



INTERNAL AUDIT

**Procurement Card Audit
Follow-up Report**

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Authorization

The City Auditor has conducted a Procurement Card (P-card) Follow-up Audit. This audit was conducted under the authority of Resolution #2013-51 and in accordance with the Annual Audit Plan approved by the League City, City Council in Resolution #2014-27.

Objective

This is a follow-up of the "Procurement Card Audit" report issued on June 9, 2014. The objective was to determine if previous audit recommendations were implemented.

The objectives of the original audit were as follows:

- 1) Determine if general controls for the P-card program are designed appropriately and operating effectively.
- 2) Through data analysis, determine if the P-card program has any lapses in internal control that may cause fraud, waste, abuse or non-compliance with State Law and local policies and procedures

Scope and Methodology

The City Auditor conducted this audit in accordance with Generally Accepted Government Auditing Standards except this audit function has not had an external peer review. Those standards require planning and performing the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives. The City Auditor believes that the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objectives.

The sampling methodology is discussed in Exhibit A.

In order to determine if previous recommendations were implemented, I:

- Inquired with Management
- Examined Documentation

The scope of the audit follow-up used information from FY14 and FY15.

To assess the reliability of the data elements needed to answer the engagement objective, I (1) Performed inquiries with management, (2) Reviewed related documentation. As a result of the testing, I determined that the data was sufficiently reliable for the purposes of this report.

Overall Conclusion

Fully Implemented	Partially Implemented	Not Implemented
9	2	

Audit Follow-up

This follow-up audit was not intended to be a detailed study of every relevant system, procedure, and transaction. Accordingly, the Follow-up section presented in this report may not be all-inclusive of areas where improvement might be needed.

The following results for each finding are as follows:

Opportunity for Improvement #1 – Monthly Reviews
Condition (The way it is)
The current reviewer in Purchasing is expected to review approximately 1,000 transactions per month. During the audit it was known that the reviewer is five months behind in the reviews.
Recommendation
The City Auditor believes that to enhance the effectiveness and efficiency of the reviewer the scarce resources of this position need to be reallocated to higher risk areas and data analysis should become an integral part of the review. The top risk areas should be addressed such as noncompliance with State Law and improper payments.
Management Response
We agree
Action Plan
By lowering limits and redirecting large dollar purchases back through the purchasing system, we expect the volume of P-Card purchases to decline. Before we restructure the review to a sample basis, purchasing will conduct training for department heads and department P-Card coordinators to remind them of their responsibilities in the process. Purchasing will create a process which will allow the staff to review and audit transactions both in a spot/sample or individual user basis. With the anticipated reduction in P-Card review, staff will then establish data analytics utilizing the P-Card system to detect trends, issues/concerns or opportunities for changes/modifications.
Implementation Date
September 1, 2014
Follow-up
Management has lowered limits and redirected large dollar purchases back through the purchasing system which has lowered the volume of P-Card purchases. Training has been conducted. Purchasing has a process in place which will allow staff to review and audit transactions both in a spot/sample or individual user basis. Inquiry with management indicated no data analytics utilized. During this audit, the auditor was unable to acquire a requested data dump (10/1/13 – 2/28/15). A data dump was received for months August and September 2014. This limited the testing that could be performed and further substantiates no data analysis has been

performed.

Implementation

Partially Implemented

Opportunity for Improvement #2 – Policies and Procedures/Merchant Cost Categories

Condition (The way it is)

The P-card policy was last updated on July 1, 2011.

Even though the P-card policy states that the P-card is governed by all City of League City policies, procedures and directives it is doubtful that employees will refer to the Purchasing Policy (e.g., Sole Source and Emergency Purchases)

The policy section on what can be purchased with a P-card does not state prohibited expenditures. Along with this the prohibited Merchant Cost Categories (MCCs) may need to be expanded as they were set up in 2007. Only six MCCs are listed as prohibited.

Recommendation

- 1) Review and update the P-card policy ensuring that important points from other Policies and Procedures are incorporated in the updated policy.
- 2) Perhaps Sole Source and Emergency Purchases should be eliminated from the P-card program due to the extra documentation needed.
- 3) Review and update MCCs for prohibited cost categories.

Management Response

We agree

Action Plan

Purchasing staff will review and update the P-Card Policy and Procedures manual to be more succinct and aligned with City adopted Purchasing policies.

Sole Source purchases will no longer be acceptable with P-Card transactions. Purchasing will seek “best practices” from similar municipalities and advisement from P-Card bank and city administration in regard to adjusting/updating MCC codes.

Implementation Date

September 1, 2014

Follow-up

Observed the new Purchasing Policy which includes P-Card information. New policies do not directly state that P-Cards cannot be used for Sole Source and Emergency Purchases. However, the new policy states that a Sole Source must have an attached Requisition Coversheet specifying the Sole Source purchase and the corresponding justification. Emergency purchases exceeding \$3,000 require a justification documenting the emergency and must be approved by the City Manager or his designee via the Requisition Coversheet form.

Additionally, the majority of monthly transaction limits do not exceed \$3,000 with single transaction limits set to \$1,000.

MCC's were reviewed and updated. Prohibited MCC's increased from six to over 100.

Implementation

Fully Implemented

Opportunity for Improvement #3 - Training

Condition (The way it is)

Department reps are not trained on their departmental duties.

Recommendation

Create a tradition of new department rep training and annual refresher training thereafter.

Management Response

We agree

Action Plan

Purchasing and Accounts Payable will develop a training program for department P-Card Coordinator (DPC)* and Department Head/Director that will include power-point presentation and a discussion of relevant issues, etc. Once complete, department representatives will sign an affidavit that they have attended this session. We anticipate the session to be very comprehensive and last between 2-4 hours and cover policies, reconciliation, data analysis, assistance, etc. The goal is to have a class for all current department representatives prior to the end of the current fiscal year, quarterly sessions for new representatives (as needed) and then an annual refresher class.

* The DPC will be the central documentation control point for each department. The DPC is responsible for the correct appropriation of the department's funds and the coordination of the Purchasing Card Program for the department

Implementation Date

September 8, 2014

Follow-up

Auditor personally observed training take place on March 11, 2015. Two other sessions took place on March 12, 2015 and another on March 24th. Signatures from the training were observed by the auditor.

Implementation

Fully Implemented

Opportunity for Improvement #4 – P-card Limits

Condition (The way it is)

The limits on the P-cards need to be reviewed. 10 of the cards have -0- for a single transaction limit which would then default to the monthly limit which would then put them within State law criteria.

Many of these cards have single transaction limits above the \$3,000 threshold requiring quotes and HUB requirements. A few of these single transaction limits are \$30,000 and above with monthly limits up to \$85,000. The limit should be based on need if over the \$1,000 standard single transaction limit. For example, one individual with a single transaction limit of \$40,000 had a high purchase of \$20,000 over a two year period. Another individual with a single transaction limit of \$30,000 had a high purchase of \$17,000 over a two year period. Another individual with a single transaction limit of \$30,000 had a high purchase of \$10,000 over a two year period of time.

Some cards have the same single transaction dollar limit as they do their total monthly limit.

The Cardholder Agreement form that is signed by the cardholder does not indicate the limits.

Out of 10 cards over \$2,999.99 only one had a Purchasing Manager's approval.

Recommendation

- 1) Review and adjust these limits as appropriate.
- 2) The city has the ability to raise and lower limits within minutes. Use this to the City's advantage.
- 3) Reemphasize compliance with State Law and our policies at the next training class.
- 4) Place the limits on the cardholder agreement.
- 5) Make sure the Purchasing Manager approves all P-cards above \$2,999.99.

Management Response

We agree

Action Plan

Purchasing will again rely on "best practices", State Law and Purchasing Policies with regard to adjusting P-Card limits.

Purchasing will develop a new cardholder agreement which will be very clear regarding transaction limits, unauthorized purchases, etc. This form will be provided to all current and future cardholders and maintained by our office. We anticipate updating our P-Card training and requiring all current cardholders to attend to receive up-to-date training, sign a new agreement, etc.

As part of the new policy, the Purchasing Manager must approve all cards issued that will have limits increased beyond \$ 2,999.99 for a single purchase. Any increases must be on a very limited basis and should be rare exceptions. The Purchasing Manager will rely on the Department Director to justify approval of this increase. It will be incumbent on the Purchasing Manager to monitor the transaction and reduce the increase once the transaction is complete.

Clearly, having -0- limits on single purchase for P-Cards is unacceptable and will be corrected immediately.

Implementation Date

September 1 , 2014

Follow-up

- 1) Limits have been adjusted.
- 2) Temporary increases have been used.
- 3) Training has been completed.
- 4) The Purchasing Manager does make approvals for amounts over \$2,999.99.
- 5) Limits and Manager Approvals were found on the Cardholder Agreement.

Implementation

Fully Implemented

Opportunity for Improvement #5 – Preferred Vendors

Condition (The way it is)

The Purchasing Policy states the following, “The Purchasing Department maintains a vendor listing by commodity of vendors wishing to do business with The City of League City that may be utilized.” However, when asked about this list the P-card Administrator indicated there was no list. This was confirmed by the Purchasing Manager. He indicated the city uses “Public Purchase” as a vehicle to allow vendors to register according to their commodity. Bid notices can then be sent to them.

The data analysis showed there were opportunities for the city to use its large purchasing power to leverage for discounts from various vendors.

Recommendation

- 1) Create a vendor listing according to the Policy or provide information on “Public Purchase.”
- 2) Use data analysis to determine high expense vendors and negotiate discounts.

Management Response

We agree

Action Plan

Purchasing will create reports and analytical tools inside the P-Card software (SDOL) and begin working and negotiating with our high expense vendors, negotiate discounts and/or better terms and produce an agreement for that provider.

Implementation Date

September 8, 2014

Follow-up

Purchasing now utilizes a vendor expense report to monitor vendors that might be likely candidates for negotiation of discounts.

Implementation

Fully Implemented

Opportunity for Improvement #6 – Capitalized Expenses

Condition (The way it is)

The Purchasing Policy and P-card Policy needs to address capitalization vs. expensing an item. It was noticed during this audit that several items in the Public Works Department (Lift Station Pumps, Sewage Pumps and Hot Mix Asphalt) and should have been capitalized.

Recommendation

- 1) Create a Capitalization Policy for the City.
- 2) Create a mechanism for the review of account coding particularly capitalized expenses.

Management Response

The City has a Fixed Asset policy which covers capitalization guidelines. The threshold for capitalization is \$5,000. If the repair of an item does no more than return the asset to its original condition and thus provides no additional value, then the cost of the repair will be expensed. If the repair or replacement of the item increases capacity or serviceability of the original asset or extends significantly the life of the asset, then it will be capitalized as an addition to the original asset. The items questioned during the audit were properly coded and would have been considered maintenance items in accordance with City policy. Expenses coded to the correct capital outlay object codes are reviewed and capitalized by the accounting department. Accounting also reviews maintenance accounts for mis-coded items that should have been charged to capital outlay. Management agrees that the asphalt purchase was a capital improvement that was overlooked in the review process.

Action Plan

We will reinforce to the departments during the Purchasing training the capitalization limits and the correct account numbers to utilize. Purchasing will also be mindful of the policy and the account numbers. Purchasing, accounting and budget will be mindful of the potential for capital expenditures as we review maintenance accounts, and work to identify them in advance in order to facilitate appropriate accounting treatment.

With lower PCard limits, and expenses going through the traditional purchasing channels, these errors should be easier to avoid.

Implementation Date

September 1, 2014

Auditor's Comment

The City Auditor desires to clarify the position taken.

At the time of this audit, the auditor found no capitalization policy on Policy Tech which is the city's central repository for all policies. Employees cannot be expected to follow policies that are not easily accessible to all employees.

The auditor understands that there are gray areas surrounding the capitalization

issue.

According to the publication Accounting for Capital Assets, A Guide for State and Local Governments it states for an Improvement, "An improvement provides *additional value*. Such added value is achieved either by 1) lengthening a capital asset's estimated useful life or 2) increasing a capital asset's ability to provide service (i.e., greater effectiveness or efficiency).

The same article states for Repairs and Maintenance, "In contrast to improvements, repairs and maintenance *retain value* rather than provide additional value."

Improvements should be capitalized and recognized as expense (i.e., depreciation or amortization) over the estimated useful life of the improvement. The cost of repairs and maintenance must be reported as expense of the period in which incurred.

Pumps – Subsequent to the management response additional review was conducted by the City Auditor. The pumps invoice amounts were \$5,853, \$6,375, \$39,394.

In a recent city survey that Auditor performed it was mixed as to the way cities handle the rebuild, repair or replacement of a lift station pump. Some cities expense all costs associated with pumps. Some cities capitalize all expenses associated with pumps. Another city it depends on the size of the pump. Another city expenses the rebuild of a pump while capitalizing the replacement of a pump.

Care must be taken if the new pump is more efficient or effective than the previous pump. That would require capitalization. Ultimately, the accounting used must come from a thorough understanding of whether value is being retained or additional value is being added.

Beyond the standard definition provided above an asset is an economic resource of the organization that provides future benefit. An expense is generally consumed within the year. The pump provides future benefits that exceed one year.

The City Auditor is respectful of Finance's judgment regarding pumps.

Follow-up

New card limits reduce the possibility of a capitalized expenditure from happening.

Additionally, Purchasing and Accounting have combined efforts in monitoring for P-Card capital expenditures.

Implementation

Fully Implemented

Opportunity for Improvement #7 – Department P-Cards/Emergency Cards

Condition (The way it is)

The P-card program in the city has numerous Department P-cards where any individual from the department can use the card. Generally, these cards have high limits as opposed to individual cards. According to JPMC, the purpose of these cards is to eliminate the need for individual cards. That does not seem to be the case. The audit found many individual cards along with high limit department cards.

Additionally, according to JPMC, “The issue with a department card is that it prevents the cardholder the ability to dispute a transaction with a vendor for a chargeback. The merchant can deny the chargeback claim since they cannot validate the individual did the purchase since there is not a name on the card.”

The city has 10 emergency cards in a file cabinet in the purchasing department. These cards are used just-in-case. The issues that apply to the department cards also apply to the emergency cards.

Recommendation

The city should do away with departmental cards and emergency cards

Management Response

We agree

Action Plan

Purchasing will discontinue both department and emergency cards, collect all of them and dispose of them by shredding. As noted in Finding # 2: The notable exception is that of a city-wide emergency (hurricane for example) where city administration will identify individuals who will be authorized to purchase goods and supplies during the emergency. Those individuals will have their limits increased during the phase.

Implementation Date

Immediately

Follow-up

Inquiry with management and reviewing the limit list indicates no department or emergency cards in existence.

Implementation

Fully Implemented

Opportunity for Improvement #8 – Sole Source, Emergency Purchases and Required Quotes

Condition (The way it is)

The audit found numerous items (nine) in the sample that did not have the requisite documentation for sole sources and emergency purchases.

Approximately, 11 in the sample did not have quotes as required.

Recommendation

- 1) Update the P-card Policy with sole source, emergency purchases and purchases over \$3,000 information or require no sole source or emergency purchases can be made with a P-card.
- 2) Create a mechanism to monitor the performance of getting the required quotes. Repeat offenders should have their limits dropped or their card privileges taken away.

Management Response

We agree

Action Plan

Sole Source and Emergency purchases will no longer be acceptable with P-Card transactions. The notable exception is that of a city-wide emergency (hurricane for example) where city administration will identify individuals who will be authorized to purchase goods and supplies during the emergency. Those individuals will have their limits increased during the phase.

Policy requirements will be reinforced at the upcoming training and as policy dictates cards will be cancelled for violators.

Implementation Date

June 2, 2014

Follow-up

- 1) The new Purchasing Policy does discuss Sole Source, Emergency Purchases and over \$3,000 information.
- 2) Due to the lower limits now in existence quotes will be rarely seen with P-Cards.

Implementation

Fully Implemented

Opportunity for Improvement #9 – IT Purchases

Condition (The way it is)

The P-card Administrator indicated to the City Auditor that IT does not always go through Purchasing. The question came about when the P-card Administrator could not answer if certain IT vendors had contracts with the city.

Additionally, the P-card policies do not state if all IT purchases go through IT.

Recommendation

- 1) Management needs to ensure that IT goes through the Purchasing Dept.
- 2) All IT purchases are vetted by IT.

Management Response

Agreed

Action Plan

The Finance Director and Purchasing Manager have met with IT and have reinforced the policy and revised the practices. Purchase orders and standard purchasing channels will be utilized by IT, and all departments.

Implementation Date

Immediately

Follow-up

Evidence was provided to indicate that IT is going through Purchasing and IT purchases are vetted by IT

Implementation

Fully Implemented

Opportunity for Improvement #10 - \$50,000 Threshold

Condition (The way it is)

The city has several vendors that appear to be over the \$50,000 threshold.

Recommendation

Create a monitoring mechanism that checks monthly for the \$50,000 threshold and explain in the Policies.

Management Response

We agree

Action Plan

Purchasing has initiated a procedure to reduce the P-Card limits as addressed in Finding #4. Purchasing will rely on "best practices", State Law and Purchasing Policies with regard to adjusting P-Card limits

Implementation Date

June 30, 2014

Follow-up

IT has created a quarterly report that provides all forms of expense payments which will be used to monitor the \$50,000 threshold.

Implementation

Fully Implemented

Opportunity for Improvement #11 – P-card Rebates

Condition (The way it is)

The city is provided a rebate on P-card Purchases. Currently that rate is 1.60%. It is determined by the Consortium's purchases and the city's purchases. No monitoring was found to ensure it is accurate.

Additionally, in communication with Fort Worth it was found the Commercial Card Agreement is its Third Amendment. Only the initial contract was provided to the auditor.

As part of the Commercial Card Agreement there is a section called Single Use Account (SUA). This is a card-less Account used in connection with a single, unique transaction. Our accounting system would need to be integrated with JPMC. This would cost approximately \$2,000 however the payback if, for example, we put \$2,000,000 of Accounts Payable on this system per years would yield an additional rebate of \$24,800 per year. SUA's are fraud protected.

Recommendation

- 1) Verify the accuracy of the rebate.
- 2) Ensure the city has the latest amendment in its possession.
- 3) Consider a SUA free analysis to determine if that payment system would be advantageous to the city.

Management Response

Agree

Action Plan

Accounting will work with purchasing to review the rebate and assess the reasonableness of the funds received.

The SUA has been considered in the past and was not implemented at the time due to a lack of rebate available on SUA payments. We will revisit this option.

Implementation Date

June 30, 2014

Follow-up

- 1) Timing difficulties hamper the verification of the rebate. Purchasing is conferring with the card provider about this.
- 2) The city has the fourth and latest amendment in its possession.
- 3) A free SUA analysis has been requested.

Implementation

Partially Implemented

EXHIBIT A

Sampling Methodology

As stated in Opportunity for Improvement #1 (OFI#1), the requested data dump (1/1/13 – 2/28/15) was not received. Testing took place with only two months data. This scenario was mentioned in OFI#1. While the sufficiency and appropriateness of the evidence appears to be lacking, it does not significantly affect the Implementation Status provided by the City Auditor.