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Statement of Position Federal Check 21 Act

Before the enactment of the Federal Check Clearing for the 21st Century Act (Check 21 Act) in 2003, the Office of the State Auditor (OSA) required that public entities obtain their cancelled checks from their depository banks.¹ The Check 21 Act allows a bank to create a digital version of an original check, thereby eliminating the need to further handle the physical document. Because of the Check 21 Act, electronic check processing has become standard practice in the banking industry. Fewer banks routinely provide original checks to their customers, including to public depositors.

Neither the Check 21 Act nor state law prescribes the method banks must use to return (or not return) cancelled checks to their customers. Some banks return original paper checks, some provide substitute checks or optical images, while others simply identify the check numbers and amount paid in the monthly statement. Whether a public depositor receives its check in any form, original, substitute or by optical image, is determined by the contract it has with its depository. The Check 21 Act leaves this decision up to individual banks and it does not restrict their ability to charge customers for substitute checks or other services. Therefore, each public entity will need to make a cost-risk analysis of the various options offered by banks and credit unions regarding the return or provision of cancelled checks, substitute checks, or optical images. The public entity should consider looking for a bank or credit union that does not charge fees or for one that charges lower fees.

The Check 21 Act provides a special expedited recredit procedure to resolve errors involving substitute checks under certain circumstances. The Check 21 Act rules make it clear, however, that only "consumers" receive expedited recrediting of their account. For public depositors, the automatic recrediting is not available. Consequently, timely review of the bank statement and check images is necessary. The actual paper check may still exist even though it has not been returned. By identifying a problem check to the bank, it may be possible to postpone or avoid the destruction of the paper check along with its evidentiary information. In addition, the Check 21 Act has a one-year statute of limitation. Any losses arising out of the Check 21 Act process must be brought within that time period.

¹ 12 U.S.C. §§ 5001-5018. The OSA's objective in requiring public entities to obtain their cancelled checks was to preserve public records and to protect the investigatory and evidentiary aspects of the original checks.

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The action to be taken when a problem check is identified depends, in part, on the nature of the problem. If the problem is one of encoding—that is, a difference between what was written on the check and what was debited from the account, public entities should immediately contact their depositories. Most encoding problems can be expeditiously rectified. Simply show the bank the cancelled check image or original, and most banks will recredit the account.

If the problem with the check is an alteration of the payee or the amount of the check, the public entity should contact its depository. Some alteration problems can be resolved quickly; others will require time. If only check images are available and problems with a particular check cannot be quickly resolved, we recommend that a substitute check be requested at that time. The depository will proceed with resolving the matter and will likely start by requesting a document signed under oath attesting that the check was altered or stolen. Until the matter is resolved between the banks handling the check, the recredit to the account may remain unresolved. In most instances, there will be no charge for items unless they are properly payable from the account.

For a number of different reasons related to internal controls and to the discovery and prosecution of check fraud, it would be optimal to receive cancelled original and substitute checks with the monthly statement. If receipt of original checks becomes impossible or impractical, optical images of checks may provide a cost-effective substitute. Other alternatives may also be acceptable. Public entities should identify options still available from different depositories and weigh the costs against the risks of check fraud or human error. Once a particular depository is chosen with its own check return system, each public entity will need to review its internal controls regarding check issuance and bank statement review. A timely review and reconciliation of the monthly statement will help identify potential issues and enable the public entity to request a substitute check.