



INTERNAL AUDIT REPORT

DATE: June 28, 2016

TO: Jim Gray, Mayor

CC: Sally Hamilton, Chief Administrative Office
Glenn Brown, Deputy Chief Administrative Officer
Aldona Valicenti, Chief Information Officer
William O'Mara, Commissioner of Finance & Administration
Phyllis Cooper, Director of Accounting
Mike Nugent, Director of Computer Services
Todd Slatin, Director of Purchasing
Susan Straub, Communications Director
Urban County Council
Internal Audit Board

FROM: Bruce Sahli, CIA, CFE, Director of Internal Audit
Teresa Gipson, CFE, Internal Auditor

RE: Accounts Payable Controls Audit

Background

The Division of Accounting's Accounts Payable department is responsible for ensuring that timely payments are made to vendors and suppliers for goods and services received by the LFUCG. Duties within that function include ensuring that such payments are properly approved and authorized and meet purchasing and budget specifications, related payments are accurate, timely, and properly recorded, and there is sufficient monitoring for duplicate payments or erroneous payments to vendors.



Many of these Accounts Payable control functions are automated through the Accounts Payable feature contained within the PeopleSoft Financial Module. Efficient and effective coordination and workflow between Accounts Payable and various LFUCG Departments and Divisions is also required, primarily between requisitioning personnel, the Division of Purchasing, and Accounts Payable.

An Accounts Payable Continuous Monitoring Report was issued on April 28, 2016. That report contained the results of a comprehensive search for duplicate payments in the Accounts Payable function using ACL audit software under four different test scenarios. The transaction period of the comprehensive search was December 1, 2015 through February 19, 2016. No duplicate payments were found for the period December 1, 2015 through February 19, 2016.

Scope and Objectives

The general control objectives for the audit were to provide reasonable assurance that:

- Payments to vendors are properly processed for goods and services received
- Vouchers are matched to authorized expenditures and paid in a timely manner
- Purchase requisitions, purchase orders, and P-Card purchases are processed and paid according to LFUCG purchasing procedures
- Accounts Payable transactions are posted to the correct fund and cost center
- Accounting controls exist to prevent or detect duplicate payments
- Check stock is properly secured
- Vendors are set up, approved, and properly maintained on Vendor Files by authorized individuals
- Employees have adequate Accounts Payable system access controls
- Prior audit findings are resolved

Audit results are based on observations, inquiries, transaction examinations, and the examination of other audit evidence and provide reasonable, but not absolute, assurance controls are in place and effective. In addition, effective controls in place during an audit may subsequently become ineffective as a result of technology changes or reduced standards of performance on the part of management.



The scope of our audit included payment activity from July 1, 2015 through February 29, 2016.

Statement of Auditing Standards

We conducted our audit in accordance with the International Standards for the Professional Practice of Internal Auditing. Those standards require that we plan and perform the audit to afford a reasonable basis for our judgments and conclusions regarding the organization, program, activity or function under audit. An audit also includes assessments of applicable internal controls and compliance with requirements of laws and regulations when necessary to satisfy the audit objectives. We believe that our audit provides a reasonable basis for our conclusions.

Audit Opinion

In our opinion, the controls and procedures provided reasonable assurance that the general control objectives were being met. Opportunities to improve controls are included in the Summary of Audit Findings.

Prior Audit Findings Resolution

This function was previously audited in 2012. The February 2012 Audit Report contained fifteen findings. All but three of those findings have been resolved. The repeat findings are noted in the Summary of Audit Findings Section of this Report.

Priority Rating Process

To assist management in its evaluation, the findings have been assigned a qualitative assessment of the need for corrective action. Each item is assessed a high, moderate, or low priority as follows:

High - Represents a finding requiring immediate action by management to mitigate risks and/or costs associated with the process being audited.



Moderate – Represents a finding requiring timely action by management to mitigate risks and/or costs associated with the process being audited.

Low - Represents a finding for consideration by management for correction or implementation associated with the process being audited.

SUMMARY OF AUDIT FINDINGS

Finding #1: Payment Processing Delays Identified **Priority Rating: High (Repeat Finding)**

Condition:

All LFUCG purchases of goods and services are initiated by the end user departments. In order for Accounts Payable to process related payments, they rely on the end user department to enter receipt of the goods or services into the PeopleSoft Financial Module. Accounts Payable enters invoices into PeopleSoft by way of vouchers with payment terms, usually 30 days within receipt of invoice. Prior to payments being processed, Accounts Payable initiates a match exception report within PeopleSoft that conducts a three-way match between the purchase order, receipt, and voucher. If any of these three items are missing, or if an item cannot be matched due to a quantity or pricing discrepancy, PeopleSoft will designate these as match exceptions.

As was the case in the 2012 audit, we noted that end user departments were often lax in entering the receipt of goods and services into PeopleSoft, as 159 of 182 (87.4%) of match exceptions occurring during our testing were due to the end user not completing a receiving report in PeopleSoft. There were also an additional 21 of 182 (11.5%) of match exceptions occurring due to differences between the purchase order and invoice regarding quantity received and/or pricing errors that must be resolved by the end user.

We also noted there were issues with the timely receipt of goods purchased with Procurement Cards (P-Cards). P-Card end users are not consistently approving their purchases within two business days as required in the P-Card Policies and Procedures Manual. Accounts Payable indicated that the turnaround time is sometimes so bad that during some months Chase Bank has already debited LFUCG's account (usually the 15th of each month) for the monthly transactions before the end user has verified



and/or approved the purchase. In addition, these purchases are not being applied to the departmental budgets until the transaction has been loaded to the voucher stage.

Additional issues noted regarding the timeliness and accuracy of processing and payment include:

- Invoices were not always paid in a timely manner. We noted 11 of 75 (14.7%) of invoices tested were paid from 2 to 475 days late.
- We stratified invoice line items over \$100,000 and selected a sample from that population. There were 2 of 25 (8%) invoices over \$100,000 paid from 1 to 14 days late.
- We performed an analytical test of a population of 2,700 vouchers (each invoice is assigned a unique voucher number) and noted that 169 (6.3%) were made more than 90 days after the invoice date.
- We noted 4 of 75 (5.3%) expenditure transactions tested were coded to the incorrect account.

Effect:

Most of these issues were traced to inadequate processing and receiving at the end user level. Delays in entering receipt of goods or services may produce decreased vendor participation since some smaller businesses may not have the cash flow to receive payments in excess of 30 days.

Recommendation:

LFUCG senior management should convey to end user departments the importance of executing their purchasing responsibilities in a timely manner. As stated in the LFUCG Purchasing Procedures, “When all goods ordered have been received, the purchasing requester shall receive the items via the receiving component of the PeopleSoft system. Receiving of goods and/or services should be completed as soon as the goods and/or services are received. The only exception is if the item(s) is incorrect or defective. In that situation, receiving should not be completed until the correct or undamaged goods have been received.”

The repeat nature of this finding, and the pervasiveness of some of the exceptions, indicate there may be a need for a CAO Policy that addresses issues of purchasing and receiving goods and services through either the Purchase Order or P-Card routes. Items to consider in such a Policy should be to assist end users in understanding their requirements to perform timely P-Card reconciliations, performing timely receiving of



good and services in PeopleSoft, and promptly following up with Accounts Payable on any match exceptions. In our opinion, the primary responsibility for compliance in these areas should rest with the highest level employee included in the workflow process. Receiving of goods and/or services should be completed in PeopleSoft as soon as the goods or services are received. The only exception is if the item(s) is incorrect or defective. In that situation, receiving should not be completed until the correct or undamaged goods have been received.

Director of Accounting Response:

I concur with the Internal Audit recommendation.

Director of Purchasing Response:

The Division of Central Purchasing will retrain PeopleSoft Requesters and P-Card holders and emphasize the purchase order receipt and P-Card reconciliation processes. In addition, the Purchasing Manual and P-Card Manual will be revised to include more severe suspension policies. Requesters and P-Card holders who have more than two unexplainable delinquent receipts or reconciliations in a month will be suspended from requester or P-card activity for 30 days.

Commissioner of Finance & Administration Response:

I concur with the response from the Director of Accounting and the Director of Purchasing.

Chief Administrative Officer Response:

I agree and will work with the Finance Department to issue a CAO Policy.

Finding # 2: Printed Checks and Check Stock Safeguards Need Improvement
Priority Rating: High (Repeat Finding)

Condition:

Accounts Payable checks are printed in the Division of Computer Services and then picked up by Accounts Payable personnel for distribution. Although the printed checks are held in a secured Computer Services #####, the printed checks and all excess check stock are still accessible to any Computer Services employees who enter #####.



Effect:

Insufficient security of printed checks and check stock increases the risk of theft.

Recommendation:

Computer Services should secure both printed checks and excess check stock in ##### accessible to only those employees necessary to complete the check run and provide the checks to Accounts Payable.

Director of Computer Services Response:

The Division of Computer Services has placed a locking file cabinet ##### and placed all check stock in this cabinet. Both keys to the filing cabinet have been given to the Director of Accounting. When we are notified of a check run (AP or Payroll) that needs to be printed we will contact the Division of Accounting and request that a sufficient quantity of check stock be provided to us to use in the printing of checks. This will be in addition to the check stock register that is maintained by Computer Services personnel when printing checks.

Chief Information Officer Response:

I concur with the remediation steps outlined by the Director of Computer Services.

Auditor's Note: The Commissioner of Finance's position regarding this finding is that the strongest internal control for check printing and check stock is a three way separation of duties, i.e. check run is controlled by Accounts Payable personnel, positive pay file is controlled by Accounting personnel, and check stock maintained in Computer Services is controlled by Computer Services personnel. The Office of Internal Audit agreed with that position. This position was then brought to the attention of the Chief Information Officer and the Director of Computer Services, who are also in agreement with the Commissioner of Finance's position regarding the possession of the locking cabinet keys. The Director of Accounting has returned the keys to the Director of Computer Services.



Finding #3: Unnecessary System Access Should be Removed**Priority Rating: High****Condition:**

We ran a query of users and roles in PeopleSoft and noted that one Accounts Payable employee had payment processing abilities but does not perform any payment processing duties.

Effect:

Unnecessary system access is inconsistent with general information technology controls.

Recommendation:

Payment processing capabilities assigned to this Accounts Payable employee should be removed. This has been communicated to Accounting management for corrective action.

Director of Accounting Response:

I requested removal of access to AP payment processing from the employee on May 9, 2016. This was confirmed as complete by DES on May 10, 2016. The Director of Internal Audit was notified via email.

Commissioner of Finance & Administration Response:

I concur with the Director of Accounting's response.

Finding #4: Duplicates Noted in Vendor Master File**Priority Rating: Moderate (Repeat Finding)****Condition:**

The PeopleSoft Vendor Master File is maintained by the Division of Purchasing and contains 35,484 vendors (active and inactive). Purchasing's response to a finding in the previous audit stated that duplicate vendor records may be necessary, e.g., one company with many d/b/a companies with different Tax Identification Numbers (TINs), a particular company is a supplier and also an HCM vendor, etc. The response also stated that a Purchasing designee will run the duplicate vendor report on a monthly basis, research and inactivate duplicates.



Our testing identified 22 vendors with at least two duplicate records, including one vendor with 90 duplicate records, one vendor with 50 duplicate records, and one vendor with 20 duplicate records. After Purchasing reviewed our results, they noted that the vendors having multiple duplicate records were due to revenue refunds to citizens for various properties, i.e. street light refunds. There were an additional six vendors who had tax ID errors accounting for their duplicate records, and four of the vendors with duplicate records were inactivated after our review.

Effect:

The existence of multiple vendor records for the same vendor may hamper the payment system's ability to detect and avoid duplicate payment activity.

Recommendation:

The Division of Purchasing should coordinate with Enterprise Solutions to determine if a more efficient method can be used to issue refunds to large groups instead of adding multiple records for the same vendor to the Vendor Master File. The Division of Purchasing should also conduct a regularly scheduled review of the Vendor Master File to inactivate unnecessary duplicate vendor records.

Director of Purchasing Response:

The Division of Central Purchasing will coordinate with Enterprise Solutions to investigate more efficient methods for issuing large group refunds and will also conduct a quarterly review of the Vendor Master File to inactivate unnecessary duplicate vendor records.

Commissioner of Finance & Administration Response:

I concur with the response from the Director of Purchasing.

