

Sonoma County

Auditor-Controller-Treasurer-Tax Collector

Internal Audit Report

# Sonoma County Cash Management

For the Period: July 1, 2016 to March 31, 2017

Engagement No: 4007  
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**Erick Roeser**  
Auditor-Controller-Treasurer-Tax Collector

**ERICK ROESER**  
AUDITOR-CONTROLLER  
TREASURER-TAX COLLECTOR

**AUDITOR-CONTROLLER  
TREASURER-TAX COLLECTOR**  
585 FISCAL DRIVE, SUITE 100  
SANTA ROSA, CA 95403  
PHONE (707) 565-2631  
FAX (707) 565-3489



**JONATHAN KADLEC**  
ASSISTANT AUDITOR-CONTROLLER  
TREASURER-TAX COLLECTOR

**AMANDA THOMPSON**  
ASSISTANT AUDITOR-CONTROLLER  
TREASURER-TAX COLLECTOR

Kanchan K. Charan, CPA	Audit Manager
Damian Gonshorowski, CPA	Audit Supervisor
Vanessa Thomas, MBA	Auditor-In-Charge
Olga Gray, CPA	Auditor
Ryan Burns, CISA	Auditor

Auditor-Controller-Treasurer-Tax Collector Web Site  
<http://sonomacounty.ca.gov/Auditor-Controller-Treasurer-Tax-Collector/>

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## Table of Contents

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### Cash Management

#### Engagement No. 4007

For the Period: July 1, 2016 to March 31, 2017

	<u>Page</u>
Executive Summary .....	.1
Introduction and Background.....	.3
Objectives, Scope and Methodology .....	.5
Findings and Recommendations .....	.6
Observations.....	.14
Staff Acknowledgement .....	.15
Appendix A: GFOA Best Practice – Cash Flow Analysis .....	.16
Appendix B: Risk Classifications.....	.18
Appendix C: Management Response .....	.19

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## Executive Summary

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As a part of the 2016/2017 Annual Audit Plan, the Internal Audit Division of the Sonoma County Auditor-Controller-Treasurer-Tax Collector's (ACTTC) Office conducted a review of Sonoma County's (County) cash management process, controls over its investment activities, and collection and transportation of cash from collection points around the county.

The two objectives of the review were to determine if the County's 1) cash management activities were optimizing asset growth and 2) cash collection and handling controls at the Departments adequately secure all cash collected and mitigate untimely deposit risks.

Our report provides five recommendations for improvements in the County's investment management and cash collection processes. In accordance with our established procedures, we are bringing to management's attention all our significant observations applicable to the processes we reviewed. Those that fall within our stated objectives are discussed under findings and recommendations. Those not clearly within the stated objectives but relevant to the processes we reviewed are discussed under other matters.

### Summary of Findings, Recommendations and Observations

#### Findings and Recommendations

#### **Finding 1: Additional resources should be allocated to investment management to optimize asset growth and better safeguard principal**

Although the Treasury employs a full time Investment and Debt Manager (Civil Service Title: Investment & Debt Officer, hereafter referred to as Manager in this report), only half of his time is spent managing investments. The remainder of time is spent in activities unrelated to investments. Treasury should assign a full time Manager devoting 100% of his/her time managing investments, and performing key investment management related activities such as cash flow forecasting, credit analysis of investees and market research to enhance the safety and return of the County's \$2.1 billion investment pool. We also recommended that the ACTTC Office continue to employ some combination of a second Full Time Employee (FTE) to provide support and back up for the investment function to mitigate coverage risk and support the Manager.

#### **Finding 2: At least annually ACTTC should require the County departments and special districts under its jurisdiction to confirm that they have disclosed all bank accounts they opened.**

There is a County policy requiring departments and special districts under the County Treasurer's jurisdiction to obtain authorization from the ACTTC prior to opening a bank account. However, there is no procedure in place to identify bank accounts that may have been opened without such authority. The ACTTC should confirm with the County departments and the special districts on an annual basis that they have disclosed all bank accounts they opened.

#### **Finding 3: Safeguarding of County Assets Needs Improvements**

- **Communicate the County's policy for timely cash deposits.**

Some departments which collect large amounts of cash do not deposit collections as frequently as required by county policy. The ACTTC should periodically communicate to County departments the County's cash handling policy to reduce the risk of untimely deposits.

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## Executive Summary

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- **Implement a Countywide policy requiring safe combinations to be changed periodically.**  
There was no County-wide policy covering the resetting of safe combinations. As a result we noted some departments had not changed safe combinations for long periods of time. Since the completion of our review, ACTTC updated and issued Sonoma County Fiscal Policy C-6-Cash Handling (Cash Handling Policy) effective June 30, 2017 which includes guidance on changing safe combinations. The ACTTC should annually communicate the guidance on resetting safe combination to County departments.
- **Develop a policy for transportation of cash from the collection locations to the Treasury.**  
We noted that a number of departments assign only one individual to transport cash to the Treasury, which at times could be material. Since the completion of our review, the ACTTC updated and issued the Cash Handling Policy which requires departments to assign two employees when the amount to be transferred is material.

### Observations

- **Observation 1: Documentation of evaluation of banking agreements**  
The Treasury should continue to evaluate the agreements it has with banks before they are renewed/extended to ensure the County's needs are satisfied at a reasonable cost. These evaluations should be documented to support that user needs were considered and the price remained competitive.
- **Observation 2. Monitoring the collateral maintained by the banks**  
The Treasury should periodically confirm that the banks it does business with have, in compliance with the law, maintained the dollar values of collateral necessary to adequately protect the County in the event of bank failure.
- **Observation 3: Computer access reviews**  
Treasury management should implement policies and procedures over access to applications utilized by Treasury and periodically conduct reviews to ensure that the individuals with access and access levels are appropriate. Additionally, employee's no longer requiring access should be removed or deactivated from the applications.
- **Observation 4: Comprehensive Business Continuity Plan**  
Treasury management should work with ISD to develop a comprehensive business continuity plan to include disaster recovery protocols. The plan should be periodically tested.
- **Observation 5: Segregation of incompatible cash collection functions**  
Currently, since there is only one staff assigned to work at the jail industries plant managed by the Sheriff's Office, the collection and recording of cash and deposit preparations are done by one individual, increasing the risk that errors or irregularities will occur and not be discovered in a timely manner. Sheriff's management should implement detective controls to timely identify errors and irregularities should they occur.

A detailed discussion of findings, recommendations and observations are provided in the body of the audit report. Management's responses and implementation plan are included in their entirety in Appendix C of the audit report.

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## Introduction and Background

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### Introduction

The Internal Audit Division completed a review of the County's Cash Management process for the period July 1, 2016 to March 31, 2017, reviewing controls over investment and cash handling functions. We conducted the audit in accordance with the *International Standards for the Professional Practice of Internal Auditing (Standards)*. These Standards require that sufficient information and evidence to achieve audit objectives are identified, evaluated and documented. The evidence obtained provides a reasonable basis for the results, observations, and recommendation contained in our report.

The purpose of this report is to provide advice and recommendations that will help County Management improve the risk management and control processes to better achieve its operational goals and objectives.

The Internal Audit Division as well as the Assistant Auditor-Controller-Treasurer-Tax Collector, who is responsible for the Treasury and Investment functions covered by this review, report to the elected ACTTC. Except for conducting this review, the Internal Audit Division has no other responsibilities or involvement in the management or performance of Treasury, Investment and cash collection functions.

### Background

The Treasurer serves as the depository for all funds belonging to the county, school district, and some special districts within the county. These entities rely on the County Treasurer to provide them with the daily liquidity needed to carry out their respective businesses. Operating primarily under the Government Code, the Treasurer receives, deposits, and manages investments of \$2.1 Billion generated from taxes, fees, grants, and bond proceeds and currently apportions approximately \$12 million in interest earnings annually. The Treasurer oversees all banking operations for the County and its Departments. In addition, the Treasurer is responsible for the issuance of county debt obligations which support a variety of projects and other county financing needs. The ACTTC is responsible for setting policies and procedures over the collection, deposit and investment of cash for County departments and certain special districts.

In Sonoma County, the Treasurer-Tax Collector and the Auditor-Controller functions are combined and assigned to the elected Auditor-Controller-Treasurer-Tax Collector (ACTTC).

Throughout the County various departments receive cash (physical currency and checks) for services performed or taxes due in person and via mail. The following seven Departments have the largest collection:

Department	Estimated annual amount of cash brought into Treasury
Auditor-Controller-Treasurer-Tax Collector	\$1.04 Billion
Health Services	\$26.5 Million
Permit and Resource Management	\$23.5 Million
Regional Parks	\$5.6 Million
Probation	\$5.3 Million
Clerk-Recorder-Assessor	\$3 Million including ACH receipts
Sheriff	\$1.7 Million

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## Introduction and Background

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California Government Code Section 27000 states, "...the county treasurer shall receive and keep safely all money belonging to the county..."

The County departments are required to receive, record and safeguard all cash collected in accordance with policies and procedures prescribed by the ACTTC and transport the collection to the Treasury. The Treasurer, as required by law, receives, safeguards and deposits all funds submitted by the departments. In addition, the Treasurer is responsible for investing and safeguarding all funds in their custody.

The Treasury staff ensure the total collection submitted by the department for deposit agrees with the total recorded in the County's Enterprise Financial System (EFS) by the department. Monthly, the total cash and investments held by the Treasury is reconciled with the total cash recorded in EFS.

The Manager is responsible for investing excess cash, ensuring there are sufficient funds available to pay for the county's obligations as they come due. The investments manager is restricted to purchase only those types of investments that are allowed by the County's investment policy and the law. An audit is conducted annually to provide assurance that the Treasurer complied with such requirements of the investment policy and the law. The three main objectives of the investment policy are:

1. **Safety of Capital** – The preservation of capital is the primary objective. Each transaction shall seek to ensure that capital losses are avoided, whether they be from securities default or erosion of market value.
2. **Liquidity** – As a second objective, the Pooled Investment Fund should remain sufficiently flexible to ensure the County Treasurer meets all operating requirement, which may be reasonably anticipated in any depositor's fund.
3. **Maximum Rate of Return** – As the third objective, the Pooled Investment Fund should be designed to attain a rate of return through budgetary and economic cycles, consistent with the risk limitations, prudent investment principals and cash flow characteristics identified.

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## Objective, Scope, and Methodology

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### Objective

In 2014, The Internal Audit Division conducted a county wide risk assessment that identified Cash Management as having inherently high potential risk, primarily due to the large amount of cash being collected in multiple departments across the County and the large dollar value of investments managed by the County Treasurer. Based on our risk assessment of the area and discussion with management, we agreed to pursue the following two audit objectives:

1. Are the County's cash investment activities optimizing asset growth?
2. Do cash collection and handling controls at departments adequately secure all cash collected and mitigate untimely deposit risks?

### Scope

The audit covers the period July 1, 2016 through March 31, 2017 and includes cash held in banks, mutual funds, investments and the cash collection process in the County's Sheriff's, Probation and Health Services Departments.

### Methodology

To address our audit objectives, the Internal Audit Division conducted the following activities:

- Performed a risk assessment of the Treasury operations, investment and cash collection activities.
- Identified key risk areas to Treasury operations, investment and cash collection activities.
- Surveyed 7 departments on their cash handling process.
- Performed interviews with Treasury management and department staff.
- Performed walkthroughs of the cash handling procedures at the Sheriff's, Probation and the Health Services Departments, starting with the receipt of cash and ending with the deposit in the Treasury.
- Performed a walkthrough of the deposit receipting process at the Treasury.
- Performed a walkthrough of the Treasury investment function.
- Conducted a general controls review of the County's cash management process to assess potential risks to the safeguarding of cash and investments.
- Conducted a review of cash flow management to assess the potential risk of the county not being able to meet its financial responsibilities.
- Conducted a detailed assessment of cash collection risks for the population of all County departments and selected three departments for detail cash processes review.
- Reviewed user access for systems administered/controlled by Treasury.
- Reviewed Government Finance Officers Association (GFOA) best practices for cash handling and investments.



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## Findings and Recommendations

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### Objective 1: Are the County's cash investment activities optimizing asset growth?

**Finding 1: Additional resources should be allocated to investment management to optimize the investment of assets and better safeguard principal.**

**Risk Classification:** B – Significant Control Weakness

**Criteria:**

1. A key component to the management of any investment fund is having a clear understanding of the dynamics of the cash flow needs of the pool participants, which is an essential part of managing cash and investments. A detailed cash flow forecast, provides greater understanding of cash needs, and reduces the amount of cash necessary to maintain liquidity, thus increasing investment opportunities. A detailed cash flow forecast estimates all cash receipts and disbursements during a given period. Receipts may include items such as property taxes, other revenue from fees and penalties, grants, bond proceeds and investment maturities. Disbursements may include debt service payments, employee payroll and benefits, payments to vendors and other discretionary expenditures. Actual cash flow results should be compared with projections. Historical cash flow data is used to identify potential liquidity risks. When used consistently a detailed cash flow forecast can help improve investment earnings and identify maximum maturity limits.

The GFOA recommends six key activities for implementing cash flow forecasts in Treasury Operations (see Appendix A).

2. County's Investment Policy states the following:

- **Safety of Capital** - The preservation of capital is the primary objective. Each transaction shall seek to ensure that capital losses are avoided, whether they be from securities default or erosion of market value
- **Liquidity** - As a second objective, the Pooled Investment Fund should remain sufficiently flexible to ensure the County Treasurer meets all operating requirements, which may be reasonably anticipated in any depositor's fund.
- **Maximum rate of return**- the Pooled Investment Fund should be designed to attain a rate of return through budgetary and economic cycles, consistent with the risk limitations, prudent investment principles and cash flow characteristics identified herein.

3. Certain types of investments within the investment portfolio are subject to default/investment risk. To address default/investment risk the Manager should perform credit analysis of investments that are subject to this risk. Credit analysis is a type of analysis performed on debt issuing entities encompassing the entity's ability to meet its debt obligations (an entity's ability to repay principal and interest in a timely fashion). This credit analysis seeks to identify the appropriate level of default risk associated with investing in that particular entity.

**Condition:**

1. The ACTTC utilizes a high level cash flow forecast to manage liquidity and make investment decisions over a pool of approximately \$2.1 Billion. The high level cash flow forecast, tracks investment maturities, potential calls, large checks (over \$100,000) and large payments (such as debt payments). Projected ending cash balances are compared to the actual bank balances on a daily basis. According to management actual receipts and disbursements for very large expenditure and revenue items are compared with projections and historical data is used to develop a cash flow forecast. However detailed receipt and disbursement information, other than those described above, was not present in the high level cash flow forecast. The detailed cash flow forecast will help to reduce cash and mutual fund balances. The ACTTC's investment returns are in line or above other comparable counties. The average rate of return on cash invested by the ACTTC (during March 2017) was 1.19%, before administrative expenses. The average daily bank balance (Exchange Bank and Bank

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## Findings and Recommendations

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of America) for March 2017 was approximately \$17MM, the average interest earned on this cash was approximately 0.22%. The average daily mutual fund balance was \$69MM during the same period, the average interest earned was approximately 0.78%.

2. Certain types of investments within the investment portfolio are subject to default/investment risk. As of 7/1/17, 18.3% (\$410 million) of the investments in the pool are assets that would benefit from credit analysis. According to the external auditors report all of these investments conform to the Sonoma County Investment Policy and are in compliance with the various California Government Code sections. In addition, none of the corporate debt is rated below 'A-'(within the 3 highest ratings tiers). The incumbent Manager does not have sufficient time to perform credit analysis of these certain types of investments and conduct adequate market research. By identifying entities that are about to experience a change in debt rating, a Manager will be in a better position to react to the change and minimize default/investment risks. For example, if the manager believes that the entity's debt rating is about to decline, which is a signal of higher default risk, then the manager may be able to sell the security before the rating change takes place. Having more quality information may enable the County to avoid potential losses, such as San Mateo County experienced in the past with Lehman Brothers, a global financial services firm, Lehman's failure initially resulted in a \$155 million loss to the San Mateo County's investment pool which held funds for the county, school districts, special districts and other public agencies. The San Mateo County's investment pool ultimately recovered more than \$71 million — or 46 percent of losses — through bankruptcy proceedings and litigation against Lehman Brothers' directors and officers and Lehman's auditors, Ernst & Young<sup>1</sup>.

Credit analysis and market research assist with arriving at a reasonable market price for securities. The market sets the price, however a Manager can have a reasonable opinion whether the price of the security looks above, below or in-line with current market prices. This takes into account default/investment risk. Market research also helps to determine the right mix of the securities in the investment pool. Credit analysis requires a substantial amount of the Manager's / staff time. The other California counties with a similar portfolio size are dedicating on average 2 FTEs (includes only investment staff such as Chief Investment Officer, Assistant Investment Officer, Senior Accountant, etc.) and does not include top management such as Department Head (Chief Deputy Treasurer) or Assistant Department Head to managing their investment pool. For example, Tulare County with \$1.4 billion in investments has 2 FTEs (\$700K per FTE); San Bernardino County with \$6.5 billion pool has 4 FTEs (\$1.63 billion per FTE); Fresno County with a \$3.3 billion pool has 2 FTEs (\$1.65 billion per FTE) compared to Sonoma County with \$2.1 billion pool and 0.5 FTE.

Adequate and timely market research allows a Manager to have an up-to-date opinion of what is effecting the market and how that relates to the securities the Treasury purchases or holds in the pool. This facilitates entering into transactions at reasonable prices or that are otherwise advantageous to the primary goals of the pool.

Having a dedicated full-time Manager will allow for more frequent meetings with pool participants, custody banks, brokerage firms and peers. This will greatly assist with the accumulation of information and the back and forth flow of information. It will also allow the Treasury to better optimize the cash flow and the mix of the funds invested on behalf of all pool participants.

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<sup>1</sup> County of San Mateo Treasurer's website, Lehman, Ernst and Young Distribution 5-18-15 (final distribution)

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## Findings and Recommendations

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### Cause:

The following were the primary contributing factors:

1. Although the Treasury is currently using a high level cash flow forecast, management indicated they do not have adequate staffing in place to capture the data required to develop and maintain a detailed cash flow forecast. The incumbent Manager is spending approximately 50% of his time to manage the \$2.1 billion investment pool. This is due to the fact that he has other major responsibilities as his position oversees multiple other countywide programs such as Transient Occupancy Tax, Deferred Compensation, and the new Cannabis Tax Collection program. When this position was first created in 2006-07 the Treasury pool was much smaller (approximately \$1.2 billion) and the ability to focus on Treasury investments was much greater. Since that time, many of the large programs under the Manager have more than doubled in size, which has greatly reduced the ability to prioritize the Treasury investment work. As a result, the necessary data cannot be collected (identification of all operating expenditures and revenues as well as historical data and budgeted to actual analysis) because of a lack of available staff time.
2. During the process of creating the Cannabis program the ACTTC made a formal request for additional resources to cover the non-investment related duties currently performed by the Manager. While some resources were approved, the program manager position was denied and, as a result, management and oversight of the Cannabis program stayed with the Manager. If all of the requested resources had been approved, the Manager would have been freed up to devote nearly 100% of his time to investment related activities.

### Effect:

The following are the primary effects as a result of conditions identified on pages 6 and 7:

1. Limited market awareness, potential investment/default risks and opportunities are not identified timely.
2. Missed opportunity to optimize the investment of available cash and possibly earn additional interest income each year. With additional resources the Manager will be better able to optimize the interest earnings of the investment pool while maintaining a high level of safety and liquidity. As a result, the pool may be able to realize increased interest earnings on behalf of the pool's participants.
3. Greater uncertainty of cash flows, high bank and mutual fund balances are necessary to maintain sufficient liquidity cushion.

### Recommendation

In order to perform the recommended additional procedures including implementing a more actively managed approach to the investment pool, detailed cash flow and credit analysis, it is recommended the ACTTC add one full-time position so that a Manager is primarily dedicated to the management of the investment pool. Also, it is critical that investment activities be continued during any unanticipated absence of the Manager in order to avoid coverage risk. Therefore, it is also recommended that the ACTTC continue to employ some combination of a second FTE to provide support and back up for the investment function to mitigate coverage risk and support the Manager.

A detailed cash flow forecast should be developed and maintained to ensure adequate liquidity while maximizing cash available for investing.

The Manager should perform necessary credit analysis to supplement any reports received from outside analysts.

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## Findings and Recommendations

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**Objective 2: Do cash collection and handling controls at the Departments adequately secure all cash collected and mitigate untimely deposit risks?**

**Finding 2: At least annually the ACTTC should require the County departments and special districts under its jurisdiction to confirm that they have disclosed all bank accounts they opened.**

**Risk Classification:** C-Control Finding

**Criteria:**

According to State of California Government Code Section 27000, “The county treasurer shall receive and keep safely all money belonging to the county.” The County’s website for the Sonoma County Treasurer also states, “... the Treasury section is responsible for the safekeeping and investment of funds for the County, school districts and special districts. The Treasury oversees all banking operations for the County and its departments and is the paying agent for all debt and special assessments.”

Currently, if a department, special district or agency wants to open up a bank account under the county’s tax ID they must go through several steps such as the following:

- Send a letter to the County Treasurer requesting the opening of the bank account. Including the names of the signers on the account
- Have the governing board of the department, special district or agency approve the opening of the bank account and describe the purpose of the account
- Obtain written approval and authorization from the Treasurer for the department, special district or agency to open the bank account

The department, special district or agency requesting to open a separate bank account is required to provide a justifiable business reason for maintaining a separate account, which could be the excessive cost of transporting cash to the Treasury due to the distance between the collection point and Treasury office.

**Condition:**

Treasury has a list of bank accounts that departments, special districts and agencies have opened and are maintained outside the control of the Treasury. There are 43 accounts on this list and on a weekly basis Treasury performs a sweep of these accounts. Since Treasury has not performed any additional procedures to ensure the list is complete, there is a risk that funds are being accumulated in bank accounts of which the Treasury is not aware. Based on inquiry of the departments whose cash processes we reviewed, we identified three bank accounts outside of Treasury. Treasury is aware of these 3 accounts and performs a weekly sweep to transfer cash from these accounts to an account maintained by Treasury.

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## Findings and Recommendations

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### Cause:

The ACTTC relies on bank policies which require that entities provide certain documentation to open outside accounts. The ACTTC has not identified a practical means to reduce this risk.

### Effect:

There is a risk that funds belonging to the County are being accumulated in bank accounts and not being recorded in the County's books, increasing the risk of errors and irregularities.

### Recommendation:

ACTTC should periodically confirm with the departments that they have disclosed all bank accounts under their control.

### Finding 3: Safeguarding of County Assets Needs Improvements.

#### Risk Classification: B-Significant Control Weakness

To minimize the risk of loss, cash collected should be properly secured while in custody, deposited as quickly as practical, and transported in a safe and secure manner.

#### a) Timely Deposit of County Assets

##### Criteria:

California Government Code and County policies and procedures emphasize the importance of the timely deposits of cash to the Treasury. In addition, County policy requires employee safety be given the highest priority.

- **California Government Code Section 24351** - Unless otherwise specifically provided for by law, each officer of a county or judicial district shall on the certificate of the auditor immediately deposit in the county treasury all trust money coming into his possession officially.
- **Sonoma County Fiscal Policy Manual C-2, Policy for Handwritten and Cash Register Receipts** - "All monies collected or received by County departments, agencies or districts, shall be deposited whenever practical, in the County Treasury, no later than one working day following the date received.....If it is not practical to deposit monies by the next working day following the date received, then deposits should be made at least weekly or whenever \$500 is accumulated..." It also states "...employee safety and guarding of the assets should be given first consideration in any of these decisions."

##### Condition:

Only two of the seven divisions in the three departments reviewed made deposits on a daily basis. A majority made deposits on a weekly basis.

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## Findings and Recommendations

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### Cause:

Some departments do not deposit funds as frequently as required by county policy due to lack of resources and others due to being unaware of the county policy requirements.

To assist departments in making timely deposits, Treasury considered a system where departments would drop cash bags in drop boxes located close to departmental offices which would later be picked up by couriers contracted by Treasury. Management ruled out the drop boxes as it would not be cost effective. Other options were also considered but were also ruled out due to not being cost effective.

### Effect:

Not depositing cash on a timely basis results in lost opportunity for earning interest and increased risk of loss of cash.

### Recommendation:

Prior to the end of our audit the ACTTC General Accounting Division developed and distributed an updated cash handling policy to the County Departments requiring County Departments to do the following: the following:

- 1) Annually certify that his/her department complied with County's cash handling policy.
- 2) Submit written cash handling procedures as part of the annual certification.

Treasury should do the following as part of rolling out the revised policy:

- 1) Send out the revised cash handling policy to departments on an annual basis.
- 2) Review and update the cash handling policy annually as necessary.
- 3) On a case by case basis, the Treasury Manager should approve department requests to be granted exception to the policy requirements. The exception should be based on business needs described by the department and add controls to address increased risk of noncompliance with the policy.

### b) Combination to the safe

#### Criteria:

Best practices dictate that access to cash and other assets convertible to private use should be restricted in order to reduce the risk of loss.

The updated Sonoma County Fiscal Policy C-6-Cash Handling (Cash Handling Policy) effective June 30, 2017 states as follows: "Provide safe combinations only to employees who require access and change safe combinations periodically (such as when there is employee turnover of staff with safe combination). At least two staff should be present to open a safe."

#### Condition:

At some of the cash collection points reviewed, we noted safe and drawer lock combinations had not been changed for extended periods of time. We also noted that the combinations were not routinely changed when

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## Findings and Recommendations

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employees with knowledge of the safe/drawer lock combinations separated from the County and/or transferred to other areas of the County.

**Cause:**

The department staff was not aware of the risk of not resetting safe/drawer locks timely or the County policy requiring to do so.

**Effect:**

There is increased risk that safes and drawers where cash is stored will be accessed by unauthorized individuals. In the event of a loss, it would be difficult to establish responsibility.

**Recommendation:**

The ACTTC should collaborate with departments/agencies/offices to develop greater awareness of the cash handling risks and policies for those individuals involved in handling cash. At a minimum the ACTTC and affected departments should develop a documented process to ensure employees involved in cash handling provide written confirmation that they have read and will comply with the County cash handling policy.

**c) Safe and secure transportation of cash collected**

**Criteria:**

Reasonable precautions should be taken to minimize the risk to the employees and the cash being transported. Banking and other industries that routinely handle cash have established practices to minimize losses. One of those practices is to assign dual control over material amounts of cash when being transported or accessed. An additional practice would be to make the location of cash as inconspicuous as possible. In so doing the risk of loss from theft is reduced.

The updated Cash Handling Policy, effective June 30, 2017 states: "Establish procedures for safely transporting cash around the County campus as appropriate: a.) Ensure that another employee or security officer accompanies an employee transporting large amounts of cash; b.) Implement controls needed to minimize risk to staff's safety and protect cash; c.) Cash should be transported in concealed bags or locked containers.

**Condition:**

Only one employee takes the deposit to Treasury for all three departments reviewed.

**Cause:**

Departments are not able to assign a second person when cash is transferred due to lack of resources.

**Effect:**

There is an increased risk of robbery resulting in loss of cash and potentially unsafe conditions for the employee(s) assigned to transfer deposits to the Treasury.

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## Findings and Recommendations

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### Recommendation:

As required by the revised county wide Cash Handling Policy updated and distributed on June 30, 2017, departments should assign two employees when large amounts of cash is transported. The County policy should be periodically communicated to the departments.



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## Observations

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In performing our review, we identified the following observations and opportunities for improvements:

### **Observation 1: Documentation of evaluation of banking agreements**

Treasury should continue to evaluate the agreements with the banks when they are renewed/extended or at least every two to five years and move forward with plans to conduct an RFP.

Treasury Management should periodically reevaluate current banking relationships and banking service needs, to determine whether the current banking relationships and services are meeting user needs at competitive prices. This evaluation should be documented and identify all users of banking services. This evaluation should also consider changes in financial services environment, including such factors as regulatory developments, technological advances, new entrants in the market place and economic conditions.

### **Observation 2: Monitoring the collateral maintained by the banks**

By law banks are required to maintain assets and/or securities with a market value in excess of 105% to 150% (depending on type of security used) of the value of deposits they are holding for government entities above FDIC limits. In the event of a bank failure, these assets are to be used to make the government entities whole. As Sonoma County participates in the Local Agency Collateralization Pool, banks are required to report their compliance with this requirement of the law to the California Administrator of Local Agency Security.

To safeguard the County's interest, Treasury should periodically confirm that banks the County utilizes have maintained the required market value of assets/securities as required by law.

### **Observation 3: Computer Access Reviews**

To ensure continued availability, reliability and accuracy of business systems, it is important to restrict access to the systems administered/controlled by the Treasury, only to those who have a business purpose. The level of access a user has should be commensurate with his/her assigned responsibilities. A user should not have access that will allow him/her to perform incompatible functions.

Formal user access policies and procedures are currently not in place.

Activities to ensure appropriate access to systems impacting the County's Financial Systems should be strengthened.

Treasury Management should conduct reviews of user access rights periodically using a formal process. User access rights should be reviewed or reallocated after any job changes, such as transfer, promotion, demotion or termination of employment. Authorizations for special privileged access rights should be reviewed independently at more frequent intervals.

### **Observation 4: Comprehensive Business Continuity and Disaster Recovery**

Activities to ensure successful Disaster Recovery tests and appropriate Business Continuity Plans are not in place.

ACTTC Management should work with ISD to develop a comprehensive Business Continuity Plan (BC Plan) with all IT systems administered by ACTTC personnel. This BC Plan should be incorporated with the overall County ISD BC Plan, as ISD resources will be working with all County Departments and should include:

- A list of all IT systems administered by ACTTC. The list should be prioritized to ensure most critical systems are up and running first in the case of a disaster. The amount of time it will take to bring each system online should be estimated and the impact on business continuity should be assessed.

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## Observations and Staff Acknowledgement

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- Business Impact Analysis. Document the lengths of time each operating unit will be able to work off line and the issues that will arise as a result. The plan should address these issues and provide for appropriate level of resources.
- Disaster Recovery Testing – each system listed should be tested annually to ensure recovery is possible and efficient.

### **Observation 5: Segregation of incompatible cash collection functions.**

The North County Detention Facility has a unique program where they teach inmates how to grow and sell 200 varieties of plants. There are three annual plant sales that are open to the public. Purchases can also be made by appointments with the instructor at the facility.

The program has only one employee who sells the plants, receives payments, records the sale and prepares deposits. As a result there is a high risk that any errors or irregularities occurring in the collection and deposit of cash will not be discovered in a timely manner. In order to cost effectively mitigate the risks, a second person (the program sergeant) should account for all receipts issued and ensure that total collection per receipts issued agrees with total being deposited. As part of this process, the second person should ensure that all copies of the any voided receipts are retained.

### **Staff Acknowledgement**

We would like to thank the ACTTC Treasury Division, Investment/Debt Division, the Sheriff's Department, Probation Department and Department of Health Services for their time, information and cooperation throughout the review



# BEST PRACTICE

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## Cash Flow Analysis

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### **BACKGROUND:**

Governments conduct cash flow analysis to estimate available cash deposits, expected inflows, and required disbursements during a given period so they can ensure sufficient liquidity. Common inflows include tax receipts, bond proceeds, utility payments, grants, other revenue from fees and penalties, and maturities of all securities held in investments that will mature during the forecast time frame. Outflows represent anticipated payments such as debt service, employee payroll or benefits, and payments to vendors for goods and services anticipated during the forecast time frame. Governments should also consider and accommodate non-repetitive payments such as capital expenditures or expected legal settlements, using reasonable assumptions.

The analysis is intended to measure and assess the government's ability to meet its needs, to negate the need for any short-term borrowing or liquidation of long-term investments before maturity, and to identify any idle funds, and the duration of that idle period, to determine whether those funds could be invested over that time frame. Cash flow analysis can also help governments recognize issues that might have a negative impact on their cash positions. When looking at the entire organization, governments can use cash flow analysis to coordinate spending patterns to mitigate potential shortfalls by using information to improve revenue collection practices. Cash flow analysis is therefore an essential tool for informed management decision making.

### **RECOMMENDATION:**

GFOA recommends that governments perform ongoing cash flow analysis to ensure that they have sufficient cash liquidity to meet disbursement requirements and limit idle cash. When conducting a cash flow analysis governments should:

- Create a pooled portfolio of unrestricted operating funds across all government funds, creating one pot of money that will be available for all routine operating obligations. This allows cash flow to be analyzed more efficiently. A government might need to exclude unspent bond proceeds or other similarly restricted funds from its cash flow planning analysis, depending on the timing and purpose of their use.

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## Appendix A

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- Consider historical information and projected financial activity, which are critical to developing and maintaining the cash flow analysis process. Historical information, which can be derived from banking or financial system reports, is particularly useful if a given government's cash flows are predictable over time. Prospective information (e.g., a subsequent year's budget or the amortization schedules associated with new debt issuance) can help the analyst anticipate deviations from the historical norm.
- Compare actual cash flow results with projections and determine the reasons for those differences in the analysis. The precision of cash flow analysis depends on a government's size and complexity, and the size of its cash liquidity position, but adding this step will help make future analysis more accurate.
- Make conservative assumptions about both the cash receipts and disbursement portions of the analysis, and update these assumptions regularly, as well after any major changes in operations (e.g., a new debt issuance or at the beginning of a fiscal year).
- Monitor cash position daily to ensure sufficient liquidity. The accuracy of the cash flow forecast should be evaluated at least quarterly, and if any adjustments are needed, they should be made at this point. No forecast will be 100% accurate, and governments should weigh the amount of effort these evaluations require against any expected improvements in the model. A simple model often works best; consider making the model as straightforward as possible (while maintaining the reliability and precision of information needed for making appropriate management decisions).
- Select an appropriate tool for conducting the cash flow analysis. Many governments can complete an analysis using simple spreadsheet software, while organizations that require more complex modeling can use commercially available analytic or business intelligence systems, or modules found within common enterprise resource planning (ERP) or financial management systems.

An effective cash flow analysis should also encourage the government to communicate decisions that could affect cash inflows and outflows (e.g., decisions regarding legal settlements, changes in revenue collections, or significant milestones for capital projects) to the responsible parties so they can ensure sufficient cash liquidity.

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## Appendix B

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For purposes of reporting audit findings and recommendations, audit report items are classified into three distinct categories to identify the perceived risk exposure:

- **Risk Classification A: Critical Control Weakness:**  
Serious audit findings or a combination of Significant Control Weaknesses that represent critical exceptions to the audit objective(s), policies, and/or business goals of a department/agency or the County as a whole. Management is expected to address Critical Control Weaknesses brought to their attention immediately.
  
- **Risk Classification B: Significant Control Weakness:**  
Audit findings or a combination of Control Findings that represent a significant deficiency in the design or operation of internal controls. Significant Control Weaknesses generally will require prompt corrective actions.
  
- **Risk Classification C: Control Findings:**  
Audit findings concerning internal controls, compliance issues, or efficiency/effectiveness issues that require management's corrective action to implement or enhance processes and internal controls. Control Findings are expected to be addressed within our follow-up process.

**ERICK ROESER**  
AUDITOR-CONTROLLER  
TREASURER-TAX COLLECTOR

**AUDITOR-CONTROLLER  
TREASURER-TAX COLLECTOR**  
585 FISCAL DRIVE, SUITE 100  
SANTA ROSA, CA 95403  
PHONE (707) 565-2631  
FAX (707) 565-3489



**JONATHAN KADLEC**  
ASSISTANT AUDITOR-CONTROLLER  
TREASURER-TAX COLLECTOR

**AMANDA THOMPSON**  
ASSISTANT AUDITOR-CONTROLLER  
TREASURER-TAX COLLECTOR

### **Finding 1: Additional resources should be allocated to investment management to optimize the investment of assets and better safeguard principal**

#### **Recommendation**

Although the Treasury employs a full time Investment and Debt Manager (Manager), only half of his time is spent managing investments. The remainder of time is spent in activities unrelated to investments. Treasury should assign a full time Manager devoting 100% of his/her time managing investments, and performing key investment management related activities such as cash flow forecasting, credit analysis of investees and market research to enhance the safety and return of the County's \$2.1 billion investment pool. We also recommended that the ACTTC continue to employ some combination of a second Full Time Employee (FTE) to provide support and back up for the investment function to mitigate coverage risk and support the Manager.

#### **Management Response:**

We agree.

#### **Action Plan:**

Work with the County Administrator and Human Resources to advocate for the creation/addition of 1 Full Time Equivalent (FTE) Manager. The new position would be able to utilize the existing cash flow forecasting tool as a basis for a more detailed analysis, and would also be able to perform credit risk analysis in order to optimize the investment of pooled assets and better safeguard principal.

#### **Responsible Party:**

Erick Roeser, ACTTC; Jonathan Kadlec, Assistant ACTTC.

#### **Target Completion Date:**

9/30/2018.

### **Finding 2: At least annually ACTTC should require the County departments and special districts under its jurisdiction to confirm that they have disclosed all bank accounts they opened.**

#### **Recommendation:**

There is a County policy requiring departments and special districts under the County Treasurer's jurisdiction to obtain authorization from the ACTTC prior to opening a bank account. However, there is no procedure in place to identify bank accounts that may have been opened without such authority. The ACTTC should confirm with the

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## Appendix C

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County departments and the special districts on an annual basis that they have disclosed all bank accounts they opened.

### Management Response:

We agree.

### Action Plan:

We will prepare an annual letter addressed to all County departments and special districts over which the Treasurer has authority that will request a listing of all open bank accounts.

The ACTTC General Accounting Division has already made a request of departments to provide this information as a part of their request to departments to certify they are in compliance with the Fiscal Policy C-6, Cash Handling. Staff will follow up with a request to special districts for bank account information as well.

### Responsible Party:

Jonathan Kadlec, Assistant ACTTC; Amanda Clark, Assistant ACTTC; Dana Shern, Treasury Manager.

### Target Completion Date:

1/31/18 and annually thereafter.

### Finding 3: Safeguarding of County Assets Needs Improvements

#### Recommendations:

- **Re-communicate the County's policy for timely cash deposits.**  
Some departments which collect large amounts of cash do not deposit collections as frequently as required by county policy. ACTTC should periodically communicate to County departments the county's cash handling policy to reduce the risk of untimely deposits.
- **Implement a Countywide policy requiring safe combinations to be changed periodically.**  
There was no County-wide policy covering the resetting of safe combinations. As a result we noted some departments had not changed safe combinations for long periods of time. Since the completion of our review, ACTTC updated and issued Sonoma County Fiscal Policy C-6-Cash Handling (Cash Handling Policy) effective June 30, 2017 which includes guidance on changing safe combinations. The ACTTC should annually communicate the guidance on resetting safe combination to County departments.
- **Develop a policy for transportation of cash from the collection locations to the Treasury.**  
We noted that a number of departments assign only one individual to transport cash to the Treasury, which at times could be material. Since the completion of our review, ACTTC updated and issued the Cash Handling Policy which requires departments to assign two employees when the amount to be transferred is material.

#### Management Response:

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## Appendix C

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We agree.

**Action Plan:**

As mentioned, we have recently implemented Fiscal Policy C-6, Cash Handling. The policy includes a requirement for the timely deposit of cash, the periodic resetting of safe combinations, and the need for departments to establish procedures for the safe transportation of cash to the Treasury.

The policy requires an annual certification which was communicated to departments in August 2017 requiring that they certify they are in compliance with the requirement to have written cash handling procedures in place, and that they provide the ACTTC with a copy of those procedures. Departments were also requested to provide a listing of all outside bank accounts.

The ACTTC will review the Cash Handling Policy annually as needed.

The ACTTC will need to develop criteria by which Cash Handling Policy exceptions may be considered and/or granted prior to implementing an exception process.

**Responsible Party:**

Amanda Clark, Assistant ACTTC (Or new General Accounting Manager); Jonathan Kadlec, Assistant ACTTC; Dana Shern, Treasury Manager.

**Target Completion Date:**

6/30/2018.

**Observations**

**Observation 1: Documentation of evaluation of banking agreements**

Treasury should continue to evaluate the agreements with the banks when they are renewed/extended or at least every two to five years and move forward with plans to conduct an RFP.

Treasury Management should periodically reevaluate current banking relationships and banking service needs, to determine whether the current banking relationships and services are meeting user needs at competitive prices. This evaluation should be documented and should identify and include all users of banking services. This evaluation should also consider changes in financial services environment, including such factors as regulatory developments, technological advances, new entrants in the market place and economic conditions.

**Management Response:**

We agree.

**Action Plan:**

Staff continually evaluates the Treasury's banking relationships and contracts. On a periodic basis the County of Sonoma sends out a survey to several comparable counties regarding banking services, the most recent being



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## Appendix C

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performed in 2015. Surveys vary in what is being requested and therefore at times will include different items of interest such as monthly fees paid or compensating balances realized.

The results of the survey are compiled and reviewed which allows the County of Sonoma to better evaluate the banking relationships that are currently in place and whether a change in banks should be considered.

Consideration is always given to the possibility of conducting a formal request for proposal process (RFP). However, any consideration of changing the primary banking relationship requires considerable financial and staffing resources due to the integration of systems with banking processes and thus the work needed to make a banking change is very significant. At the present time the resources needed are unavailable and it is currently not feasible to conduct a formal solicitation process for banking services. The cost of a change is significant and the anticipated cost savings would be extremely minimal compared with the added expense. Staff also gave some consideration to the services banks provide and through our research and networking with other California counties learned that we have access to the same suite of services that any other bank would provide. We speak with our customer base on a daily basis and have a keen understanding of their banking needs and are not aware of any service deficiencies at the present time.

**Responsible Party:**

Dana Shern, Treasury Manager; Jonathan Kadlec, Assistant ACTTC.

**Target Completion Date:**

Completed. Re-evaluate in the future.

**Observation 2: Monitoring the collateral maintained by the banks**

By law banks are required to maintain assets and/or securities with a market value in excess of 105% to 150% (depends on type of security used) of the value of deposits they are holding for government entities above FDIC limits. In the event of a bank failure, these assets are to be used to make the government entities whole. As Sonoma County participates in the Local Agency Collateralization Pool, banks are required to report their compliance with this requirement of the law to the California Administrator of Local Agency Security agency.

To safeguard the County's interest, Treasury should periodically confirm the banks the County utilizes have maintained the required market value of assets/securities as required by law.

**Management Response:**

We agree.

**Action Plan:**

On 12/31/16 we provided letters to the Audit staff verifying that both of our primary depository banks, Bank of America and Exchange Bank, meet or exceed the required 110% collateralization threshold for our uninsured deposits.

**Responsible Party:**

Dana Shern, Treasury Manager; Jonathan Kadlec, Assistant ACTTC.

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## Appendix C

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### Target Completion Date:

Completed. On-going.

### Observation 3: Computer Access Reviews

To ensure continued availability, reliability and accuracy of business systems, it is important to restrict system access to only those who have a business purpose. The level of access a user has should be commensurate with his/her assigned responsibilities. A user should not have access that will allow him/her to perform incompatible functions.

A formal user access policies and procedures are currently not in place.

Activities to ensure appropriate access to systems impacting the County's Financial Systems should be strengthened.

Treasury Management should periodically conduct reviews of user access rights using a formal process. User access rights should be reviewed or reallocated after any job changes, such as transfer, promotion, demotion or termination of employment. Authorizations for special privileged access rights should be reviewed independently at more frequent intervals.

### Management Response:

We agree.

### Action Plan:

This response pertains to banking system access only. Treasury Division staff have reviewed and updated the current user access rights for both Bank of America and Exchange Bank and documented those users. We have implemented a semi-annual review of the existing list of authorized bank users. The majority of users have read only access to specific bank accounts for reporting purposes. Staff with rights to process payments (wires/ACH) are internal to the ACTTC only. We are in the process of drafting a formal bank account access policy which will be communicated with the semi-annual certification of authorized users/employees.

### Responsible Party:

Dana Shern, Treasury Manager; Jonathan Kadlec, Assistant ACTTC.

### Target Completion Date:

4/1/2018

### Observation 4: Comprehensive Business Continuity and Disaster Recovery

Activities to ensure appropriate Disaster Recovery test work and Business Continuity Plans are not in place.

ACTTC Management should work with ISD to develop a comprehensive Business Continuity Plan (BC Plan) with all IT systems administered by ACTTC personnel (Note, This BC Plan should be incorporated with the overall County ISD BC Plan as ISD resources will be working with all County Departments). The Business Continuity Plan should include:

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## Appendix C

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- A list of all IT systems administered by ACTTC. The list should be prioritized to ensure most critical systems are up and running first in the case of a disaster. The amount of time it will take to bring each system online should be estimated and the impact on business continuity should be assessed.
- Business Impact Analysis. The lengths of time the operating units will be able to work off line should be estimated and the issues that will arise as a result. The plan should address these issues and provide for appropriate level of resources.
- Disaster Recovery Testing – each system listed should be tested annually to ensure recovery is possible and efficient.

### **Management Response:**

Treasury response: We agree with the need to have a Disaster Recovery Plan (DRP) or business continuity plan in place for banking and related cash management functions.

A Disaster Recovery Plan for other county financial systems (EFS, HRMS) is in the very early planning stages by the Information Systems Department (ISD). There is no firm timeline for delivery of a final DRP for those systems.

### **Action Plan:**

We have a DRP on file from both of our banks. In the event that the County computer network is off line we have an offsite computer that can be used to access the banking functions and allow for business to continue. If the banking institutions experience a failure then we will have to rely on their DRP process. We also have a written DRP for Treasury operations in place.

### **Responsible Party:**

Erick Roeser, ACTTC, Jonathan Kadlec, Assistant ACTTC, Amanda Thompson, Assistant ACTTC, Dana Shern, Treasury Manager; Paul Cocking, Investment and Debt Manager.

### **Target Completion Date:**

Partially Completed. On-going.

### **Observation 5: Segregation of incompatible cash collection functions.**

The North County Detention Facility has a unique program where they teach inmates how to grow and sell 200 varieties of plants. There are three annual plant sales that are open to the public. Purchases can also be made by appointments with the instructor at the facility.

The program has only one employee who sells the plants, receives payments, records the sale and prepares deposits. As a result there is a high risk that any errors or irregularities occurring in the collection and deposit of cash will not be discovered in a timely manner. In order to cost effectively mitigate the risks, a second person (the program sergeant) should account for all receipts issued and ensure that total collection per receipts issued agrees with total being deposited. As part of this process, the second person should ensure that all copies of the any voided receipts are retained.

### **Management Response:**

We agree.

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## Appendix C

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**Action Plan:**

Require NCDF to submit a cash handling certification per the Cash Handling Policy C-6, Section II. Staff shall work with NCDF to ensure they implement proper controls over the plant sale cash collection and deposit process.

**Responsible Party:**

Amanda Thompson, Assistant ACTTC, Levi Ehrlich, Accounting Manager, Jennifer Calderon, Supervising Accountant.

**Target Completion Date:**

6/30/18