



CITY AUDITOR'S OFFICE

TO: Mayor and Council Members
THRU: Margaret Krym, City Auditor
FROM: Kathy Magaw, Assistant City Auditor *KM*
DATE: July 16, 2014
SUBJECT: Follow Up – Internal Control Review, Procurement and Accounts Payable

In 2011, the City experienced high turnover in the Financial Services Department. This coupled with concerns regarding internal control awareness and the decentralization of the procurement and accounts payables processes prompted the new Financial Services Director to request a review of the internal controls within the Procurement and Accounts Payables processes.

Our defined objectives for this review were:

- Strengthen the Control Environment
- Provide Management with a documented process map
- Educate staff and provide a tool for training new employees
- Raise awareness of processes flowing across department boundaries
- Establish accountability for internal control activities
- Provide the external auditor's with a control assessment to help reduce audit work
- Identify critical controls for further audit testing

We engaged Clifton Larson Allen, LLP (CLA) to review these internal controls. We issued their report on February 1, 2012. In their report, CLA stated the following:

Overall, we found that the City's procurement and accounts payable process include sufficient internal controls to allow for achievement of operational objectives, including safeguarding of assets, generating reliable financial reporting data, and compliance with applicable regulatory requirements, policies and procedures.

Nonetheless, our assessment of the seven procurement and accounts payable sub-processes resulted in a number of observations and recommendations to improve the efficiency and effectiveness of the procurement and accounts payable process.

They included 19 recommendations, which Management agreed to implement.

As of this memo, we have verified that Management has cleared 14 of the 19 agreed upon action items. Management determined the associated risks for three of the items (#15, #17 and #18) are minimal and acceptable; therefore will not be modifying existing controls. Implementation of the remaining two items (#7 and #13) is in progress. A description of each item follows in the body of this report.

Methodology

The City Auditor's office internal staff performed this engagement as a follow up to a previously published audit report (Internal Control Review – Procurement and Accounts Payable). The scope was narrow and limited to ascertaining the status of the implementation of previously agreed to recommendations only. The nature of this engagement therefore does not constitute an audit in compliance with generally accepted government auditing standards (GAGAS.) However, we believe that the evidence obtained provides a reasonable basis for our conclusions.

Our verification of the follow up work is not designed nor intended to be a detailed study of every relevant system, procedure or transaction. Although we exercised due professional care in the performance of this engagement, this should not be construed to mean that unreported noncompliance or irregularities do not exist. The deterrence of fraud is the responsibility of management.

Agreed Upon Action Items - Not implemented

Agreed Upon Action Item #7:

In 2012, CLA reported:

"Policies and procedures: Quotes' requirement – The City should adjust City ordinance to require written (not verbal) quotes for all procurements under the formal bid threshold of \$50,000."

Procurement indicated they would work with the City Attorney's office to review and modify the ordinance where applicable and submit it to Council for approval. As of this date, the ordinance has not been amended. Management has advised us that they will continue to pursue this ordinance change.

Currently, the ordinance requires one quote for procurements under \$2,500 (the ordinance does not specify whether the quote is verbal or written), three verbal quotes for procurements between \$2,500 and \$20,000, and three written quotes for procurements between \$20,000 and the bid threshold of \$50,000.

Agreed Upon Action Item #13:

In 2012, CLA reported:

"Policies and procedures: Intra-department invoicing - The City should establish consistent procedures for intra-departmental invoicing."

Continued staff turnover and short staffing in the Financial Services Department, as well as the urgency of other priorities, has hindered the Departments ability to complete this action item. Management has advised us that implementation is in progress.

Agreed Upon Action Items - Cleared

Agreed Upon Action Item #1:

In 2012, CLA reported:

"The City should consider the advantages and disadvantages of a centralized versus a decentralized procurement model.

The strength of a decentralized procurement model is that it ensures the City locates and orders goods and services that conform to the specifications of the operating department. Conversely, a centralized procurement model's strength is that 1) it promotes economy and efficiency by facilitating accounting and finance control, and by enabling quantity purchasing and the standardization of frequently used items; 2) channels all procurement through a specialized purchasing department, and; 3) facilitates effective vendor selection and management of vendor performance."

In response to the audit recommendation, the City agreed to consider the advantages and disadvantages of a centralized versus a decentralized procurement model. In 2012, Management indicated that they review the procurement model annually as part of their budget process and organizational review. The City has not chosen to pursue a more centralized model due to financial constraints. Management has indicated that they will continue to rely on a decentralized procurement model.

Agreed Upon Action Item #2:

In 2012, CLA reported:

"Due to the decentralized model, there is a risk that the City is not securing the lowest competitive prices for goods and services procured.

The City should increase economies of scale and realize savings and/or lower prices by centrally maintaining and effectively communicating all existing state/local contracts that could be of benefit to the City. Additionally, the City should explore the benefit of centralized versus decentralized procurement with respect to enabling quantity purchasing and the standardization of frequently used items."

Procurement staff agreed to work closely with department/division Certified Agency Buyers (CABs). We verified that Procurement has:

- Created a contract vendor master list to inform all CABs of preferred vendors
- Incorporated awareness of preferred vendors into regular CAB training
- Required regular annual training for all CABs

Agreed Upon Action Item #3:

In 2012, CLA reported:

"The City should establish measures to improve vendor performance management.

Currently the City does not have established criteria of what constitutes unsatisfactory vendor performance and vendor performance is not tracked centrally or consistently; additionally, a

master list to track vendor performance or to support vendor warnings and debarment does not exist.”

Procurement agreed to develop benchmarks, templates, and hold quarterly meetings for their major contracts.

The Procurement Division has vendor performance measurement tools that they developed and implemented as follows:

- A standardized evaluation template to document vendor performance
- A post-mortem report template to document project performance
- A list of approved vendors current contracts is maintained on the City's intranet
- Quarterly meetings with major vendors to discuss any relevant concerns, and document any open items on an action plan to keep track and address these concerns.

We observed the use of these tools for several major vendors.

Agreed Upon Action Item #4:

In 2012, CLA reported:

“Planning is key to the procurement operation. While it appears that key departments are planning to an adequate extent, the City should continue to stress the importance of planning across the board. Further, the City should standardize the method by which departments track budget to actual information, maximizing the use of JDE and providing to staff training as needed.”

The City has moved to a three-year budgeting cycle that has enhanced planning for all departments. Additionally, we randomly verified that departments regularly receive “Budget to Actual” reports from the Financial Services Department.

Procurement is providing regular training to all CABs annually, monitoring department purchases and training CABs in the best use of JDE.

Agreed Upon Action Item #5:

In 2012, CLA reported:

“Procurement and accounts payable effectiveness can improve by addressing certain staff-related issues. Both procurement and accounts payable appear to be short staffed due to recent staff cuts and open positions. This situation has an impact on the operations and increases the risk of exception.”

Management indicated that as budget allows, they would review positions and job duties to address staff related issues. Since issuance of the original CLA report, the Procurement Division filled the vacant Procurement Manager position and various vacant support staff positions. Additionally, in May 2014 they filled a vacant Contract Specialist position.

For Agreed Upon Action Items # 6 – 17 CLA reported the following:

“The City can improve its procurement and accounts payable operation by developing and instituting certain new policies and procedures. During the course of our work, we identified the following opportunities for improvements that, if implemented, could result in lower risk of exceptions and gains in process efficiencies. ”

Agreed Upon Action Item #6:

In 2012, CLA reported:

“Policies and procedures: Stale POs – It is unclear whether all departments are reviewing and closing stale POs. The City should develop a reasonable calendar for CABs to run an open PO report during preparation for year-end, and note procurements that are off-target (blanket POs with no activity). Management should address this information and consider requesting PO cancellation. As appropriate, training to CABs to run an open PO report should be imparted.”

It is Procurement’s current policy to review purchase orders throughout the year and monitor usage and if found, any stale purchase orders are closed at the end of each fiscal year.

We observed that the Accounts Payable Supervisor emails a year-end memo to all CABs in September that describes the year-end PO closing process. In this communication, the CABs are instructed to review all POs and ensure that those POs they have requested to be closed are actually closed and that no funds are encumbered unnecessarily.

This regular annual process is also now part of the CAB training.

Agreed Upon Action Item #8:

In 2012, CLA reported:

“Policies and procedures: City Manager approval – The additional approval step established by the City Manager whereby any requisitions over \$5K are approved by the City Manager is not documented in the procurement ordinance or in the existing policies and procedures.”

Since that time, the new City Manager has modified this process and currently the policy is now in compliance with the procurement ordinance.

Agreed Upon Action Item #9:

In 2012, CLA reported:

“Policies and procedures: Adequate use of Check Requests – it appears that departments may still be using Check Requests to circumvent the PO and requisition approval process. To improve, the City should continue to enforce the Check Request guidelines. Additionally, the City could increase accountability by having the AP Specialist flag instances of

inadequate use of check request; the AP Supervisor should evaluate its adequacy and have the authority to request the originating department to re-direct the transaction using the PO process.”

We observed that the Accounts Payable Supervisor is reviewing check requests and e-mailing department CABs, with a copy to the Procurement Manager, when a check request is in question. The CAB is informed that future physical purchases must utilize the PO process. If necessary, the AP Supervisor halts the check request and re-directs the transaction using the PO process.

Agreed Upon Action Item #10:

In 2012, CLA reported:

“Policies and procedures: Approving invoices supporting Check Requests- invoices supporting Check Requests are not consistently signed.”

We observed that the Procurement Manager and Accounts Payable Supervisor have added this item to the training schedules. Training is an on-going process.

We were advised that e-mail reminders are sent out when invoices supporting check requests are not consistently signed and that check requests and supporting documents are returned to the originating division or department if signatures are needed.

Agreed Upon Action Item #11:

In 2012, CLA reported:

“Policies and procedures: Observation of goods received and of services rendered – Verification of services rendered appears to be inconsistent among department. Additionally, there have been instances in the past where there was inconsistent observation of goods received. The City should formalize and consistently apply receiving procedures.”

Financial Services advised us that AR#23 (Purchasing) and the “Invoice Processing Standard Operating Guide” available on SharePoint is the formalized procedure for receiving goods and services. We observed that Procurement is reinforcing the policy with emails advising CABS that signatures are required to evidence the receipt of goods and services. During annual training CABs are instructed that all purchases must include a proof of delivery ticket and that if the expenditure is service related there must be an employee signature and date confirming the work was completed.

Agreed Upon Action Item #12:

In 2012, CLA reported:

“Policies and procedures: Distribution of goods to incumbent (requesting party) – The distribution and acknowledgement of goods received/delivered to the incumbent party appears inconsistent among department. The City should clarify and effectively communicate the proper procedure for all responsible parties.”

AR#23 addresses the transfer of goods between parties and the AP Standard Operating Guide has a paragraph related to the receiving/transfer procedures as well. Accounts Payable staff are now taking a stronger role in enforcing existing policy. We observed numerous emails sent to CABs to communicate the policy requirements.

Agreed Upon Action Item #14:

In 2012, CLA reported:

"Policies and procedures: Duplicate payment to vendors – While the automated system does not accept duplicate invoice numbers, CABs can override this control. The City should look into the appropriateness of the invoice override procedure and consider including a department's supervisor approval of the override."

To lower the risk of duplicate payments, Management responded that they would implement a procedure to monitor the Voucher Journal Report. We observed that they have implemented this process. They now monitor the Voucher Journal Report for duplicate payments and quality control.

The City Auditor's Office recently performed an Accounts Payable-Search for Duplicate Payments Review using data analytics software (IDEA) and found no significant duplicate payments.

Agreed Upon Action Item #16:

In 2012, CLA reported:

"Policies and procedures: Vendor credits – Vendor credits may not always be identified, translating into monetary losses to the City. Management should impart additional training and provide easy access to resources for CABs. Process can also be strengthened by coding discounts up-front in the system."

AP and Procurement agreed to modify the vendor registration file to include the vendor's discount terms, if any. We verified that this has been implemented.

In December 2013, the AP and Procurement Division implemented a "vendor portal." This portal allows a business to register as a City vendor. This registration process was also modified to include vendor discount terms, if applicable.

Agreed Upon Action Item #19:

In 2012, CLA reported:

"Information systems - The City should ascertain whether the current system (JDE) is utilized to the fullest extent especially with respect to the areas for improvement identified in this study. For example, the City should look into the system's capability to better manage vendor information; the City could also ascertain the capability of the system to generate the various management reports as suggested in several of the observations made above."

The Accounts Payable Supervisor agreed to coordinate with the Procurement Manager and the ITS Department to review JDE applications and to determine the capabilities of the software addressing this issue. The AP Supervisor advised us that they are regularly evaluating the ways they use JDE in order to obtain the best functionality.

Management determined that the risk associated with the following three items is minimal and acceptable and they will not be modifying the existing controls.

Agreed Upon Action Item #15:

In 2012, CLA reported:

“Policies and procedures: Timely payment to vendors – the City should consider the benefit of utilizing periodic AP aging reports to verify that no invoices remain unpaid for an excessive length of time and that vendors are timely paid.”

Management indicated that an aging report would be of no benefit. When invoices are processed in the financial system, they are paid according to the vendor’s terms automatically. Invoices not entered into the financial system cannot not be captured on an aging report.

Agreed Upon Action Item #17:

In 2012, CLA reported:

“Policies and procedures: Check signees – Current authorized check signers are not involved in all the AP process and thus do not review or approve the payments that they are endorsing through their signatures. The City should modify procedures so that check signers undertake a review role in the AP process.”

The Accounts Payable Supervisor has reached out to a number of other municipalities and ascertained that their electronic signers do not review invoices prior to check processing and printing. The City’s existing practice requires the Financial Services Director to electronically approve all check requests over \$5K. Management determined this control was sufficient and that their process was aligned with other communities.

Agreed Upon Action Item #18:

In 2012, CLA reported:

“The City could improve its procurement process by investigating and streamlining unnecessary bottlenecks using the functional flowcharts prepared as part of this study. Specifically mentioned areas include:

- *Bid approval process – Currently bids can take up to 90 days to process*
- *Manual review and corrections by AP of CAB work. Procedures dictate that whenever errors are detected by the AP Specialists, they should be directed to*

CABs for correction but due to the current workloads, AP often resolves the discrepancies.”

The Procurement Manager indicated that the 90 day process for bid approval was acceptable. Management has determined to accept this process as it is. We have observed a willingness on the part of Procurement and Accounts Payable staff to modify and improve their processes when beneficial.

We are available to respond to any questions or concerns about the information contained in this document. You may contact Kathy Magaw at 242-3381 or Margaret Krym at 242-3380.

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