



Lexington-Fayette Urban County Government
OFFICE OF INTERNAL AUDIT

INTERNAL AUDIT REPORT

DATE: September 2, 2014

TO: Jim Gray, Mayor

CC: Sally Hamilton, Chief Administrative Officer
Glenn Brown, Deputy Chief Administrative Officer
Aldona Valicenti, Chief Information Officer
William O'Mara, Commissioner of Finance & Administration
Chad Cottle, Director of Enterprise Solutions
Todd Slatin, Director of Purchasing
Phyllis Cooper, Director of Accounting
Susan Straub, Communications Director
Urban County Council Members
Internal Audit Board Members

FROM: Bruce Sahli, CIA, CFE, Director of Internal Audit
Chris Ensslin, CFE, CIA, Deputy Director of Internal Audit

RE: Procurement Card Audit

Background

The LFUCG Procurement Card program (P-Card) was established to streamline the acquisition processes by providing a low-cost, efficient vehicle for obtaining goods and services directly from vendors. The Division of Purchasing is responsible for developing P-Card policies and procedures, and for providing administrative support for the program. There are standard controls in place with P-Card programs which include single purchase limits, monthly purchasing limits, and blocking controls to keep certain merchant types from being charged on the P-Card. P-Card transactions that are not stopped via blocking controls

are allowed to be processed. Once processed, JPM Chase Bank transmits transactions electronically to LFUCG where the purchaser verifies the transaction is legitimate and another employee (typically the purchaser's supervisor or manager) approves the transaction for posting into the financial records.

The current issuing bank is JPM Chase. The major activity with JPM Chase started on July 1, 2013. There were 8,645 P-Card transactions from July 1, 2013 to March 24, 2014 totaling \$1,903,510. The average P-Card transaction was \$220.

Scope and Objectives

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

- Controls for effective purchase card administration are in place
- Controls to reasonably prevent P-Card misuse and abuse are in place
- P-Card transactions are being approved in a timely manner, and card-issuer billing reports are being reconciled on both the departmental and Purchasing Division (Administrator) level
- Internal controls for card deactivation are adequate
- Sales taxes are not being paid by LFUCG
- Single purchase limit of \$1,000 is being adhered to
- Controls exist to prevent split transactions that would circumvent the single purchase limit control
- P-Cards are not being underutilized

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 are 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 period of our audit was July 1, 2013 to March 24, 2014.

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 enhance controls are included in the Summary of Audit Findings.

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 associated with the process being audited.

Moderate – Represents a finding requiring timely action by management to mitigate risks 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. Additional Merchant Control Codes Should be Blocked

Priority Rating: High

Condition:

Merchant Control Codes (MCCs) exist to block P-Card transactions with vendors that are not on LFUCG's approved industry code list (e.g., adult entertainment). We noted numerous MCC's that were not blocked, but should be blocked because there is not a legitimate business purpose for these types of vendors. See Attachment I. We did not find any cardholders who acquired goods or services from vendors that had these Merchant Control Codes.

Effect:

The current list of questionable unblocked merchant codes could result in purchases from inappropriate vendors.

Recommendation:

The excluded merchant control group is a preventative control that could be strengthened by excluding more MCCs. The codes in Attachment I are questionable and should be blocked for the control groups.

Director of Purchasing Response:

The Division of Central Purchasing believes that some of the merchant codes in Attachment I are acceptable and are used by various Divisions for legitimate purchases, i.e. Veterinary Services is used by Fire and Parks Equestrian for service animals, Florists are used by Parks for performances and Mayor's Office receptions. The Division will review the list and block the majority of the codes recommended by Internal Audit. Estimated completion date November 1st, 2014.

Commissioner of Finance & Administration Response:

The Commissioner of Finance & Administration concurs with the response of Central Purchasing.

Auditor's Note: Leaving the merchant code unblocked allows its potential inappropriate use by Divisions that do not have a need for it. If the Division of Purchasing deems it necessary to allow the Division of Fire to purchase Veterinary Services and Drugs, Fire should be set up as a separate Merchant Code group. As noted in Attachment I, under the current setup there are several Divisions that have access to Veterinary Services and Drugs that do not have a business need for them.

Finding #2. P-Card Transaction File Should be Automatically Loaded
Priority Rating: High

Condition:

We examined a random sample of 50 P-Card transactions. It took a range of 0-5 business days for the P-Card administrator to load the P-Card transaction file, with an average of 1.9 business days to load. Loading the P-Card transaction file is a manual process currently performed by the P-Card administrator.

Effect:

Delays in loading P-Card transactions to be available for the approval process causes budget information to be non-current and could possibly allow the cardholder to overspend in an account. By loading files manually, there is a risk the file may not get loaded.

Recommendation:

Enterprise Solutions should develop a script to automatically load the P-Card transaction file as soon as it is received by LFUCG from JPM Chase.

Director of Purchasing:

The Division of Central Purchasing will work with Enterprise Solutions where needed to assist in developing the automatic script loading process. Estimated completion date October 1st, 2014.

Commissioner of Finance & Administration Response:

The Commissioner of Finance & Administration concurs with the response of Central Purchasing.

Director of Enterprise Solutions:

This has been completed and is now in Production. It automatically loads all procard files that are awaiting load in the staging folder, and then another process stages all procard transactions that are available. The P-Card Administrator has set up a recurring notification in her calendar to be sure to review for any load errors on a regular basis.

Chief Information Officer Response:

Concur.

Finding #3. P-Card Transactions Not Approved in a Timely Manner
Priority Rating: High

Condition:

We examined a random sample of 50 P-Card transactions. It took 0-17 business days for the approval process to be completed. The average number of business days to complete the approval process was 4.6 days. Purchasing's standard is to approve P-Card transactions in two business days (i.e. reconciliation and approval).

Effect:

Delays in approving P-Card transactions causes budget information to be non-current and could possibly allow the cardholder to overspend in an account.

Recommendation:

Reconcilers and Approvers should be instructed to approve transactions within two business days from the date the billing file is loaded.

Director of Purchasing Response:

The Division of Central Purchasing will begin suspending cards for persistent offenders who fail to approve/reconcile transactions in a timely manner. Effective immediately.

Commissioner of Finance & Administration Response:

The Commissioner of Finance & Administration concurs with the response of Central Purchasing.

Auditor's Note: The P-Card Users Manual should be updated to define "persistent offender" and define "timely manner".

Finding #4. Merchant Control Codes Are Not Being Transmitted by JPM Chase
Priority Rating: High

Condition:

Merchant Control Codes (MCC/SIC) are not in the data transmitted to LFUCG from JPM Chase. MCC/SICs are transaction blocking controls designed to keep certain merchant types from being charged on the P-Card at the point of sale.

Effect:

Control is weakened by not having the MCC in the P-Card transaction file. If this information is provided, audit analytics can be run that will automatically identify unapproved merchants and transactions.

Recommendation:

LFUCG should request that JPM Chase provide LFUCG with the MCC (also known as the SIC Code) for each transaction. The P-Card administrator and Enterprise Solutions should work with JPM Chase to have the MCC included in the P-Card transaction file. A detective control report should then be developed by Enterprise Solutions that identifies all transactions with vendors that should have blocked MCC's. This report should be monitored by the P-Card administrator.

Director of Purchasing Response:

Although we don't believe it's possible to make a purchase from a vendor with a blocked MCC, the Division of Central Purchasing will request that MCC codes be included in our transaction report. Estimated completion date October 1st, 2014.

Commissioner of Finance & Administration Response:

The Commissioner of Finance & Administration concurs with the response of Central Purchasing.

Director of Enterprise Solutions:

DES will develop a report or query to address this finding. The P-card administrator will need to work with the bank to get the MCCs. Once this has been delivered to DES, we will implement a report within 30 days.

Chief Information Officer Response:

Concur.

Finding #5. P-Card Manual Needs Updating
Priority Rating: High**Condition:**

The P-Card Manual, which as of June 18, 2014 is available on the LFUCG intranet, has a revision date of August 2012. We noted some discrepancies between actual P-Card practices and the current Manual. For example, the MCC 5122 Drugs, Druggist Sundries is not a blocked MCC Code even though Prescription Drugs & Controlled Substances are listed as Restricted Commodities in the LFUCG Cardholder Policies and Procedures Manual (pg. 10). In addition, a potentially necessary exception may need to be included in the P-Card Manual for the business-need use of prescription drugs carried on an EMS vehicle. Page 6 of the P-Card Manual states former Purchasing Director Brian Marcum approves changes to the monthly purchase limit of cardholders, and PNC Bank is still referred to in the Manual although our cards are now with JPM Chase. We also noted the Manual does not state that

the approval process should be completed with two business days, which is the practice that Purchasing emphasizes that arose out of a previous internal audit recommendation.

Effect:

Outdated written procedures could result in LFUCG personnel being inconsistent in the proper use of P-Cards, and in complying with management's performance expectations. Outdated procedures also make it more difficult to train employees and hold them accountable for proper implementation of training.

Recommendation:

The P-Card Manual should be updated whenever modifications occur, with an up-to-date electronic version provided on the LFUCG intranet. The P-Card Manual should be consistent with CAO Policies and should specify any exceptions to rules governing the use of P-Cards. All cardholders and approvers should be emailed when there is change in the procedures or policies. Titles should be used in place of names if possible to avoid updates when an employee leaves the LFUCG.

Director of Purchasing Response:

The Division of Central Purchasing will revise the P-Card Manual by September 30th, 2014.

Commissioner of Finance & Administration Response:

The Commissioner of Finance & Administration concurs with the response of Central Purchasing.

Finding #6: P-Cards Underutilization Represents an Unnecessary Cost to LFUCG
Priority Rating: High

Condition:

From July 1, 2013 through June 30, 2014, there were 4,650 purchase orders issued by LFUCG that were under \$1,000. The 2012 edition of the Purchasing Card Benchmark Survey conducted by RPMG Research Corporation noted that the average administrative cost of procuring and paying for goods or services via a purchase order process was about \$91 per transaction (included paperwork associated with requisitions, sourcing, approvals, purchase orders, invoices, and checks). The Survey also noted that the cost per P-Card was only about \$17 per transaction. Based on the results of that Survey, the LFUCG could have saved approximately \$344,100 in processing costs had P-Cards been used for all purchases under \$1,000. We were also informed by Division of Purchasing management that the Division of Police has declined to use P-Cards.

Effect:

Based on the results of our audit and the information contained in the Purchasing Card Benchmark Survey, the opportunity exists to significantly enhance the cost savings associated with the LFUCG P-Card program.

Recommendation:

Senior management should evaluate the justification for creating purchase orders under \$1,000 and weigh such justifications against the considerable processing cost savings that could be achieved by requiring the use of P-Cards for most transactions under \$1,000. If it is senior management's decision to use P-Cards in this manner, senior management should consider mandating their use in all LFUCG Divisions.

Chief Administrative Officer Response:

I agree that P-Cards can afford the city great savings if used appropriately. I will review the issue to determine where P-Cards are underutilized and understand the reasons for their limited use. After I review the individual areas, I will be in a better position to address the question of mandatory use.

Finding #7. Split Transactions Occurring to Circumvent Single Purchase Limit
Priority Rating: High

Condition:

We identified 78 instances where two or more transactions with a particular merchant occurring on the same day (split transactions) resulted in their exceeding the maximum single purchase limit of \$1,000 per day per merchant. This represents a violation of current P-Card procedures.

Effect:

As noted in Finding #6, the 2012 edition of the Purchasing Card Benchmark Survey conducted by RPMG Research Corporation noted that the average administrative cost of procuring and paying for goods or services via a purchase order process was about \$91 per transaction (included paperwork associated with requisitions, sourcing, approvals, purchase orders, invoices, and checks), while for P-Cards the cost was only about \$17 per transaction.

LFUCG P-Cardholders have been encouraged by the Division of Purchasing to use the P-Card for small transactions instead of purchase orders in order to reduce purchase processing costs. In the United States General Accounting Office (GAO) Audit Guide- Auditing and Investigating the Internal Control of Government Purchase Card Programs exposure draft issued in May 2003, the GAO recognized a \$2,500 single purchase limit (which GAO referred to as a micropurchase threshold) as a method for containing the

administrative costs of purchasing. The University of Kentucky's single purchase limit is \$5,000. LFUCG's \$1,000 individual purchase limit may be unnecessarily restrictive for effective P-Card use and purchasing cost containment.

Recommendation:

LFUCG senior management should consider the benefit of raising the P-Card single purchase limit to increase the costs efficiency opportunities of the P-Card program, while taking into account the increased purchasing risk this increase might create. Policies should be modified as necessary to reflect this change if implemented. If senior management decides to keep the \$1,000 limit in place, the Division of Purchasing should issue a reminder to all P-Card users that split purchases to circumvent the single purchase limit are a violation of current P-Card procedures and that continued violations may lead to removal of the P-Card.

Chief Administrative Officer Response:

I will discuss the issue with the Commissioner of Finance and the Director of Purchasing. I will also inquire as to the state's limit on P-Cards.

Finding #8. Software Modification Needed

Priority Rating: High

Condition:

A terminated employee's ID was erroneously used to set up a new P-Cardholder in PeopleSoft. The error occurred because the new employee has the same name as the terminated employee, and the new employee's ID included on the P-Card Application was not used.

Effect:

This allowed the wrong employee ID to be used on all the transactions. This was an error and no fraud was committed in this circumstance.

Recommendation:

Enterprise Solutions should make a PeopleSoft programming modification which generates a warning if a non-active employee ID is used when setting up a new cardholder.

Director of Enterprise Solutions Response:

Current LFUCG business processes necessitate that ProCards be setup with an EMPLID from the HCM system. DES can program the requested warning message. This will be a customization and may take 60 – 90 days to implement.

Chief Information Officer Response:

Concur.

Finding #9. Cardholder Agreement Not Signed

Priority Rating: High

Condition:

We could not find documentation showing that an employee was trained to perform his duty as a reconciler, and his cardholder user agreement was not on file.

Effect:

Without documented evidence of training and in the absence of a cardholder agreement, it would be problematic to enforce disciplinary action if an employee were to misuse their P-Card.

Recommendation:

Cardholder User Agreements should be signed & dated before the first transaction is made. The P-Card Administrator's Master Control Cardholder Log should accurately indicate the date on which all training occurs.

Director of Purchasing Response:

The Division of Central Purchasing will implement a check list process to ensure that all forms are appropriately completed and signed. Effective immediately.

Commissioner of Finance & Administration Response:

The Commissioner of Finance & Administration concurs with the response of Central Purchasing.

Finding #10. P-Card Reconciliations Not Being Performed at the Cardholder Level

Priority Rating: High

Condition:

The P-Card Manual states that all P-Card users must reconcile their transactions to their related bank statements on a monthly basis. A random selection of 12 P-Card users noted that only three P-Card users had checked off the recons to indicate this process had occurred, and none of the reconciliations we examined were dated and initialed by the person performing the reconciliation (to indicate successful completion of the reconciliation).

Effect:

Timely reconciliations should be performed each month to assure all charges billed to the LFUCG are legitimate.

Recommendation:

Reconciliations should be consistently performed as instructed in the P-Card Manual. To indicate the reconciliation has occurred, P-card users should check off the items on the statement, initial, and date to demonstrate that the reconciliation has been completed. It is recommended that the P-Card Manual be updated to include these documentation steps.

Director of Purchasing Response:

The Division of Central Purchasing will update the P-Card Manual accordingly and retrain users. Estimated completion date November 1st, 2014.

Commissioner of Finance & Administration Response:

The Commissioner of Finance & Administration concurs with the response of Central Purchasing.

Finding #11. One Cardholder's P-Card Limit Was Not Adjusted**Priority Rating: Moderate****Condition:**

One monthly limit was raised but not lowered as it should have been for a cardholder. The monthly limit was appropriately raised to \$10,000 in June 2013, but not lowered back to \$5,000 in August 2013 as the modification form stated.

Effect:

This could have allowed the cardholder to charge more than the approved monthly card limit. The cardholder did not go over the \$5,000 monthly limit when it was not reset to \$5,000 as the modification form stated. The P-Card Administrator was informed of this error and corrected it during the audit fieldwork.

Recommendation:

P-Card changes should be made in a timely manner whenever cardholder modification forms are received.

Director of Purchasing Response:

The Division of Central Purchasing will implement a check list system with multiple approvers to ensure that modifications are processed correctly. Effective immediately.

Commissioner of Finance & Administration Response:

The Commissioner of Finance & Administration concurs with the response of Central Purchasing.

Attachment I Merchant Control Codes Management Should Consider Blocking

LEXINGTON1 Group

- 0742 Veterinary Services
- 9223 Bail and Bond Payments
- 9311 Tax Payments
- 5995 Pet Stores/Food & Supply
- 5697 Tailor/Seamstress/Alterations
- 9216 Dry Cleaners
- 5122 Drugs, Druggist Sundries
- 5172 Petroleum Products

LEXGARAGE Group

- 0742 Veterinary Services
- 9223 Bail and Bond Payments
- 9311 Tax Payments
- 5995 Pet Stores/Food & Supply
- 7216 Dry Cleaners
- 5122 Drugs, Druggist Sundries

LEXPARKENT Group

- 0742 Veterinary Services
- 9223 Bail and Bond Payments
- 9311 Tax Payments
- 8049 Chiropodists Podiatrists
- 5995 Pet Stores/Food & Supply
- 7216 Dry Cleaners
- 5122 Drugs, Druggist Sundries

LEXFOOD Group

- 0742 Veterinary Services
- 4468 Marinas, Service & Supply
- 7829 Motion Picture & Video Distrib
- 7832 Motion Picture Theatres
- 7841 Video Tape Rental Stores
- 7911 Dance Halls/Studios/Schools
- 7922 Theatrical Producers
- 7929 Bands/Orchestras/Entertain
- 7932 Billiard/Pool Establishment
- 7933 Bowling Alleys
- 7941 Commercial/Pro Sports
- 7991 Tourist Attractions and Xhb

7992 Public Golf Courses
 7993 Video Amusement Game Supply
 7994 Video Game Arcades/Establis
 7996 Amusement Parks/Circus
 7998 Aquarium/Rec Serv
 7999 Amusement/Rec Serv
 8999 Professional Services
 5193 Florist & Nursery Supplies
 5992 Florists
 9223 Bail and Bond Payments
 9311 Tax Payments
 5995 Pet Stores/Food & Supply
 7032 Sport/Recreational Camps
 7033 Trailer Park/Camp Sites
 5697 Tailor/Seamstress/Alterations
 7216 Dry Cleaners
 5122 Drugs, Druggist Sundries
 7172 Petroleum Products

LEXMAYOR Group

0742 Veterinary Services
 5912 Drug Stores & Pharmacies
 9211 Court Costs/Alimony/Support
 9222 Fines
 9223 Bail and Bond Payments
 9311 Tax Payments
 5921 Pkg Stores/Beer/Wine/Liquor
 5932 Antique Shops
 5933 Pawn Shops
 8011 Doctors
 8021 Dentists/Orthodontist
 8031 Osteopaths
 8041 Chiropractors
 8042 Optometrists/Ophthalmologist
 8043 Opticians
 8044 Optical Goods & Glasses
 8049 Chiropodists Podiatrists
 8050 Nursing/Personal Care Fac
 8062 hospitals
 8071 Medical/Dental Labs
 8099 Med/Health Services
 5094 Precious Stones & Metals
 7631 Watch/Clock/Jewelry Repair
 7997 Member Clubs/Sport/Rec/Golf

5973 Religious Goods Stores
 5975 Hearing Aid/Sales/Service
 5976 Orthopedic Goods
 5993 Cigar Stores/Stands
 5995 Pet Stores/Food & Supply
 5996 Swimming Pools/Sales/Serv
 5997 Elec Razor Stores/Sale/Serv
 7322 Debt Collection Agency
 7393 Detective/Protective Agen
 6211 Securities Broker/Deals
 6300 Insurance Sales, Underwriting, and Premiums
 6381 Insurance Premiums
 6399 Insurance Carriers Not Elsewhere Classified
 5977 Cosmetic Stores
 7012 Timeshares
 7032 Sport/Recreational Camps
 7033 Trailer Park/Camp Sites
 7261 Funeral Service/Crematories
 7276 Tax Preparation Service
 7277 Counseling Service - All
 7279 Buying/Shopping Services
 8351 Child Day Care Services
 5697 Tailor/Seamstress/Alterations
 5697 Wig and Toupee Stores
 7230 Barber/Beauty Shops
 7251 Shoe Repair/Shine/Hat Clean
 7296 Clothing/Rent/Costume/Unifo
 5813 Bars/Taverns/Lounges/Discos
 5122 Drugs, Druggist Sundries

LEXWASTEMG Group

0742 Veterinary Services
 9223 Bail and Bond Payments
 9311 Tax Payments
 8271 Mobile Home Dealers
 5995 Pet Stores/Food & Supply
 7339 Stenographic Services
 5697 Tailor/Seamstress/Alterations
 7216 Dry Cleaners
 5122 Drugs, Druggist Sundries
 5172 Petroleum Products