



BEST PRACTICE

Adopting Electronic Payment Systems (1997, 2001, 2002, 2005, and 2008) (TIM)

Background. Moving funds electronically is both efficient and effective. Federal and state agencies are mandating the use of electronic payment for some tax receipts and payments to other governmental units. Many vendors also require or encourage the use of electronic payments.

Increasingly, governments are now using the electronic movement of funds and information to take advantage of its efficiencies and to meet the growing demands of citizens and taxpayers for more ease and accessibility in government services.

Electronic disbursement methods include:

1. Fedwire – This method provides same day processing with guaranteed settlement. The cost per transaction is high and it is generally used for large dollar transactions.
2. ACH (Automated Clearing House) – This method is a batch process with one or two day settlement. The cost per transaction is low. It is designed for high-volume, low-value transactions.
3. EBT (Electronic Benefits Transfer) – This is an electronic system that allows recipient transfer of government benefits to a point of sale terminal or ATM. Most EBT systems use magnetic stripe cards and “online” authorization. Smart cards may also be used.
4. Purchase Card (Procurement Card or PCard) – This method is used for small dollar purchases to reduce overall purchase processing costs.

For those governments who use electronic payments, the advantages and disadvantages are:

Advantages:

1. Eliminates the storage, handling, and processing of paper checks
2. Reduces the time spent on reconciliation
3. Reduces the visibility of information used in payment fraud
4. Eliminates the occurrence of lost or stolen checks and the cost of check reissuance

Disadvantages:

1. electronic payment systems may be poorly or not at all integrated with accounts payable systems
2. internal controls emphasis moves from the production cycle of physical checks to information technology controls
3. many small banks do not offer the level of sophisticated services necessary for electronic payments
4. sensitive financial account information stored in a government’s computer must be protected from internal and external access

Electronic collection methods include:

1. Fedwire – This method provides same day processing with guaranteed settlement. The cost per transaction is high and it is generally used for large dollar transactions.
2. ACH (Automated Clearing House) – This method is a batch process with one or two day settlement. The cost per transaction is low. It is designed for high-volume, low-value transactions.
3. Credit Card – This method is a batch process with one to three day settlement, merchant fees vary by card type and generally range from one to three percent of the amount charged.
4. Electronic Check Conversion – This method converts checks to ACH collections. It is low cost, and has a one to two day settlement process.

Web based collections offer many advantages to governments and citizens. Payment portals can be linked from a government's web page and allow a variety of payment methods. Convenience fees may be utilized to pass on the merchant fees to the customer.

Electronic collections offer the following advantages and disadvantages for government users:

Advantages:

1. accelerated receipts and availability of funds
2. ease of payment for customer
 - a. 24 hour access to Web payments
 - b. reduced costs for envelopes and postage
 - c. instant acknowledgement of Web payment
 - d. opportunity to establish automated recurring electronic payment
3. reduced cashiering and accounts receivable costs
4. reduced return check processing cost

Disadvantages:

1. electronic collection systems may have poor or no integration with accounts receivable systems
2. internal controls emphasis moves from manual posting of receipts to information technology control
3. many small banks do not offer level of sophistication necessary for electronic receipts

Recommendation. The Government Finance Officers Association (GFOA) recommends that state and local governments investigate and adopt electronic payment methods suitable for their specific needs. Governments should evaluate opportunities to make and receive electronic payments in the following areas:

1. Disbursements

- a. payroll and retirement payments
- b. expense reimbursements
- c. vendor payments
- d. social benefits and child support payments
- e. intergovernmental payments
- f. other recurring payments

2. Collections

- a. repetitive collections - such as utility payments
- b. tax payments
- c. license payments
- d. grant payment
- e. tuition payments
- f. traffic tickets
- g. other recurring receipts

3. Costs/Benefits

- a. cost savings
- b. customer needs and desires
- c. staff skills
- d. information technology resources
- e. impact (either positive or negative) on the availability of funds and interest earnings
- f. ability of government's financial system to either generate or receive electronic transactions
- g. statutory regulations
- h. bank services and fees
- i. merchant fees
- j. implementation costs

4. Safeguards

- a. strong internal and information technology controls on all programs and data files associated with identity information of vendors and employees to ensure privacy and prevent unauthorized use
 - i. network security to protect data files from internal and external threats
 - ii. appropriate segregation of duties
- b. written agreements that establish procedures, risk exposure, and indemnification issues should be executed with banks and third party providers
- c. dual controls for the authorization of non-repetitive transactions
- d. dual controls for the establishment of repetitive transactions
- e. establishment of dollar limits for authorized personnel
- f. establishment and use of passwords for authorized personnel to initiate transactions
- g. file receipt verification by the Originating Depository Financial Institution
- h. all ACH activity should be properly authorized as defined by NACHA rules and Federal Regulation E
- i. establishment and use of adequate controls against unauthorized ACH debits, such as blocks and filters
- j. use of separate accounts for ACH debit activity where volume and type of payment warrant
- k. pre-noting or testing ACH transactions to vendors and employees when practical
- l. use of an ACH format that supports the transmission of the remittance advice when needed
- m. implementation and periodic review of internal controls that address access control, confidentiality of data, integrity of data, and other information security issues as appropriate. Internal controls should incorporate the current Payment Card Industry Standards.

References

- *Banking Services: A Guide for Governments*; GFOA, 2004.
- "The Payment Card Industry Data Security Standard: Where to Begin," *Treasury Management Newsletter*, GFOA, January 2008.
- GFOA Best Practice, "Purchasing Card Programs," 2008.
- GFOA Best Practice, "Accepting Payment Cards & Selection of Payment Card Service Providers," 2009.
- Payment Card Industry Standards: <https://www.pcisecuritystandards.org/>.
- ElectronicPayments.org: <http://www.electronicpayments.org/bs.home.php>.

Approved by the GFOA's Executive Board, February 22, 2008.