or the check escheatment processes. It was limited to the issuing of physical checks.

Methodology

Auditors used a variety of methods to determine if the controls for processing checks were effective. Audit physically inspected onsite controls at the Council's check processing facilities to help determine if the controls for processing checks were effective. Audit also reviewed keycard access logs for unapproved accesses and confirmed if access was appropriate for employees' job duties.

Additionally, Audit also performed desk reviews of a selection check requisitions to determine if the criteria in the Council's procurement policy were being followed. Auditors reviewed invoices and payment descriptions to determine if the payment complied with the criteria. Checks were stratified based upon their value, and then selected from each stratum at random.

Finally, Audit performed general research for best practices regarding check use. This involved reviewing government agencies' practices, financial institution guidelines, and best practices from the private sector. Audit also conducted interviews with Council staff to determine what they used physical checks for and to gather insight on if physical checks were necessary. Audit also reviewed the check logs for 2021 for payments to entities that should otherwise have an electronic means of payment. This included government agencies, big box stores, utility companies, and colleges.

Limitations

There were some limitations to completing the work. The Metropolitan Council uses a variety of applications to help support and process payments. These systems do not always communicate with one another or communicate fully requiring manual transposition between systems. As such, the current suite of applications created a difficult auditing environment due to access restrictions and data availability.

Issues regarding broader Finance policies and procedures as well as Information Technology General Controls have been documented in preparation for future accounts payable or PeopleSoft system controls audits.

Recognition

Audit would like to thank Finance, Metro Transit Finance, Environmental Services Finance, and Housing and Redevelopment Authority staff for their assistance, candor, and timely responses to data requests during the audit.

Observations

Most of the Council's issued checks are for small monetary value.

The Council primarily issues checks for small dollar values. In 2021, the Council issued 13,796 checks. 61.4% of the checks were for \$1,000 or less and totaled 2% of the total amount paid by check (**Table 2**). Conversely, 18 checks were issued for \$1 million or more and accounted for 33% of the total value. Together, these conditions demonstrate the Council is spending most of its resources on processing low value items.

Table 2: Payments by Check Value

Value	Payments Count	Percent of Total Payments	Total	Percent of Total Value
\$0 to \$20	687	5.0%	\$6,624.93	0.0%
\$20.01 to \$100	2440	17.7%	\$131,929.52	0.1%
\$100.01 to \$1,000	5343	38.7%	\$2,328,718.07	2.0%
\$1,000.01 to \$10,000	4089	29.6%	\$12,781,825.49	10.8%
\$10,000.01 to \$50,000	893	6.5%	\$19,385,616.18	16.5%
\$50,000.01 to \$999,999.99	326	2.4%	\$44,254,981.02	37.6%
\$1,000,000+	18	0.1%	\$38,954,049.40	33.1%
Totals	13,796	100%	\$117,843,744.61	100%

Additionally, 95% of checks were paid as part of the Accounts Payable pay cycle. These purchases could be for a variety of items, whether it be contract payments, small purchases, or micro-purchases. The Council has alternative methods of paying contractors, including by procurement card or electronic funds transfer.

This issue is the result of the Council not prohibiting or explicitly limiting the use of checks as a form of payment. It has not required vendors, landlords, or other entities that the Council does business with to move to electronic forms of payments. Additionally, staff may be attempting to circumvent other processes to purchase items. For Housing and Redevelopment Authority (HRA) payments, this is due in part to landlords resisting giving the Council their banking information.

By not prohibiting the use of checks at the Council, staff use paper checks to pay for contractual obligations, small purchases, and micro-purchases. This overuse has required the implementation of an expansive, inefficient system of controls to limit or prevent fraud, waste, and inaccuracies.

The Council is issuing checks are to entities that should have an electronic form of payment available to them.

In 2021, 95% of all check payments were paid as part of the Accounts Payable pay cycle. It is reasonable to assume most of the entities that the Council contracts with or micro purchases from have electronic means of payment available to them, whether it be by procurement card or an Automated Clearinghouse (ACH) transaction. Audit’s macro-level review of the data revealed 10% of payments went to entities known to take electronic forms of payment. This same group accounted for nearly 20% of the total value paid by check. These included utility companies, government agencies, colleges, universities, unions, watershed districts, big box companies, media companies, and specific vendors.

There is not a clear metric for how much switching to electronic payments will save an agency. Best practices research revealed that cost savings estimates vary widely (**Table 3**). In 2011, the US Treasury estimated that each check cost \$0.92 more to process than an electronic payment. In a 2014 Wall Street Journal article, Bank of America estimated that using paper checks cost \$4 to \$20 per transaction, based on the price of the check and shipping, plus the time employees spend writing, mailing, collecting, and reconciling the check. Meanwhile, the National Automatic Clearinghouse Association estimated this year that an organization would save anywhere between \$2 to \$4 per transaction.

Table 3: Cost Savings Estimates for Switching to Electronic Transactions

Entity	Estimate	Approximate Value Saved
US Treasury ⁶	\$0.92	\$12,700
Nacha ⁷	\$2.01 to \$4.00	\$27,740 to \$55,200
Bank of America ⁸	\$4.00 to \$20.00	\$55,200 to \$275,900

Finance management stated that it takes 15-20 additional minutes to process physical check runs over electronic transactions. Based off this estimate, Regional Administration spent an unnecessary 62.5 additional hours processing paper checks. These resources could be spent elsewhere in the process to improve controls or efficiencies.

Additionally, this use of checks has resulted in lost or stopped checks, which incur additional resource and labor costs. The use of these checks has incurred additional environmental effects, as electronic checks do not require ink, paper, or gas to transport the checks to their destination.

⁶ Barrett, Melody. (2011). “U.S. Treasury to “Retire” Paper Check for New Recipients of Social Security and Other Federal Benefits, Saving Taxpayers \$1 Billion.” *Bureau of the Fiscal Service, U.S. Department of the Treasury*. Web. <https://www.fiscal.treasury.gov/news/treasury-to-retire-paper-check.html>

⁷ Kahn, Michael. (2022). “ACH Costs are a Fraction of Check Costs for Businesses, AFP Survey Shows.” *National Automated Clearinghouse Association*. Web. <https://www.nacha.org/news/ach-costs-are-fraction-check-costs-businesses-afp-survey-shows>

⁸ Monga, Vipal. (2014). “U.S. Companies Cling to Writing Paper Checks.” *The Wall Street Journal*. Web. <https://www.wsj.com/articles/u-s-companies-cling-to-writing-paper-checks-1394494772>

Finally, an additional effect of issuing a large number of checks is the increased chance for fraud. In 2021, check payments continued to be the form of payment most impacted by fraud attempts.⁹ The Council has experienced check fraud attempts in the recent past. Identifying and tracing fraud attempts requires additional staff hours to identify. Continuing to use checks in the current amount continues to expose the Council to increased fraud risk.

Payments are consistently being requested and issued for purchases that do not comply with the Procurement Procedure's Check Requisition process.

The Council has a process for situations where a purchase order or a p-card is not appropriate. This process has clear, concise criteria and does not allow for exceptions nor for executive override. Eighteen of the 25 sampled payments were used for purchases that did not meet the exception criteria in the Procurement Procedure. These included payments to disburse money to HRA tenants, issue refunds due to overpayments or accidentally depositing a check not issued to the Council, and legal services. The Procurement Procedure states that check requests are to be used only for:

- Newspaper and journal advertising
- Professional dues and memberships
- Conferences, seminars, and travel
- Books, and subscriptions
- Permits, licenses, and easements
- Utilities; taxes
- Insurance
- Required federal, state, and local fees and charges
- Legal settlement payments

This noncompliance with the Procurement Procedure unnecessarily increases the number of payments the Council issues, the resources the Council spends processing payments, and fraud opportunities. This process must be addressed to successfully remove paper checks as a method of payment.

Recommendations:

1. The Metropolitan Council should stop issuing paper checks and require vendors to be paid electronically.

Management Response:

Management agrees that paper checks should be stopped. The process to convert vendors to electronic payments will involve many people and many steps such as the following items:

- 1) An update in policies and procedures will need to be completed. This will help clarify the payment processes at the Council, this will need to include documentation on what can be placed on a Purchase Order, purchasing card, or a payment request (formerly check requisitions).
- 2) The bank system will need to be in place to verify vendors bank account numbers.

⁹ J.P. Morgan. (2021). *Payments Fraud and Controls Survey Report*. Association for Financial Professionals. Web. Retrieved from: https://www.afponline.org/docs/default-source/protected-files/mbr/2021_paymentsfraudsurveyreport-3.pdf

- 3) Communication to all check vendors they must provide banking information for any payment from the Council. A clear date of cut off should be established with vendors and enforced.
- 4) Staff will be in place to process vendor's information for system input.

Timetable:

- 1) Policies and Procedures updated, bank system in place, and Communication plan created by September 30, 2022.
- 2) Communication plan to be multiple correspondence methods, email, information on the checks, letter. Information and reminders should be sent September – December 2022.
- 3) No checks to vendors will be issued after January 1, 2023.

Staff Responsible:

- Marie Henderson, Deputy CFO
- Jody Jacoby, Director of Contracts and Procurement
- Mark Thompson, Sr. Manager Treasury
- Michele Heupel, Manager P-card

Audit Follow-Up: Assess Risk

2. Metropolitan Council Finance should enforce the existing controls for check requisitions and consider updating the exceptions to accurately reflect the Council's needs. It should also require the CFO to document and justify each exception.

Management Response:

Management agrees that the policies and procedures on payments need to be updated. The check requisition process is a process to be followed when a P-card or PO do not apply. The name of the process will be changed to a payment request, (just to clarify that a check requisition was a process that was followed when a P-card or PO processes do not apply, the payment method may be check or electronically). The items that are placed on a payment request will be reviewed and best payment processes will be documented for end-users to follow. If a check would ever need to be processed, an extensive approval process will be documented and enforced.

Timetable: Policies and Procedures updated by September 30, 2022

Staff Responsible:

- Marie Henderson, Deputy CFO
- Jody Jacoby, Director of Contracts and Procurement
- Mark Thompson, Sr. Manager Treasury
- Michele Heupel, Manager P-card

Audit Follow-Up: Confirmation

Controls for printing facilities can be improved.

The Council has printing facilities for its paper checks. These facilities have various controls associated with them to prevent unauthorized access. Audit reviewed the facilities and their controls based on the auditors' judgment. The controls at the facilities differed in perceived effectiveness. Controls at a facility can be improved by implementing cameras inside and outside one of the

facilities. Additionally, a review of access logs revealed that multiple, approved staff had accessed the room after 6:00 p.m. Audit did not observe unauthorized staff accessing the room.

Furthermore, one of the facilities stores additional items that are not a part of the check cutting process. These items have not been inventoried. Without a regular inventory, Finance cannot confirm that all items are accounted for. Additionally, storing these items in the printing room increases the number of staff who require access to the facility, which also increases the amount of people who have access to the check printer and blank check stock.

Management has been informed of these issues and to which locations the issues apply.

Recommendations:

1. Metropolitan Council Finance should consider and implement additional controls for the printing facilities. This should include implementing cameras, limiting access to normal hours of operation, and periodically reviewing who should have access to the facilities.

Management Response:

Management agrees that more controls in place around the printing facilities.

- 1) A camera will be placed outside the door of the printing facilities.
- 2) The door access will be limited to 6:00am to 6:00pm per contract operation hours.
- 3) Yearly review will be in place to have access to the room reviewed, or when employees with access leave.

Timetable:

- 1) Camera to be ordered and placed into service by September 30, 2022
- 2) Door access to be changed by April 30, 2022
- 3) Yearly review documented

Staff Responsible:

Marie Henderson, Deputy CFO

Audit Follow-Up: Assess Risk

2. Metropolitan Council Finance should immediately inventory the items stored in the facility.

Management Response:

Management agrees to completing this inventory. A physical safe was placed in the locked check room for added security.

The staff will document the contents of the safe and maintain the document so at year-end the staff can do a physical inventory against the working document of the safe's contents.

Timetable: Document the contents of the safe by April 29, 2022, annual physical inventory by December 31 each year.

Staff Responsible:

Marie Henderson, Deputy CFO

Audit Follow-Up: Confirmation

Conclusions

The Council's continued use of paper checks to pay its vendors is not aligned with industry or security best practices. It is time for the Council, like other federal and state governments, to phase out paper checks. By reducing the amount of checks it issues, the Council will reduce its fraud risk by reducing the opportunities for check tampering and theft schemes. It will also save the Council money in the long run and allow it to redirect internal resources to more effective tasks.

Implementation of these recommendations will likely take time and effort. It will require a one-time, but significant, shift in internal resources to move vendors to electronic means of payment and implementing effective controls for the purchasing card process. It will also require Council stakeholders in all divisions to communicate and work together to implement these recommendations. This transition aligns with *Thrive MSP 2040's* stewardship outcome to responsibly manage the region's financial resources.



March 11, 2022
Matthew J. LaTour, Director Program Evaluation & Audit
Chief Audit Executive

Appendix A

Program Evaluation and Audit recommendations are categorized according to how Audit will follow-up on them. The categories are:

- **Retest** — Audit will retest the area using the same or similar procedures after a recommendation has been implemented and sufficient time has passed for the changes to take effect. The retest will take place on a specified timetable. The recommendation will be closed once the change has occurred. A new audit project will be opened for retesting and any new findings will include new recommendations.
- **Confirmation** — Audit will confirm that an adequate risk response has been completed on the agreed upon timeline. The recommendation will be closed once the change has taken place.
- **Assess Risk** — Audit will not plan for specific follow up to these recommendations. Audit will discuss the area as part of its annual risk assessment activities and consider future audit work in the area.

Distribution List

All audit reports are reported to the general public and are available on www.metrocouncil.org. This audit report was distributed to the following parties:

- Members of the Audit Committee
- Regional Administrator
- Deputy Regional Administrator
- Deputy Chief Financial Officer
- Director, Metro Transit Finance
- Director, Metropolitan Council Environmental Services
- Director, Procurement
- Manager, Housing and Redevelopment Authority



390 Robert Street North
Saint Paul, MN 55101-1805

651.602.1000
TTY 651.291.0904
public.info@metc.state.mn.us
metro council.org