

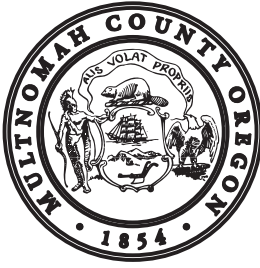
Purchase Card Audit:
Increase efficiencies with expanded
use of Purchase Cards

June 2011

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Date: June 29, 2011

To: .. Jeff Cogen, Multnomah County Chair
Commissioners Kafoury, Smith, Shiprack, and McKeel
Michael D. Schrunk, District Attorney; Daniel Staton, Sheriff

From: Steve March, Multnomah County Auditor

Re: Purchase Cards: Expand Usage to Increase Efficiencies

This audit on the use of Purchase Cards finds that Multnomah County has an opportunity to significantly improve administrative efficiency as well as capture larger rebates by expanding the use of purchase cards. By clarifying current policies regarding the preference for purchase cards as a method of payment, as well as reducing some of the current restrictions on card use, the County can further reduce the number of checks written. And, while some controls could be improved, purchase card controls that are currently in place appear to be working well. We also found the County can better utilize data available from the P-card administrator and County systems for monitoring County spending and internal controls. In addition, better use of that data may also assist Central Purchasing in future efforts around strategic sourcing.

This report on Purchase Cards is our second audit relating to how Multnomah County does business with vendors and pays its bills. Our previous audit "Accounts Payable: Continue Improvements" commended the County in its efforts and success in utilizing electronic payment methods, including the use of P-cards, as a more efficient way of doing business.

We appreciate the assistance we received from the County's Accounts Payable group and County employees who responded to our questions and survey on purchase card usage.

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Introduction

Changing technology and growth in the use of electronic payments have created opportunities to improve the efficiency of how an organization pays for goods and services. Purchase cards are a form of electronic payment that offers tangible benefits, including: improved payment efficiency, increased convenience for staff, more sustainable (green) way of doing business, rebates from card issuers, and improved insight into purchasing behavior through data collection.

The objective of this audit was to determine if: 1) opportunities existed to expand the use of purchasing cards at Multnomah County; 2) existing controls were sufficient to warrant such an expansion; and 3) opportunities existed to incorporate continuous monitoring and data analysis to improve controls.

Background, Scope, and Methodology

The use of purchase cards for high volume, small dollar purchases is a widely accepted best practice because it can be a source of greater organizational efficiency and effectiveness. Using a purchasing card can:

- significantly reduce the administrative cost of processing both purchases and payments – issuing checks can be ten times more expensive than using an electronic form of payment.
- provide lower prices in the form of rebates from the card issuer – Multnomah County collected more than \$145,000 in rebates in 2010.
- provide better and more accessible data about organizational purchases.
- improve relationships with vendors because they are paid more quickly and with less paperwork; and
- save staff time because they are more convenient to use.

Multnomah County's purchase card program began in 1997 and is managed centrally by the Accounts Payable (AP) unit. Individual purchase cards are managed within individual divisions, generally with oversight by department financial units.

For fiscal year 2010 the county had a total of 902 active cards with a total spending of \$6.6 million and an average purchase transaction of \$310. County purchase cards include the following:

- *Travel Cards* are used for travel related expenses, conferences, and association costs. In 2010 there were 117 travel cards issued to individual employees and 201 department travel cards that are temporarily checked out by individual employees when traveling.
- *Petty Cash Cards* replace petty cash funds for small purchases. There are 112 department petty cash cards that are checked out to individual employees as needed.
- *Regular Purchase Cards* are issued to individual employees for purchases of materials and supplies to support County programs. Many of the 457 regular purchase cards are for employees who are designated buyers for their work unit or department.
- *Ghost Cards* are not actual plastic cards (thus the name ghost) and function like single vendor charge accounts. The county has 15 of these cards, which represent a payment method for some vendors with which the county has contracts.

Payments using purchase cards have grown more than 45% over the past three fiscal years. The majority of this growth has come with ghost cards, which are primarily used to purchase computers as well as medical supplies and services.

Exhibit 1

Purchase Card Payments by Card Type

	2008	2009	2010
Travel Cards	\$773,936	\$1,025,157	\$1,035,725
Ghost Cards	\$2,051,750	\$2,459,798	\$3,276,780
All Other Cards	\$1,668,873	\$2,156,341	\$2,242,550
Total	\$4,494,559	\$5,641,296	\$6,555,055

Multnomah County works with its card issuer, Bank of America, to operate the purchase card program. Bank of America manages the operational side of all purchase card transactions and provides real-time access to transaction data in a system called WORKS. County purchase card administrators use WORKS to review and approve individual transactions, to allocate purchases to individual County cost centers, and to reconcile monthly statements. The WORKS system also includes reports on a variety of aspects of the purchase card program, such as the number of active cards or the specifics regarding each instance where a card is declined. A limited subset of the data from each transaction is uploaded from WORKS to the County's financial system every month.

We looked at internal controls associated with purchase card use. These controls included those that are part of the card issuers system as well as the guidance and procedures for documentation and review of purchases made by County employees. Due to the broad range of purchases that would be appropriate for County programs under the governing policies and rules, we did not review individual purchase decisions. Instead, we reviewed whether purchases had the required documentation and approvals.

We conducted a series of tests of both the card issuer's system controls and the County's process and procedural controls. We used three fiscal years of individual transaction data as the basis for many of these tests. In some cases, we merged the transaction data from the card issuer, Bank of America, with data from the

County's SAP financial system. We also interviewed those employees in every department who managed the purchase cards for their department. In addition, we sent an opinion survey to 431 employees who were purchase card holders as of June 30, 2010.

This audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Audit Results

Multnomah County has an opportunity to significantly improve administrative efficiency as well as capture larger rebates by expanding the use of purchase cards. By clarifying current policies regarding the preference for purchase cards as a method of payment, as well as reducing some of the current restrictions on card use, the County can further reduce the number of checks written. And, while some controls could be improved, purchase card controls that are currently in place appear to be working well.

Greater Efficiency with Expanded Purchase Card Use

While increasing the use of purchase cards and other forms of electronic payment has been the goal of county financial managers, a number of factors have slowed growth in the purchase card program. As a result, the County is not achieving the level of administrative savings it could or maximized the amount of rebates it could earn.

Some of the factors that have slowed growth in the purchase card program include difficulty using purchase cards to make payments on contracts and restrictions on card use that complicate some purchases. Moreover, the County could improve its purchasing decisions by improving and better using the purchase card data it collects.

In a recent audit of the County's Accounts Payable function¹, we found that the increased use of electronic payments methods, such as purchasing cards, had reduced the number of checks written. This, in turn, reduced administrative costs and improved controls. However, after an initial jump, the use of purchase cards had stalled, leaving significant potential for efficiency gains.

Of the all AP invoices in fiscal year 2010:

- More than 70 percent of the AP invoices were paid by check. Checks are one of the least efficient forms of payment available.
- More than 55 percent of checks were for less than \$500, and more than 6,000 of the checks (24%) were for less than \$100. Best practices suggest that small dollar payments are excellent candidates for purchase cards.
- The County wrote nearly 1,000 checks, totaling more than \$8 million, for utilities and mobile phone service. Many of these recurring payments could have been made using purchase cards.

Most of the County's goods and services purchases are made through contracts with vendors. It is difficult to credit purchase card payments against a contract in the County's financial system. As a result, the most common way the County can make payments on a contract is with a check. This issue may become more acute as the County moves forward on its strategic sourcing initiative, which has the potential to lump what have been small individual purchase card transactions into larger contracts that would require payment by check.

The County's practice has been to block purchase card use for vendors that categorize themselves as professional service providers. This has added complexity to relatively simple transactions and has inhibited the use of purchase cards. Purchases of professional services must be reported to the Internal Revenue Service and blocking purchase card payments to these providers

¹ "Accounts Payable Audit: Continue Improvements", Multnomah County Auditor's Office, June 2010

made it possible to better track County responsibilities with this requirement. However it also meant that purchases of materials and supplies from these merchants were blocked as well.

Sixty percent of the card users who responded to our survey reported that they had difficulty using a purchase card because the purchase was blocked. Many of these purchases eventually went through via an exception process, but others ended up being paid using more expensive payment methods. Federal requirements have recently changed, relieving the County of its obligation for reporting payments for professional services when the payments are made with a purchase card. The County's blocks on these service providers could now be removed without a significant risk of not meeting the reporting requirements.

The County could also further consolidate the number of active purchase cards in use by County staff. Such a consolidation would make it possible to obtain a higher rebate from the card issuer for any dollar volume of card spending from the card issuer. The rebate amount is based on the dollar volume of transactions per active card, so reducing the number of active cards increases the dollar volume per card and the amount of the rebate. Thirty two staff members have both a County purchase card and a County travel card. The staff currently need one of each type of card because travel related expenditures like airfare are blocked for purchase cards and the purchase of materials are blocked on travel cards.

The number of cards could be reduced further by consolidating cards that are infrequently used. For example, 130 out of 377 individual purchase and travel cards used by our survey respondents were used less than once a month.

County financial policy does not specify a preference for any particular payment method for small purchases. More than 28% of our survey respondents reported that their preferred payment method is something other than a purchase card. To further illustrate this point, we identified individual vendors that in one instance were paid with a check and in another were paid with a

purchase card. Payments to these vendors totaled more than \$1.5 million in FY 2010, but only 59% of the transactions were paid by purchase card.

Data on staff purchases would also be a useful tool as the County pursues new purchasing strategies. By analyzing purchase card data, it is possible to identify categories of purchases that would be good candidates to pursue in volume at discounts. Exhibit 2 shows some examples of categories of purchases and individual vendors in these categories where the County makes significant purchases.

Exhibit 2

Examples of FY 2010 High Volume Purchases

Category and Individual Vendor - examples	Total Purchases
Food and Grocery	\$225,792
Fred Meyer	\$41,917
Safeway	\$43,740
Office Supplies	\$79,455
Office Depot	\$34,088
Drug Stores and Pharmacies	\$38,091
Rite Aid	\$16,517

Purchase Card Controls There is the potential for significant gains in administrative efficiency with the expanded use of purchasing cards and, while controls could be improved, we did not find significant weaknesses. We tested *system controls* established by the County and operated by the card issuer, and *process controls* that are designed and administered by County staff. Generally, system controls are implemented by the card issuer to prevent purchases from certain categories of vendors or purchases beyond specified dollar limits. Process controls are designed to ensure that County rules and policies are followed, such as supervisory approval and review of purchases. We also reviewed broader internal controls over purchase card use, such as the quality of policies and procedures. A list of specific fraud related internal controls and our findings related to these controls is found in Appendix A.

System Controls System controls, such as those that ensure purchase limits are not exceeded, are generally the responsibility of the card issuer. However County managers establish the parameters of these controls. For them to be effective, the County must also monitor and maintain them. While there is room for improvement in the County's testing of system controls, we concluded that these system controls were operating as intended in limiting the County's exposure to improper use of purchase cards.

Daily, monthly, and transaction dollar limits are some of the primary system controls available with purchasing cards. These controls help to limit the exposure an organization has to any one card or card user by restricting the amount of money that can be spent using that card. Establishing these dollar limits according to needs, with the ability to temporarily raise limits by request, is a best practice in card administration. Purchase card administrators also have the ability to block purchases from certain categories of merchants based on Merchant Category Codes (MCC). Rather than preventing individual items from being purchased, blocking by MCC eliminates all purchases from merchants that identify themselves as being within a blocked category, such as pawn shops or cruise lines. Like credit and transaction limits, MCC blocks can be removed temporarily if necessary.

We tested these controls by reviewing system data from the card issuer. We performed analytic tests on card transaction data that were designed to identify combinations of transactions that might have been made as an attempt to work around system controls. We also interviewed card administrators, and surveyed card users.

System Control Audit Results Purchase limit controls in place appear to be working effectively. Based on a review of card declines from the WORKS system, it appears that the bank does, in fact, block purchases that exceed transaction and monthly spending limits. The County has a system for approving temporary limit increases and card system controls appear to be preventing the use of cards above established limits without authorization.

While establishing limits reduces exposure, best practice also suggests it is important to carefully monitor transactions to ensure that controls like these are not being subverted. A common method to monitor the effectiveness of purchasing card limits is to test for “split transactions”. These are multiple transactions with the same vendor over a short period of time and that have the effect of working around card limits. Using data analytics software, we tested three years of purchasing card data for instances that appeared to be split transactions and found only seven out of nearly 56,000 unique transactions that matched the criteria for a split transaction². We forwarded these exceptions to the AP manager for follow-up.

Multnomah County also uses MCC blocks as part of its purchase card system control program. Individual cards are assigned to a group, each with a specific set of MCCs that are blocked. In some cases, cards are highly specialized in that they can only be used for one or two merchant categories such as health services. Other cards have fewer restrictions. MCC restrictions can be lifted by request, with the most common request being for purchases from merchants that categorize themselves as service providers but also sell books and other supplies.

MCC restrictions in place appear to be working, but the large number of exceptions that are required reduces the control’s effectiveness. Based on a review of card declines from the WORKS system, it appears that the bank does, in fact, block purchases from merchants with blocked MCCs. Using data analytics software, we tested purchase card data to determine if any purchases from blocked merchant categories got through the WORKS system. Our attempt to compare purchases at merchants that have excluded MCCs to requests for exceptions were complicated by the age of the data, the large number of exceptions granted, and the fact that the requests and approvals had been saved in an old email system. However, the existence of

² To be considered a likely split transaction, the activity would have to meet these criteria: the transactions would have to be made at the same vendor within two days of each other, and the total amount of the combined transactions would have to exceed the individual purchase card’s daily transaction limit.

overlapping controls, such as requirement for supervisory approval and review of all card purchases compensates for the weaker controls on the exception process.

Process Controls We found the County follows best practices for most of its process controls. Process controls include: (1) County-wide policies and procedures on purchase card use; (2) training materials and other information for both cardholders and card approvers; and (3) various department level procedures for the approval and documentation of purchases by purchase cards. Although there are areas where process controls could be improved, our tests and analysis did not uncover any fundamental flaws.

We reviewed County administrative rules, user manuals and other guidance and training on purchase card use, authorizations and review by management for card purchases, and centralized monitoring via audits and data mining. We found processes used to manage and control purchase card use vary somewhat from one department or division to another. We tested these controls by interviewing individuals responsible for managing purchasing cards in every County department and followed up the interviews by testing documentation for a sample of individual purchase card transactions.

Process Control Audit Results Policies and guidance regarding the appropriate use of purchase cards that are regularly reviewed and updated is a widely accepted best practice. Multnomah County has published extensive guidance on purchase card use, which is readily available for all employees on the County's intranet site. We found that County departments use this guidance and, in some cases, provide supplemental materials for card users and administrators. Central Accounts Payable is also available by phone to provide additional guidance and help for cardholders and purchase card administrators on request. They also recently began a newsletter with additional tips and help for County employees.

While there is little specific County-wide training provided for purchase card users, most department card administrators provided

information to card holders and believed that the combination of County guidance and department specific instruction was sufficient. In our survey 75 % of cardholders said they received training and thought training was adequate; 16% said they had not received training, and 8% thought training was not adequate. We recommend central accounts payable review training materials and perhaps provide a refresher on an annual basis.

Documentation of purchases and approvals is also a best practice and required by County administrative procedures. Like all purchases, the county requires management approval and submission of original receipts for all purchase card transactions. For purchase cards, the receipts are verified with monthly bankcard statements, which require additional review and approval by management. We sampled transactions to test if departments met documentation requirements. Our sample included 117 individual transactions; only one transaction had inadequate documentation. This suggests that policies and controls are working.

Once approved the bankcard data for the purchase card transactions is uploaded into SAP. We verified the accuracy of the amounts from the WORKS bankcard system to SAP. In discussing the processes for recording purchase card transactions, many departments noted they had additional workload because the SAP uploads did not include the details from WORKS, such as the vendor name or text fields that described the reason for the purchase or work order numbers. This information is often needed for grant reporting. For some departments, all the additional information has to be re-entered into SAP. The accounts payable manager is in the process of working with purchase card users to determine the additional information that would be useful, and with the County's Information Technology section to determine the feasibility of uploading additional details into SAP.

The lack of transaction detail in SAP also complicates the task of monitoring and data mining. For example, we were asked to look for duplicate payments; instances where the County had paid the same invoice with a purchase card as well as some other form of payment. Duplicate payments like this are not caught by the standard edit checks in the County's finance system because

(among other things) purchase card transactions uploaded into the County's financial system from the card issuer do not reference an invoice number, which is one of the keys to the verification process.

Our analysis confirmed the existence of duplicate payments between purchase cards and checks paid out of the central finance system. All but one of these duplicates had been identified and corrected by the time of the audit. Department finance staff corrected the remaining duplicate. However, the number of possible duplicates identified over the past two years, along with the relatively small total dollar volume of duplicates, does not suggest that a significant change in the existing control structure is necessary. Incorporation of monitoring of payments using some sort of data analytics would be sufficient to minimize the risk to loss from duplicate payments in the future, if the County expands the use of purchase cards.

Other process controls include audits of purchases and other monitoring functions. Some County business units have gone some time since their last central purchase card audit. Moreover, these audits were announced prior to the audit, which may reduce their effectiveness. We understand central accounts payable is in the process of beginning some travel and purchase card audits in the near future. Finally, neither the central card administrator, nor the departments appear to be taking advantage of the data and reports that are available through the card issuer WORKS. Although some of the departments we met with had a good idea of how to add text information and how to get reports from WORKS, many others simply used the system for the required administrative approval process. While it is not as critical in preventing improper use of purchase cards as some of the other controls we reviewed, we believe controls could be strengthened with unannounced audits and with the use of purchase card data in WORKS for both centralized and department monitoring.

While not technically part of the scope of this review, we also identified two areas of activity that warrant additional attention by central and departmental finance managers. First, County program staff bought large numbers of gift cards from a variety of

merchants. In FY 2010, staff purchased nearly \$20,000 worth of gift cards from a single merchant. While County finance managers are trying to reduce the exposure to risk at the program level by replacing petty cash funds with purchase cards, the purchase of gift cards, which are essentially equivalent to cash, is reintroducing this risk. The County has procedures for the purchase and distribution of gift cards and future purchase card audits should include an examination of any gift card activity.

The second area that warrants attention is the use of personal vendor rebate or rewards type programs that are used by staff when making purchases for County programs and clients. Like collecting frequently flyer miles when traveling on County business, using a personal rebate account, such as the Fred Meyer Rewards Program, when making purchases with County funds is prohibited by County policy. Card administrators should emphasize this point when providing training or instruction to card users.

Recommendations

1. There are three opportunities to expand the use of purchasing cards as a way to improve administrative efficiency; the existing controls are operating well enough to warrant such an expansion. Ways to achieve this:
 - A. Consider purchase cards as part of County's overall purchasing strategy rather than just as a payment method.
 - B. Expand ways to use purchase card data.
 - Use data for analysis for opportunities and control monitoring.
 - Utilize WORKS reporting capabilities
 - Upload details to SAP.
 - C. Keep controls simple and improve communications (training, newsletters, etc.).
2. The County can potentially achieve higher rebates by reducing the total number of cards:
 - A. Combine some travel and purchase cards and replace them with a single card with fewer restrictions and a slightly higher limit.
 - B. Eliminate cards that are not being used.

3. Control could be improved:
 - A. Increase routine monitoring processes using existing reports and use of data analysis.
 - B. Institute recurring audit processes to evaluate compliance with program policies and requirements.
 - C. Work with bank to redesign face of purchase cards so they look different from other cards and will stand out clearly as belonging to Multnomah County.
 - D. Require online or other training updates for all cardholders annually.

Appendix A: Fraud Prevention Controls:

	Recommendations:
1. Design dedicated and detailed policies and procedures and update them regularly to reflect the p-card program roles and responsibilities accurately.	We recommend the County continue this good practice.
2. Appoint a permanent administrator with responsibility for, and authority over, the p-card program.	We recommend the County continue this good practice.
3. Implement a detailed cardholder agreement requiring the signature of the cardholder and the cardholder's supervisor to reinforce responsibility and to improve accountability.	We recommend the County continue this good practice.
4. Designate and communicate detailed roles and responsibilities for the transaction reconcilers and approving officials.	We recommend the County continue this good practice.
5. Use a p-card design that minimizes the possibility of "accidental" use.	The County's purchase card design could be strengthened with a larger county logo that would minimize accidental use. County would need to talk to bank about options. See Recommendations
6. Establish reasonable card limits to reduce excessive or inappropriate use issues.	We recommend the County continue this good practice.
7. Require face-to-face training before issuing a p-card to a new cardholder, and require refresher training at least every two years for continuing cardholders. The refresher training can be face-to-face or computer/Web-based.	Training is currently done but could be improved. See Recommendations
8. Require original receipts for every p-card purchase made.	We recommend county continue this good practice.
9. Require electronic transfer of cumulative data from the card-services provider for data mining and analysis based on known risk factors.	Recommendation that the County use available data for department management review and continuous monitoring. See Recommendations
10. Provide a hotline process to report suspected abuse.	We recommend the County continue this good practice.
11. Have meaningful and enforced policies governing consequences for misuse.	We recommend the County continue this good practice.
12. Institute recurring audit processes to evaluate compliance with program policies and requirements.	Recommendation that the County continues and improves audit process. See recommendations

Source: "Fraud Resistant P-Cards: Procurement Card Programs Can't Be Foolproof, But There Is Help," Donald Holdegraver, Internal Auditor, April 2005



Department of County Management

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To: Steve March, County Auditor
Judith DeVilliers, Principal Auditor

From: Mindy Harris, Chief Financial Officer

Date: July 14 23, 2011

Re: Response to Purchase Card Operation Audit

The Department of County Management, and Finance and Risk Management Division appreciate the time that you and your staff have invested in the review of the County's Purchase Card operations. We recognize the value these recommendations can bring to the program and would like to thank you for the thorough audit. We will be working with both our Purchase Card Services Provider (Bank of America) and internal customers to implement the recommendations. We appreciate the opportunity to comment on your findings and recommendations.

Finance and Risk Management intends to expand the use of Purchase Cards and has completed the following initiatives to improve payables efficiency and increase rebates:

- Purchase Cards for services was approved on May 24, 2011
- Enrolled more vendors to ePayables program.

In order to maintain internal controls and preserve best practices, a few restrictions will continue to exist until the implementation of workflow approval. A more detailed plan addressing some of the recommendations noted in the report regarding processes and system controls are available for further review. These anticipated tasks will begin in July, 2011, and should be completed by the end of the year.

The Finance and Risk Management Team will also continue to strengthen end-user training and make more data available for reviews. We will also update the Administrative Procedures and other operating guidelines to reflect the changes in system and process controls. Draft changes will be shared with the auditor's office for feedback before implementation.

Again, we appreciate the time and effort taken to compile this report and your recommendations for continued improvement. We would be happy to provide your office with progress updates or check-ins as we address and implement the recommendations.

cc: Satish Nath, AP Manager