County Payment Transactions

Better communicate expectations
March 2006

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MEMORANDUM

Date: March 15, 2006

To: Diane Linn, Multnomah County Chair
           Maria Rojo de Steffey, Commissioner, District 1
           Serena Cruz Walsh, Commissioner, District 2
           Lisa Naito, Commissioner, District 3
           Lonnie Roberts, Commissioner, District 4

From: Suzanne Flynn, Multnomah County Auditor

Subject: Audit of Payment Transactions

The attached report covers our audit of County payment transactions in SAP. This audit was included in our FY05-06 Audit Schedule.

We reviewed thousands of transactions in SAP, the County's automated accounting system, to determine if there was a need for any in-depth audit work. For the most part our review was favorable. We did look at three areas in more depth and make recommendations in those areas.

We have discussed our findings and recommendations with the Chief Financial Officer and management in the Accounting, Benefits, and Risk Management section of Department of County Management. A formal follow-up to this audit will be scheduled within 1-2 years.

We would like to acknowledge and thank the management and staff in the Department of County Management and those contacted in the departments for the cooperation and assistance extended to us.

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Summary

In FY01, the County installed a new computerized financial accounting system (SAP). The adoption of this system allowed some work to be de-centralized. The Auditor's Office reviewed records in the accounting system to determine whether there were areas requiring further study. Based upon that review, the audit looked at the County's credit card purchasing program, contract data used for payments, and the risk of duplicate payments.

For the most part, our review of thousands of bill payment records was favorable. We did find that the County was not always maximizing all of the controls available. Specifically, while the County's centralized staff's review of payment transactions was strong, expectations were not sufficiently communicated to departmental employees and supervisors. As a result, some employees were not aware of their responsibilities.

We also found room for improvement in other areas. About 1/6 of credit cards were not used. Payments were sometimes made against contracts that were not approved. Inconsistent data entries reduced the ability to avoid duplicate payments.

The audit recommends that the County better communicate with and train all employees involved in making and approving purchases. The County should also study the causes of contract payments made on unexecuted contracts and develop and communicate better standards for invoice number and vendor data entry.

Background

Multnomah County (the County) is a government organization entrusted with about $1 billion budget in the fiscal year 2005 (FY05). The County is responsible for developing an adequate system to safeguard its funds.

A key area of control is the disbursement and tracking of payments made by the County. The primary responsibility for paying the County's bills is with the Accounting, Benefits, and Risk Management Division in the Department of County Management. The County uses the automated financial system called SAP to process and track payments. The implementation of this financial system allowed the County's accounts payable (A/P) function, which is responsible for processing and approving payments of bills, to be somewhat decentralized. Departmental staff process invoices to pay bills while Central A/P staff review payment requests and issue checks weekly.

An adequate system to safeguard assets not only relies on policies and procedures, but also depends upon the organizational environment. Activities must be monitored on a regular basis. Further, procedures, the purpose of the procedures, and the expectations of employees must be clearly communicated. The adequacy of the system depends upon the employees' understanding of their role and their commitment to the appropriate use of funds.

Scope and Methodology

The purpose of this audit was to determine whether:
1. internal controls of the County's credit card purchasing program were adequate to prevent misuse or abuse, and that County procedures were followed;
2. contract data used for payments was accurate; and
3. the County took steps to avoid duplicate payments.

This audit focused on data available in SAP. We reviewed various SAP reports, policies and procedures, relevant laws and regulations, Central A/P field audit reports, and other relevant audits, documents, and literature. We also interviewed staff from centralized and departmental accounts payable, Department of Community and Human Services and Department of Community Justice contracting, Central Procurement and Contract Administration, SAP Support, General Ledger section, and a section that creates and modifies vendor codes. We interviewed some county credit card holders, and attended SAP Finance User meetings. We compared County practices with best practices.

We also reviewed:
- credit card transactions made on monthly statements ending from January 2005 through September 2005 to identify any unique patterns;
- support documentation for a sample of 1,008 transactions made by 50 credit cardholders with 54 cards selected from the same period;

- the usage of County credit cards in 2005 and their credit limits; and
- the status of duplicate vendor records for 60 vendors with similar names

We compared SAP contract data and actual contract documents to a small sample of major vendors among contracts with an ending date after June 30, 2004 in October 2005 and also tested for duplicate payments of three major utility vendor payments in FY05.

Because an audit was performed for all but utility vendor payments by a consultant in 2003 and few duplicate payments were found, testing of duplicate payments were limited to major utility vendors. We tested 91% of total utility payments in FY05.

This audit was included in our FY06 audit schedule and conducted in accordance with generally accepted government auditing standards.

During the course of this audit, we observed that some County credit cardholders extensively used vendors outside of Central Stores. The County's policy is that employees should contact Central Stores for availability of goods prior to making retail purchases. Additional study is required to determine the most cost-effective methods to purchase goods. We have added this area to our list of future audit areas.

Results

For the most part, our review of thousands of bill payment records in the County's automated financial system was favorable. We identified three areas for further study. In all of these – credit card use, contract information, and duplicate payments – we found that the County was not always maximizing the use of some available system controls.

Each County employee has a responsibility to ensure that expenditures are for approved purchase of goods and services consumed in a course of official business. Supervisors should evaluate the reasonableness of purchases in terms of the amount and frequency of purchases in light of benefits to the County. For this reason, it is important that employees and supervisors are aware of their responsibilities in regards to the use of public funds.

While the County's centralized staff's review of payment transactions was strong, expectations were not communicated with departmental employees upfront to prevent errors and misuse. As transactions grow, the risk of possible card misuse, abuse, and fraud increases. While a control system, no matter how well designed, cannot be assured to be fraud-free, we believe that developing better countywide controls will mitigate such risk and help the County be more error and fraud resistant.

Controls on credit cards generally strong

The credit card program was created to reduce the costs of processing payments and issuing checks to vendors. The County also receives a benefit from the program via an annual rebate from the bank. In 2005, the County spent nearly $4.7 million on credit card purchases and expects to receive a rebate of approximately $25,000. This is an increase from the approximately $1.9 million spent and $4,000 received as a rebate in 2001.

The County uses three types of credit cards: procurement cards, travel cards, and ghost cards. Procurement cards are used for goods under $5,000. Travel cards are used to charge travel and training expenditures. Travel cards are issued to frequent or periodic travelers, and departmental travel cards are loaned to infrequent travelers for specific trips. Ghost cards are issued for certain vendors that the County routinely uses to reduce transaction costs and take advantage of the rebate program. Ghost cards can be only used by approved buyers. As of August 2005, there were 662 cards issued in the County.

Our review of credit card transactions and internal controls of the credit card program showed that the overwhelming majority of transactions were documented and appeared to be legitimate, and the fiscal staff acted as a strong control in general. Thorough documentation for credit card purchases is particularly important because of the need to review the legitimacy of purchases

after the fact. Credit cards allow cardholders to make purchases without involving other personnel so lack of documentation may indicate a cardholder's lack of knowledge or a sign of misuse. Inadequate documentation increases the risk of improper purchases without oversight.

We reviewed 1,008 transactions and relevant documentation for 50 cardholders with 54 cards. We were unable to find any receipt or manager-approved memo for 23 transactions. Upon further investigation, we concluded that for the most part the undocumented transactions appeared legitimate.

Cardholders need to understand policies and procedures to use their cards properly. Communicating expectations to cardholders would make it easier to enforce the rules and reduce instances of non-compliance with established procedures for those who are unaware. The County does not offer any training for cardholders and supervisors. We found that the follow-up on cardholders by reconcilers, who match and compare monthly statement charges with receipts, helped the high documentation compliance rate of card transactions. However, we encountered some violations of the County procedures, indicating a need for training, or better supervision or approval of card transactions.

Further, procedures referred to multiple documents at different locations and rules related to the County credit card use were difficult to understand. For example, the procurement card manual included some prohibited items, but not all. No quick reference existed for cardholders, supervisors, and reconcilers. Because the County offers no training, it was up to cardholders to understand all the complex rules.

Number of cards could be reduced

The County issued cards based on manager approval with no other eligibility criteria. Most procurement cards had monthly credit limits of $10,000 while most travel cards had $5,000 limits regardless of actual needs. We found that many cards were not utilized. Of the 662 issued as of August 3, 2005, 106 cards were never used in 2005.

Blanket credit limits give some cardholders significantly more purchasing power than they actually need, which increases the risk of abuse and the impact to the organization should the card be misused. Maximum monthly purchases made in 2005 were significantly below their credit limits for many cardholders. Thirty-nine cards had total annual purchases of less than $100 in 2005. We believe that under-utilized cards unnecessarily increase administrative tasks and risk.

One way to balance between the purchasing needs of cardholders and credit card limits is to provide card limits for individual cardholders that slightly exceed the highest actual purchase in any month of the preceding year. Another way to protect the County and meet cardholders' needs may be to set credit card limits for groups of cardholders based on their purchasing levels. For example, all procurement cardholders with monthly credit card purchases less than $1,000 would have a credit limit of $1,500 rather than $10,000.

Exhibit 1

Highest Monthly
Purchase 2005

Highest Monthly Purchase	Number of Cards	Percent of Cards
Credit transaction only	4	1%
$50 and under	20	3%
Over $50 to $100	26	4%
Over $100 to $500	167	28%
Over $500 to $1,000	147	25%
Over $1,000 to $5,000	198	33%
Over $5,000 to $10,000	22	4%
Over $10,000 to $100,000	10	2%
Over $100,000	2	0%
Total Number of Active Cards	596	100%

Contract data not always reliable

The purpose of contracts is to buy goods and services in the most cost-effective manner and/or protect the County from receiving unsatisfactory goods and services from vendors. Contract information is mostly entered by department contract staff into the automated financial system (SAP). As a system control, each payment on a contract is matched to the contract information already entered in SAP and limited up to the total contract. To make the system control function as intended, the data entered in SAP must be accurate.

We compared SAP contract data and actual contract documents for two major human service vendors used by many departments. Although this was not a statistical sample, the examination revealed that data were not always reliable. In all cases reviewed, we found no evidence of overpayments.

We found that SAP contract data did not differentiate between completely processed and approved contracts and those that were not. Payments were made against some contracts not fully approved, particularly for human service contracts. The County policy is for all contracts to be fully approved prior to delivery of services or goods. The Central Accounts Payable section had developed procedures to provide some fiscal controls for those types of contracts.

The contract helps the County set expected performance, clarify responsibilities of both parties, and enforce those terms and conditions. Lack of a fully-approved contract does not either provide accountability or encourage good performance. Further, the County may have no recourse when contractors do not perform satisfactory or bill for something for which the County should not be responsible.

Inconsistent data entry increases risk of duplicate payments

The County processed nearly 84,000 invoices to make payments in FY05. In light of the volume of invoices processed, a system should be in place to avoid duplicate payments.

Three years ago, the County contracted with a consulting firm to audit for duplicate payments. There were few findings. Because major utility payments had not been a part of that audit, we tested duplicate payment data for major utility payments. Our test revealed no duplicate payments paid to vendors.

We observed that system controls functioned as designed and reviews occurred to avoid duplicate payments. However, improvements in invoice number data entry and vendor master records will decrease the risk of duplicate payments.

 SAP recognizes duplicate payments and gives a warning when an employee enters the same invoice number and the same invoice date for the same vendor. To allow the system control to function, consistent invoice number entry for each vendor is crucial.

Inconsistency in invoice number data entry was prominent in cases where vendors offer no invoice numbers. Staff, in some cases the same person, used various methods to create an invoice number and the information was not always unique as required by County guidelines. Best practices suggest that each aspect of invoice-coding policy be addressed, and a policy set and communicated to all processors.

Consistency in vendor names entered into SAP is also important. The County's vendor master file contained vendors with multiple names and codes. In some cases, multiple codes existed for the same vendor and remittance address. This situation increases the risk of erroneous and duplicate payments because the same invoices could be processed under different codes, bypassing the system control.

In 2003, a consultant recommended that the County review 580 vendors that might contain duplicate vendor codes and remove duplicate vendor codes from the vendor master file. Among them, we reviewed 60 vendors to determine if the recommendation was addressed. We found that 21 duplicate codes were blocked as recommended and 38 duplicate codes still remained. We encourage the continued effort to block duplicate vendor codes. Creating standards for vendor name data would help avoid creating duplicate codes.

Recommendations

1. To strengthen the internal controls of the credit card purchasing program, the County should:
   a. Clarify roles and responsibilities of cardholders, supervisors, those who reconcile monthly card statements, and procurement card administrators;
   b. Better communicate the credit card program policies and procedures with employees;
   c. Train cardholders, supervisors, and those who reconcile monthly card statements on their responsibilities and rules; and
   d. Re-evaluate the need for cards and their credit limits

2. To minimize the risk of making contract payments before the contract is executed, the County should study the causes of payments made on unexecuted contracts and take steps to reduce them.

3. To minimize the risk of potential duplicate payments of invoices, the County should
   a. Better communicate countywide standards of invoice number data and vendor name entry; and
   b. Develop written procedures at the department level regarding department-specific standards of invoice number data entry.

Responses to
the Audit

Diane M. Linn, Multnomah County Chair

March 7, 2006

Suzanne Flynn
Multnomah County Auditor
501 SE Hawthorne, Room 601
Portland, OR 97214

Dear Suzanne:

I have reviewed your audit of the County's SAP Transactions and would like to thank you and your staff for your hard and valuable work. We are interested in ways to improve our oversight of the transactions and the integrity of our financial system, and this audit will assist us in that effort.

Multnomah County's SAP system is the County's financial system of record. It is extremely important that the County continue to strive for improvement and efficiencies in managing our financial resources in every manner possible.

As you have detailed in this audit, the need to strengthen internal controls of our credit card program will aid the County in maximizing our purchasing capacity while minimizing the risk of excess credit capacity. In addition, the need to improve our contracting processes to avoid payments prior to contract execution will assist us in managing our contracts more effectively. Finally, your recommendation to take steps to minimize the risk of duplicate payments is timely as we are continuously working to improve our invoicing standards and practices and communicate them to our users.

I have discussed the audit and your recommendations with our Chief Financial Officer and his Assistant and we agree that you have outlined excellent and useful suggestions in this audit.

Once again, I appreciate your continuing efforts in helping us identify ways to improve the operations of Multnomah County.

Sincerely,

Diane Linn
Multnomah County Chair

c: Board of County Commissioners
        Dave Boyer, Chief Financial Officer
        Mindy Harris, Assistant Chief Financial Officer

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March 7, 2006

Suzanne Flynn, Auditor
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Dear Ms. Flynn:

The Department of County Management and the Accounting, Benefits and Risk Management Division appreciate the time that you and your staff have invested in a review of the SAP Transactions and Accounts Payable practices. Thank you for the opportunity to comment on your findings and recommendations. Following are specific responses to the concerns you raised in your report.

Strengthen internal controls of the credit card program

The department is working to clarify the roles and responsibilities of cardholders, supervisors, those who reconcile monthly card statements, and the Procurement Card Administrator by
- better defining the expectations of those involved in the credit card program
- providing relevant training to those involved in the credit card program
- improving the written County Administrative Procedures and the related user manuals

Annual training of departmental card coordinators will be strengthened and a cardholder competency quiz and quick reference guide will be developed as user tools to increase awareness and accountability. The department will also be implementing a new annual certification process requiring cardholders and their supervisors to acknowledge that they have re-read and understand the cardholder and supervisory responsibilities and will comply with the procurement card policies and procedures. Annual re-certification of the staff performing the credit card reconciliations will also be required. This re-certification process will be implemented by the end of June 2006.

In response to the comment regarding the re-evaluation of credit card limits, the department is currently reviewing the annual spending history of all individual credit card accounts and will recommend changing credit limits that more closely align with a credit limit sufficient to carry out similar purchasing capacity in the future. This will reduce superfluous credit capacity and minimize credit risk. As with past practice and for internal control purposes, requests to increase/decrease credit limits will only be processed with the written consent of the cardholder's supervisor and the County's Procurement Card Administrator (Accounts Payable Manager). Reduction in cardholder credit limits based on the above described assessment process will begin immediately and will be implemented department by department; we expect to be completed by July 2006.

Minimize the risk of making contract payments before the contract is executed

The Department has treated payments against unexecuted contracts as an exception rather than the norm. The Central Accounts Payable Manager and Central Procurement and Contracts Administration Manager have recognized this as an issue and have been working collectively with the County Attorney's Office and with direct service departments to minimize the occurrence of payments against unexecuted contracts and understand and mitigate the root causes of delayed contract development and execution. Some strategies to accomplish this are:

- requirement of direct service departments to prepare a monthly list of unexecuted contracts and submit it to Central AP and CPCA
- joint review of and risk assessment by Central AP and CPCA of all payment requests against unexecuted contracts, and
- introduction of the draft *Letter Contract* pilot that is currently underway and expected to be incorporated into the Administrative Procedures (CON-1).

We will continue to monitor the progress of this situation; as a result of our current efforts we expect fewer payments against unexecuted contracts in the new fiscal year and will continue to monitor progress while keeping all stakeholders appraised, including the County Attorney's Office.

Minimize the risk of potential duplicate payments of invoices

The Department will better communicate countywide standards of invoice number data and vendor name entry by examining the current practices of all departments. The Central Accounts Payable office will also work collectively with each department to assess the differences in invoice practices.

- update the SAP invoice processing manual and re-introduce the topic to county wide accounts payable staff via the County's monthly Finance User Group meetings
- work with Central Procurement and Contract Administration to introduce and standardize new contract language prescribing best practice invoice standards
- Central AP will work with departmental accounts payable staff which have vendor invoice irregularities unique to their department and establish/document the standards by which the department should consistently process these invoices.

To ensure that county-wide accounts payable staff understand and observe the invoice processing standards as defined in the SAP Invoice Processing Manual, compliance will be monitored as a function of the periodic field audits performed by the Central Accounts Payable team.

We would like to thank you and your staff for your review and recommendations, and trust that our approach is satisfactory to you. Please let us know if you have concerns or questions, and again, thank you for your feedback.

Sincerely,

Mindy Harris
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Finance & Risk Management Division
Department of County Management

Mike Waddell
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