

**Performance Audit
City's Payment Process**

January 2013

City Auditor's Office

City of Kansas City, Missouri

CITY OF FOUNTAINS
HEART OF THE NATION



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MISSOURI

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January 30, 2013

Honorable Mayor and Members of the City Council:

This audit of how payments are processed in the city was initiated by the city auditor pursuant to Article II, Section 216 of the city charter. The audit focuses on payments processed through the city's accounts payable system.

A small number of vendors received a significant number of paper checks from the city. During our review period, the city issued almost 12,000 paper checks to only 25 vendors. The city could reduce costs and increase efficiency in making payments if the Finance Department focuses efforts on converting vendors that receive the most checks from the city to electronic payments.

The city has not taken advantage of all early payment discounts. Some departments did not take discounts even though they made the payment within the required time limit; some did not pay early enough to take advantage of the discounts; and some entered incorrect invoice dates, preventing PeopleSoft (the city's financial management system) from taking the discounts.

Scheduling payments can improve the city's cash flow planning and investment efforts. Scheduling payments for when they are due instead of paying them immediately when received will give the city treasurer a better gauge of how much cash the city needs in the bank to pay city vendors and what is available to pursue investment opportunities.

We found several weaknesses with general payment controls: the city's direct payment procedure does not reflect current practices; a segregation of duties issue exists in the accounts payable system; and the definition of timely payment in the Manual of Instruction does not reflect current expectations.

We also found that departments made at least 29 duplicate payments to vendors during our review period, totaling about \$100,000. Some duplicate payments were caused by data entry staff overriding a

PeopleSoft system control or data entry error. In addition, some staff entered multiple invoices on one voucher, negating PeopleSoft's ability to identify a duplicate payment.

Departments paid the wrong vendor at least 21 times during our review period, totaling about \$24,000 in incorrect payments. Incorrect payments could be due to inattentive data entry and payment approvals or fraudulent activity. We did not identify fraud in the course of the audit.

Staff had already identified some of the duplicate payments and payments made to the wrong vendors before they were identified by this audit and were able to provide evidence of refunds or credits.

We make recommendations intended to reduce costs and increase efficiency of accounts payable; ensure the city receives all eligible discounts; minimize inaccurate payments; and ensure the city has the best opportunity to plan cash outflows and take advantage of investment opportunities. We also make recommendations to reduce PeopleSoft's tolerance level for direct payments for commodities and equipment to reflect the city's written procedures, modify the procedures regarding approvals to reflect current practices, and include the procedures in the manual of instruction to improve availability.

We sent a draft of the report to the director of finance on December 18, 2012. The director's response is appended. We would like to thank the Finance Department and accounts payable staff in all city departments for their cooperation in providing documentation and answering questions. The audit team for this project was Sue Polys and Vivien Zhi.



Gary L. White
City Auditor

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Introduction

Objectives

We conducted this audit of the city's payment process under the authority of Article II, Section 216 of the Charter of Kansas City, Missouri, which establishes the Office of the City Auditor and outlines the city auditor's primary duties.

A performance audit provides assurance or conclusions based on an evaluation of sufficient, appropriate evidence against stated criteria. Performance audits provide objective analysis so that management and those charged with governance and oversight can use the information to improve program performance and operations, reduce costs, facilitate decision making, and contribute to public accountability.¹

This report is designed to answer the following question:

- Does the city's process of paying for goods and services protect city resources?

Scope and Methodology

Our review focuses on payments processed through the city's accounts payable system. Our audit methods included:

- Analyzing citywide accounts payable data from May 1, 2009 to August 31, 2011 to determine whether the city's accounts payable practices are in compliance with city policies and guidelines and best practices, and to evaluate possible areas of internal control risks.
- Selecting a judgmental sample of accounts payable transactions and reviewing supporting payment documentation for accuracy and completeness.
- Interviewing and observing city employees to obtain an understanding of how payments are processed.

¹ Comptroller General of the United States, *Government Auditing Standards* (Washington, DC: U.S. Government Printing Office, 2007), p. 17.

- Reviewing Finance Department accounts payable training materials and attending a Finance Department accounts payable training session to determine what information Finance communicates about accounts payable transactions.
- Researching best practices for managing the accounts payable process and fraud prevention and detection to identify relevant audit criteria.

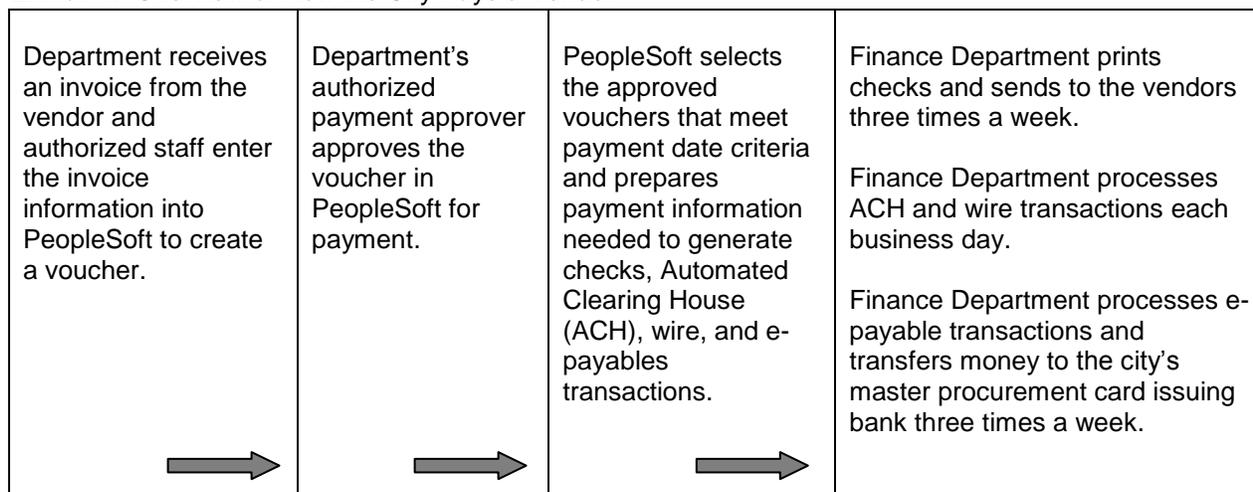
We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Information regarding a legal matter has been withheld from this report. No other information was omitted from this report because it was deemed privileged or confidential.

Background

Accounts Payable Process

Individual city departments and the Finance Department's Accounts Division share responsibility for paying for city purchased goods and services. Departments purchase goods and services and process payments using the accounts payable module in PeopleSoft. The Accounts Division monitors the PeopleSoft system, addresses department problems, issues checks, oversees electronic payments, and maintains vendor records. (See Exhibit 1.)

Exhibit 1. Overview of How the City Pays a Vendor



Source: Finance Department and City Auditor's Office staff observation.

The city paid almost \$3 billion for goods and services from May 2009 to August 2011 and processed almost 110,000 payments using checks, the Automated Clearinghouse (ACH), and wire transfers. The majority of the payments (about 87%) were made to supplier vendors. About 12 percent of the total dollar amount was paid to human capital management (HCM)² vendors. (See Exhibit 2.)

Exhibit 2. Payments by Vendor Classification, May 1, 2009 to August 31, 2011

Vendor Classification	Payments	Percent of Total	Total Dollar Amount	Percent of Total
Supplier	96,065	87.6%	\$ 2,519,150,134	86.6%
Employee	8,345	7.6%	3,840,574	0.1%
HCM ²	4,167	3.8%	336,895,199	11.6%
Attorney	690	0.6%	15,186,926	0.5%
Real Estate	342	0.3%	33,608,549	1.2%
Total	109,609		\$ 2,908,681,383	

Source: PeopleSoft Financials.

² HCM vendors include the city's labor unions, insurance company, flexible spending account administrator, etc.

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Findings and Recommendations

Summary

A small number of vendors received a significant number of paper checks. During our review period, the city issued almost 12,000 paper checks to only 25 vendors. The city could reduce costs and increase efficiency in making payments if the Finance Department focuses efforts on converting vendors that receive the most checks from the city to electronic payments.

The city has not taken advantage of all early payment discounts. Some departments did not take discounts even though they made the payment within the required time limit; some did not pay early enough to take advantage of the discounts; and some entered incorrect invoice dates, preventing PeopleSoft from taking the discounts.

Scheduling payments can improve the city's cash flow planning and investment efforts. Scheduling payments for when they are due instead of paying them immediately when received will give the city treasurer a better gauge of how much cash the city needs in the bank to pay city vendors and what is available to pursue investment opportunities.

There are several weaknesses with general payment controls: the city's direct payment procedure does not reflect current practices; a segregation of duties issue exists in the PeopleSoft accounts payable system; and the definition of timely payment in the Manual of Instruction does not reflect expectations.

Departments made at least 29 duplicate payments to vendors during our review period, totaling about \$100,000. Some duplicate payments were caused by data entry staff overriding a PeopleSoft system control or data entry error. In addition, some staff entered multiple invoices on one voucher, negating PeopleSoft's ability to identify a duplicate payment.

Departments paid the wrong vendor at least 21 times during our review period, totaling about \$24,000 in incorrect payments. Incorrect payments could be due to inattentive data entry and payment approvals or fraudulent activity. We did not identify any fraud in the course of the audit.

City Has Opportunities to Reduce Accounts Payable Costs and Enhance Controls

A small number of vendors received a significant number of paper checks. During our review period, the city issued almost 12,000 paper checks to only 25 vendors. The city could reduce costs and increase efficiency in making payments if the Finance Department focuses efforts on converting vendors that receive the most checks from the city to electronic payments.

The city has not taken advantage of all early payment discounts. Some departments did not take discounts even though they made the payment within the required time limit; some did not pay early enough to take advantage of the discounts; and some entered incorrect invoice dates preventing PeopleSoft from taking the discounts.

Scheduling payments can improve the city's cash flow planning and investment efforts. Scheduling payments for when they are due instead of paying them immediately when received will give the city treasurer a better gauge of how much cash the city needs in the bank to pay city vendors and what is available to pursue investment opportunities.

There are also several weaknesses with general payment controls: the city's direct payment procedure does not reflect current practices; a segregation of duties issue exists in the PeopleSoft accounts payable system; and the definition of timely payment in the Manual of Instruction does not reflect current expectations.

Finance Should Target Efforts to Convert Vendors to More Efficient Payment Methods

To reduce costs, improve services, and increase efficiency, the Finance Department should focus efforts on converting vendors that receive the most checks from the city to electronic payments. From May 2009 to August 2011, 94 percent of all payments were made by check. Although the city has increased its use of ACH, as of July 2012, there were only about 185 vendors signed up for ACH out of the city's over 8,000 active vendors.

Most payments are made by checks. From May 2009 to August 2011, the city issued over 100,000 checks, about 94 percent of all payments. ACH and wire payments accounted for only 6 percent of the number of payments. (See Exhibit 3.)

Exhibit 3. Payments by Method, May 1, 2009 to August 31, 2011

Payment Method	Number of Payments	% of Total # of Payments	Total Dollar Amount
Check	103,135	94%	\$1,090,072,343
ACH	4,375	4%	519,179,993
Wire	2,099	2%	1,299,429,047
Total	109,609	100%	\$2,908,681,383

Source: PeopleSoft accounts payable data.

Electronic payment methods offer several benefits compared to paper checks. The electronic methods of payment the city uses (ACH, e-payables, and wire transfers) can be less costly and more efficient than paper checks. Some electronic payment methods have lower direct costs than paper checks. Electronic methods of payment also require less handling by city staff, which reduces the city's indirect costs. Electronic payments are more efficient because of reduced transaction time, allowing vendors to receive payments faster. Electronic payments have the benefit, unlike paper checks, that they cannot be physically lost or stolen in transit. Using electronic payments does however, require information technology controls to ensure the privacy of identity information and prevent unauthorized use. (See Exhibit 4.)

The use of paper checks is decreasing while the use of electronic payments is increasing in both the private and public sector. The Government Finance Officers Association (GFOA) recommends that state and local governments investigate and adopt electronic payment methods suitable for their specific needs.³ GFOA notes that electronic movement of funds is both efficient and effective.

³ *Best Practice, Adopting Electronic Payment Systems (2010) (TIM)*, Government Finance Officers Association, February 22, 2008.

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Exhibit 4. Advantages and Disadvantages of Accounts Payable Payment Methods

Payment Method	Description	Advantages	Disadvantages
Paper Check	A written order to a bank to pay a specific sum from the payer's account.	<p>Traditional method of payment.</p> <p>Easy to understand.</p> <p>No front-end set up with bank needed.</p>	<p>Can get lost or stolen.</p> <p>Requires a lot of physical handling.</p> <p>Potential for fraud associated with check printing and mailing.</p> <p>Higher direct costs, such as the cost of paper, printing, and postage.</p>
ACH (Automated Clearing House)	A nationwide payment and collection system that provides for electronic distribution and settlement of funds.	<p>Eliminates costs associated with check printing, and postage.</p> <p>Eliminates potential for fraud associated with check printing and mailing.</p> <p>Eliminates delays caused by checks lost in the mail.</p> <p>Less expensive compared to checks.</p> <p>Verifies the availability of funds.</p> <p>The payer has recourse if the payment needs to be pulled back.</p> <p>Useful for high volume, low value transactions.</p>	<p>Requires some front-end setup.</p> <p>Supplier confusion because of unfamiliarity with the payment method, requiring staff time to respond to issues.</p> <p>Cash immediately leaves city account, so the ability to hold on to money until a check is cashed is lost, thus reducing the city's investing opportunities.</p>

Payment Method	Description	Advantages	Disadvantages
Wire	A direct bank to bank transaction that allows the payer to move money from the payer's bank account to the payee's.	<p>Eliminates costs associated with check printing, and postage.</p> <p>Eliminates potential for fraud associated with check printing and mailing.</p> <p>Eliminates delays caused by checks lost in the mail.</p> <p>Immediate settlement of funds.</p>	<p>Expensive. Financial institutions charge fees to send and receive wire.</p> <p>The payer cannot pull back the funds if there is a mistake.</p> <p>Staff have to perform some manual work to process the transactions.</p> <p>Cash immediately leaves city account, so the ability to hold on to money until a check is cashed is lost, thus reducing the city's investing opportunities.</p>
E-payable	The city issues vendor cards under a master card to each e-payable vendor. The card has a zero credit limit until payments have been approved by the city. Once approved for payment, the vendor card is funded with only the amount of the approved payment. After the vendor charges the approved amount, the credit limit on the vendor card returns to zero. The amount is charged to the city's master card.	<p>Optimized cash management and potential for interest income.</p> <p>Eliminates costs associated with check printing, including postage.</p> <p>Eliminates potential for fraud associated with check printing and mailing.</p> <p>Eliminates delays caused by checks lost in the mail.</p> <p>The city gets a rebate based on total volume charged to the master card.</p>	<p>Requires some front-end set up.</p> <p>Supplier confusion because of unfamiliarity with the payment method, requiring staff time to respond to issues.</p> <p>The standard merchant fees may apply to the vendors.</p> <p>Cash immediately leaves city account, so the ability to hold on to money until a check is cashed is lost, thus reducing the city's investing opportunities.</p>

Sources: Finance Department, Automated Clearing House, Federal Housing Finance Agency, Association for Financial Professionals, and Uniform Commercial Code.

The city is increasing the use of electronic payments. The city increased its use of ACH by about 56 percent from fiscal year 2010 to 2011, however, as of July 2012, there were only about 185 vendors signed up for ACH out of the city's more than 8,000 active vendors. The city includes an ACH sign-up sheet in new vendor packets to encourage new vendors to sign up and Finance Department management said that they had positive responses from the new vendors about signing up for ACH. The city also had a small campaign to convert vendors to e-payables, whereby the city's bank called vendors on the city's behalf. As of July 2012, about 25 vendors had signed up for e-payables. Although the city has been increasing the use of electronic payments, only 6 percent of the city's payments were made by ACH or wire⁴ during the period we examined.

A small number of vendors received a significant number of checks. From May 2009 to August 31, 2011, the average number of checks issued per vendor was about 9; however, for the 25 vendors with the most check payments during the same period, the average number of checks was 473. During the period, the most checks issued to one vendor was 1,641. In total, the city issued almost 12,000 checks to only 25 vendors.

The city has over 8,000 active vendors and switching vendors from paper checks requires staff time to obtain vendor approval as well as time to verify routing information with the bank. Because converting vendors to electronic payments methods requires Finance staff time, the city would receive the most benefit with the least commitment of resources from converting vendors that receive the most checks from the city to an electronic payment method.

In order for the city to reduce costs and increase efficiency of the accounts payable process, the director of finance should pursue converting vendors receiving a large number of checks from the city to electronic payment methods.

Not All Early Payment Discounts Taken

The city has not taken advantage of all early payment discounts offered by vendors. Some departments did not take discounts even though they made the payment within the early discount time period; some did not pay early enough to take the discounts; and some entered incorrect invoice dates, preventing PeopleSoft from taking the discounts. In

⁴ The city had not yet implemented the e-payable payment method during our review period.

addition, some staff do not understand how the city calculates discounts and how to qualify for them.

The city has not taken advantage of all early payment discounts.

Some departments did not take discounts even though they made the payment within the required time limit and some did not pay early enough to take the discounts. For example, the city's previous office supply vendors offered the city a 2 percent discount if the city made its payment within 10 days of the invoice date. From May 2009 to August 31, 2011, the city made about \$280,000 in payments to the office supply vendors within 10 days of the invoice date. The city could have taken about \$5,600 in discounts for meeting the early payment deadline. Instead, the city only took about \$1,100 in discounts.

One of the reasons for losing discounts is that the departments changed the default pay term for the office supply vendors when making a payment. The Finance Department set the PeopleSoft default pay term for one of the office supply vendors for 2 percent discount if paid in 10 days. However, when department staff entered the voucher for some of the office supply payments, they changed the pay term. In most cases, departments changed the pay term to "due now." If the pay term is not set for the discount term, PeopleSoft does not calculate a discount, even if the city makes the payment by the discount deadline.

The city lost some discounts because departments did not make payments within the 10 days of the invoice date. The city paid about \$840,000 in payments to the office supply vendors more than 10 days after the invoice date. If the city had made all of these payments in time to take advantage of the discount term, the city would have received about \$17,000 more in discounts.

Staff sometimes manually calculates discounts. Rather than letting PeopleSoft calculate the discount amount, some staff said they entered the invoice amount net of the discount amount when they created the payment vouchers. The city controller said it was important for departments to enter the invoice amount as written, rather than calculating discounts and entering the discounted amount on the voucher. The city needs an accurate record of the invoice amount as well as an ability to track discounts to perform analysis and identify problems.

Inaccurate invoice dates affect PeopleSoft's ability to calculate discounts. Departmental staff sometimes entered the wrong invoice date when creating a payment voucher prohibiting PeopleSoft from calculating the early payment discounts. PeopleSoft calculates early payment discounts based on invoice date and pay term. When staff

creates a voucher to pay an invoice, staff enters the date of the invoice and can choose a pay term or leave the default. If the pay term is set for an early payment discount, PeopleSoft calculates the number of days from the invoice date and if within the days required for the early discount pay term, the system generates the discounted payment.

In some instances, departmental staff recorded the wrong invoice date in PeopleSoft, which resulted in the number of days since the invoice date being longer than the early discount pay term. PeopleSoft assumed that the payment was ineligible for a discount and therefore did not apply the discounts to the payment. In one example, the invoice date was 1/28/2010, but staff inaccurately entered the date as 1/28/2001. Even though the city made the payment on 2/7/2010 and was therefore, eligible for the discount, the PeopleSoft system considered the payment too late to qualify for a discount.

Understanding the discount calculations and how to qualify for them could increase discounts received. Some departmental staff that perform accounts payable data entry and approval said they are not familiar with how discounts work. The city's payment data shows examples of departments losing discounts because the payments were not paid in time or because the pay terms or invoice dates were incorrect. To ensure the city receives all discounts for which it is eligible and has an accurate record of invoice and discount amounts, the director of finance should provide staff entering and approving payments with information explaining how and why:

- payments that are eligible for early payment discounts should be paid in time to receive the discount;
- staff should allow PeopleSoft to calculate discounts, when possible; and
- entering and approving the correct pay term and invoice date is critical to ensure the discount is taken.

Scheduling Payments Could Improve City's Cash Flow

Scheduling payments could improve the city's cash flow planning and investment efforts. Some departmental staff pay bills as soon as a payment voucher is created instead of waiting until the due date. Scheduling payments for when they are due and creating vouchers as soon as possible after receiving invoices will give the city treasurer a better gauge of how much cash the city needs in the bank to pay city vendors and what is available to pursue investment opportunities.

Scheduling payments could assist the city's cash flow planning and investment efforts. In order to pay its bills, the city needs to have enough available cash. According to the city treasurer, scheduling payments for when they are due instead of paying them immediately when received gives her a better gauge of how much cash the city needs in the bank to pay city vendors. In addition, the longer the city holds on to its cash, the more investment options the city has. Between May 2009 and August 2011, 94 percent of the city's vouchers had a pay term of "pay now." Some staff said they change the pay term from the city default of "net 30" to "due now," so that a payment will go out immediately. Paying now rather than when the invoice is due makes it difficult to plan and limits the city's investment options.

Vouchers should be created as soon as possible after an invoice is received so that the city treasurer can know about the obligation and better plan and expand city's investment options. Between May 2009 and August 2011, the average number of days between the invoice date and the date the voucher was created was 19 days, with a median of 9 days citywide. The more the city can decrease the days from invoice date to voucher creation date, the more cash flow planning the city can achieve. Some department staff said they do not receive the invoice promptly from the vendor after the invoice date, which can increase the number of days from invoice date to voucher creation. Larger departments with field divisions have the added challenge of getting staff, who are located at other locations, to approve the invoice before a voucher can be created. This adds days to their process of creating a voucher.

PeopleSoft has the capability to schedule payments. In order to schedule payments, staff can use the "schedule payment date" field, which allows setting a specific date for the payment to go out. PeopleSoft will also calculate the payment date based on invoice date and pay term. If there is no early payment discount available from the vendor or the vendor has not stated a specific due date, PeopleSoft's default pay term is 30 days from the invoice date or "net 30." For example, if an invoice date is 10/1/2012, the pay term is "net 30" and the invoice is entered on 10/25/2012, a payment will be issued on 10/31/2012, as long as the invoice date is entered correctly.

To ensure the city has the best opportunity to plan cash outflows and take advantage of investment opportunities, the finance director should instruct departments to create vouchers as soon as possible and schedule payments for their due dates, rather than automatically paying vendors immediately after creating the voucher.

General Payment Controls Need to Be Enhanced

We found several weaknesses in general payment controls. The city's direct payment written procedure and practices are not consistent; a segregation of duties problem exists in the accounts payable system; and the definition of timely payments in the Manual of Instruction needs to be updated to reflect expectations.

The city's direct payment written procedure and practices need to be updated. Direct payments allow departments to make small or one-time payments without having to encumber funds.⁵ Half of the city's payments are direct payments. According to the city's direct payment procedure⁶, direct payments are allowed for certain expenditures including utility payments, dues and membership, refunds to customers, and subscriptions, etc. In certain situations, direct payments may also be used to pay for contracts and commodities and equipment.

The direct payment written procedure does not reflect the dollar thresholds the city currently allows for direct payments or the approval process. Although the written procedure allows direct payments for commodities and equipment for amounts 10 percent or \$1,000 over encumbrances, whichever is less. PeopleSoft's tolerance level for direct payments over encumbrances is currently set at 10 percent or \$5,000, whichever is less. The direct payment written procedure states these direct payments for commodities and equipment also require approval from the manager of procurement services although the city's current practice does not require the manager's approval.

To ensure that the city's direct payment procedure and practices are consistent and safeguard city assets, the director of finance should:

- change PeopleSoft's tolerance level of direct payments for commodities and equipment from amounts 10 percent or \$5,000 over encumbrances to amounts 10 percent or \$1,000 over encumbrances; and
- revise the direct payment written procedure to remove the requirement for the manager of procurement's approval of commodities and equipment for amounts 10 percent or \$1,000 over encumbrances.

The direct payment procedure should be included in the Finance Department's Manual of Instruction. The direct payment procedure is

⁵ Encumbering funds involves formally committing to pay a future expenditure to prevent departments from using money for something else before the purchase is complete.

⁶ Contract Guidebook, Direct Payment Procedure, Kansas City, Missouri, May 24, 2005.

in the city's contract guidebook; however, departments use direct payments for both non-contract and contract payments. The purpose of the Finance Department's Manual of Instruction is to provide information and instruction to departments concerning operations that are the responsibility of the Department of Finance.⁷ If the direct payment procedure were included with the Manual of Instruction, it would provide guidance to a broader audience than to just those working with contracts.

To ensure the direct payment procedure is easily accessible to all appropriate city staff, the director of finance should include the procedure in the Finance Department's Manual of Instruction.

The accounts payable system contains a segregation of duties issue.

One department's final approver for accounts payable routinely delegates approval authority within PeopleSoft to employees that have the authority to also enter vouchers in the system. Because the PeopleSoft system allows the delegated approvers to keep their data entry roles at the same time, some staff that can enter a voucher can also approve it. A basic and important internal control for accounts payable is that the same person should not have the ability to both process and approve a transaction and therefore be in a position to perpetrate a fraud without detection.

Manual of Instruction 2-25 states that users with the final approval roles cannot enter a payment voucher. The Finance Department staff said PeopleSoft should prevent the delegation of approval authority to someone that already has a voucher entry role; however, there is a glitch in the system. To monitor whether the data entry and final approval roles overlap, the Finance Department started running a daily report to capture any payment vouchers that have been approved and entered by the same person.

In order to ensure that someone cannot enter and approve a voucher, the director of finance should pursue a permanent fix to PeopleSoft that would prevent the dual roles. Until a permanent fix is in place, the director of finance should notify departments when any staff enters and approves the same voucher so that the departments can ensure the payment is appropriate.

⁷Manual of Instruction 1-01," Manual of Instruction System," July 23, 2008.

The city should update the timely payment definition in the Manual of Instruction (MI). The city's controller said he considers timely vendor payments to be made within 30 days of the invoice date, or sooner if there is a discount for early payment. However, MI 2-21⁸ does not state that departments are expected to pay vendors within 30 days of the invoice date. The MI states that timely payment goals beyond meeting a discount deadline or a contract obligation includes payment 30 days from the date the goods are delivered, 30 days from the date the invoice is delivered, or 30 days from the date of the acceptance of goods by a city designee, etc. The city does not use PeopleSoft to track any of those dates. Based on the dates recorded in PeopleSoft, it is not possible to calculate whether departments are meeting those criteria.

To ensure that departments are aware of the Finance Department's expectation that vendor payments be made within 30 days of the invoice date, the director of finance should revise MI 2-21 to include 30 days from invoice date as an additional definition of timely payment.

Override of Controls and Errors Resulted in Overpayments

We found that departments made at least 29 duplicate payments to vendors during our review period, totaling about \$100,000. Some duplicate payments were caused by data entry staff overriding a PeopleSoft system control, which does not allow the use of the same invoice number and vendor when creating a voucher. In addition, some staff entered multiple invoices on one voucher, negating PeopleSoft's ability to identify a duplicate payment.

Departments paid the wrong vendor at least 21 times during our review period, totaling about \$24,000 in incorrect payments. Incorrect payments could be due to inattentive data entry and payment approvals or fraudulent activity. In the payments made in error that we identified, sometimes the vendors had similar names and other times the vendor names were very different.

Departmental staff had already identified some of the duplicate payments and payments made to the wrong vendors before they were identified by this audit and were able to provide evidence of refunds or credits for the overpayments.

⁸ Manual of Instruction 2-21, "Accounts Payable Payment Documents Review," January 1, 2002.

Some Vendors Were Paid Twice for the Same Invoice

Departments made at least 29 duplicate payments to vendors during our review period, totaling about \$100,000. Some duplicate payments were caused by data entry staff overriding a PeopleSoft system control, which does not allow the use of the same invoice number and vendor when creating a voucher. In addition, some staff entered multiple invoices on one voucher, negating PeopleSoft's ability to identify a duplicate payment.

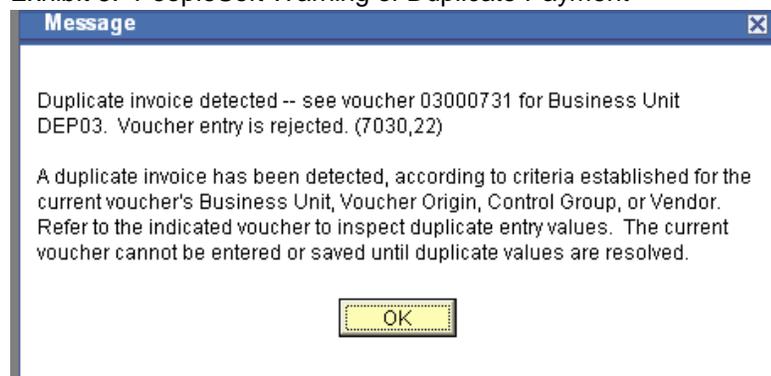
Departments made at least 29 duplicate payments to vendors.

Between May 1, 2009 and August 31, 2011, duplicate payments totaled about \$100,000. The duplicate payments ranged from about \$14 to \$50,000 and were usually paid less than a month after the first payment was made. Most of the duplicate payments were made by the department that also paid the invoice the first time, but there were also some instances when two different departments received and paid the same invoice.

PeopleSoft warns the data entry person of duplicate payments.

PeopleSoft has a built-in control to prevent duplicate payments that does not allow the use of the same invoice number and vendor when creating a voucher. If both the vendor and invoice number are used to create a voucher more than once, a warning box is displayed on the screen telling the data entry person that a duplicate entry has been detected and that the voucher entry is rejected. (See Exhibit 5.)

Exhibit 5. PeopleSoft Warning of Duplicate Payment



Source: PeopleSoft Financials.

Some duplicate payments were caused by data entry error or data entry staff overriding a PeopleSoft control. In some cases, changes to invoice numbers appear to be simple errors of dropped characters. In other cases, data entry personnel made small changes to the invoice numbers, such as adding an extra character, in order for PeopleSoft to

accept the voucher and not flag it as a duplicate. This system override allowed second payments for the same invoice to vendors. (See Exhibit 6.) The person in the department that purchases the product or service usually approves the invoice before submitting it for payment. Because the invoices have been approved, data entry staff might assume the invoices are legitimate, even after receiving the duplicate payment warning from PeopleSoft. However, data entry staff need to understand the purpose of the warning box and know that even if the invoice was approved, it may not be correct.

Exhibit 6. Examples of Invoice Number Errors and Alterations

	Vendor	Invoice Number	Invoice Date	Payment Date	Amount
Correct Payment	Vendor A	102728472	4/6/2009	5/27/2009	\$728.91
Duplicate Payment	Vendor A	1027284721	4/6/2009	6/29/2009	\$728.91
Correct Payment	Vendor B	13946	11/29/2010	1/24/2011	\$309.75
Duplicate Payment	Vendor B	13946*	11/29/2010	2/14/2011	\$309.75

Source: PeopleSoft Financials.

"1" was left off and "*" added to invoice numbers.

Small alteration of the invoice number whether accidental or intentional can result in a duplicate payment. Staff entering vouchers need to understand the importance of entering accurate invoice numbers. In addition, staff approving vouchers need to understand the importance of verifying the accuracy of the invoice number before approving because staff approving vouchers are the final control to prevent duplicate payments.

To ensure that PeopleSoft's control to identify duplicate payments works as intended, the director of finance should communicate the purpose and importance of the duplicate payment warning box to staff entering accounts payable vouchers and the importance of verifying the accuracy of the invoice number to the staff approving payments.

Entering multiple invoices on one voucher negates PeopleSoft's duplicate payment warning. Some departments enter multiple invoices on one voucher. Entering more than one invoice on a voucher eliminates PeopleSoft's ability to detect duplicate payments, based on invoice number. When combining invoices on one voucher, the multiple invoice numbers are entered into the one invoice number field. PeopleSoft reads that field as one number. If a voucher is created to pay the same invoice,

PeopleSoft will not recognize that invoice number as a duplicate, because it was combined with other invoice numbers.

In the city's PeopleSoft Financials training, the departmental staff creating vouchers are told only one invoice should be entered on one voucher, however, training staff do not explain that having a single invoice on a voucher would help identify duplicate payments. To ensure PeopleSoft's control to identify duplicate payments works as intended, the director of finance should communicate the purpose and importance of entering one invoice per voucher to staff entering accounts payable vouchers.

Some Payments Made to the Wrong Vendor

Departments paid the wrong vendors at least 21 times between May 1, 2009 and August 31, 2011. Departments paid two different vendors from the same invoices for a total of about \$24,000 in incorrect payments. We identified these errors by reviewing payments made with the same invoice number and for the same amount. The hard copy records of the payments made in error had invoices from other vendors attached. Usually, the incorrect vendor was paid first. It is likely that the correct vendor contacted the city when they did not receive payment and the city issued a new payment to the correct vendor. The department may still not have noticed that the wrong vendor was paid previously with the invoice. Incorrect payments could be due to inattentive data entry and payment approvals or fraudulent activity. In the payments made in error that we identified, sometimes the vendors had similar names and other times the vendor names were very different.

In interviews with departmental staff that approve payments, one approver said he does not compare the original hard copy invoice to the electronic voucher before approving. If he was not the original approver of the purchase, he may not know for sure whether the voucher was entered for the correct vendor. In order to ensure accuracy of payments, the director of finance should communicate the importance of comparing hard copy invoices to the electronic vouchers to staff assigned to approve accounts payable vouchers and specify which fields should be compared.

Staff Pursued Refunds for Some Incorrect Payments They Had Already Identified

Departmental staff had already identified some of the duplicate payments and payments made to the wrong vendors before they were identified by this audit, and were able to provide evidence of refunds or credits for the overpayments. For the payments that departments were unaware of or

had not recovered, we informed the departmental staff and sent a memo to the affected department directors, recommending that they pursue repayment and reassess their accounts payable processes to determine whether changes need to be made to avoid these duplicated payments in the future. By September 18, 2012, about \$77,000 of the \$100,000 in duplicate payments had been recovered and over \$16,000 of the \$24,000 of payments made in error had been recovered.

Recommendations

1. The director of finance should pursue converting vendors receiving a large number of checks from the city to electronic payment methods.
2. The director of finance should provide all staff entering and approving payments with information explaining how and why:
 - payments that are eligible for early payment discounts should be paid in time to receive the discount;
 - staff should allow PeopleSoft to calculate discounts whenever possible; and
 - entering and approving the correct pay term and invoice date is critical to ensuring the discount is taken.
3. The director of finance should instruct departments to create vouchers as soon as possible and schedule payments for their due dates.
4. The director of finance should:
 - change PeopleSoft's tolerance level of direct payments for commodities and equipment from amounts 10 percent or \$5,000 over encumbrances to amounts 10 percent or \$1,000 over encumbrances; and
 - revise the direct payment written procedure to remove the requirement for the manager of procurement's approval of commodities and equipment for amounts 10 percent or \$1,000 over encumbrances.
5. The director of finance should include the direct payment procedure in the Finance Department's Manual of Instruction.

6. The director of finance should pursue a permanent fix to PeopleSoft that would prevent someone who has been delegated approval authority from approving a voucher that he/she has entered. Until a permanent fix is in place, the director of finance should notify departments when any staff have entered and approved the same voucher.
7. The director of finance should revise Manual of Instruction 2-21 to include 30 days from invoice date as an additional definition of timely payment.
8. The director of finance should communicate the purpose and importance of the duplicate payment warning box to staff entering accounts payable vouchers and the importance of verifying the accuracy of the invoice number to the staff approving payments.
9. The director of finance should communicate the purpose and importance of entering one invoice per voucher to staff entering accounts payable vouchers.
10. The director of finance should communicate the importance of comparing hard copy invoices to the electronic vouchers to staff assigned to approve payments and specify which fields should be compared.

City's Payment Process

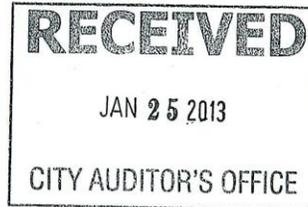
Appendix A

Director of Finance's Response

City's Payment Process



Finance Department Director's Office



DATE: January 24, 2013
TO: Gary L. White, City Auditor
FROM: Randall J. Landes, Director of Finance 
RE: Response to Auditor's Recommendation on Performance Audit City's Payment Process

The Finance department appreciates the quality and detail of the work performed by your office in preparing this report and in crafting its recommendations. We are in agreement with the recommendations addressed to the Finance department:

Recommendation #1

The director of finance should pursue converting vendors receiving a large number of checks from the city to electronic payment methods.

Agree. As noted in the audit, the city is encouraging all new vendors to sign up for electronic payments. Finance will also continue to pursue converting older vendors to electronic payments.

Recommendation #2

The director of finance should provide all staff entering and approving payments with information explaining how and why:

- payments that are eligible for early payment discounts should be paid in time to receive the discount;
- staff should allow PeopleSoft to calculate discounts whenever possible; and
- entering and approving the correct pay term and invoice date is critical to ensuring the discount is taken.

Agree. These issues will be added to the accounts payable training curriculum. This information will also be added to Manual of Instruction (MI) 2-21, Accounts Payable Payment Documents Review.

Recommendation #3

The director of finance should instruct departments to create vouchers as soon as possible and schedule payments for their due dates.

Agree. Finance will instruct departments to create vouchers as soon as possible and to schedule payments for their due dates. This will also be added to Manual of Instruction (MI) 2-21, Accounts Payable Payment Documents Review.

Recommendation #4

The director of finance should:

- change PeopleSoft's tolerance level of direct payments for commodities and equipment from amounts 10 percent or \$5,000 over encumbrances to amounts 10 percent or \$1,000 over encumbrances; and
- revise the direct payment written procedure to remove the requirement for the manager of procurement's approval of commodities and equipment for amounts 10 percent or \$1,000 over encumbrances.

Agree. Finance will insure that the written direct payment procedure and the current dollar thresholds in PeopleSoft are in agreement with each other. Finance will also revise the written procedure to remove the requirement for the manager of procurement to approve overruns that are within the tolerance levels.

Recommendation #5

The director of finance should include the direct payment procedure in the Finance Department's Manual of Instruction.

Agree. Finance will incorporate the direct payment procedure in Manual of Instruction (MI) 2-21, Accounts Payable Payment Documents Review.

Recommendation #6

The director of finance should pursue a permanent fix to PeopleSoft that would prevent someone who has been delegated approval authority from approving a voucher that he/she has entered. Until a permanent fix is in place, the director of finance should notify departments when any staff have entered and approved the same voucher.

Agree. Finance will recommend a permanent fix to PeopleSoft. In the meantime, Finance is monitoring the delegate approval process to maintain sufficient internal controls throughout the payment process.

Recommendation #7

The director of finance should revise Manual of Instruction 2-21 to include 30 days from invoice date as an additional definition of timely payment.

Agree.

Recommendation #8

The director of finance should communicate the purpose and importance of the duplicate payment warning box to staff entering accounts payable vouchers and the importance of verifying the accuracy of the invoice number to the staff approving payments.

Agree. This issue will be emphasized in the curriculum for accounts payable training. This information will also be added to Manual of Instruction (MI) 2-21, Accounts Payable Payment Documents Review.

Recommendation #9

The director of finance should communicate the purpose and importance of entering one invoice per voucher to staff entering accounts payable vouchers.

Agree. This issue will be emphasized in the curriculum for accounts payable training. This information will also be added to Manual of Instruction (MI) 2-21, Accounts Payable Payment Documents Review.

Recommendation #10

The director of finance should communicate the importance of comparing hard copy invoices to the electronic vouchers to staff assigned to approve payments and specify which fields should be compared.

Agree. This issue will be added to the curriculum for accounts payable training. This information will also be added to Manual of Instruction (MI) 2-21, Accounts Payable Payment Documents Review.

cc: Troy Schulte, City Manager
Eric Clevenger, City Controller
Rusty Williams, Operations Manager