

City of
Gainesville

Inter-Office Communication

November 25, 2003

TO: Audit and Finance Committee
 Mayor Tom Bussing, Chair
 Mayor-Commissioner Pro Tem Chuck Chestnut, Member

FROM: Alan D. Ash, City Auditor

SUBJECT: Review of Internal Controls Over General Government's Procurement Card Program

RECOMMENDATION

The Audit and Finance Committee recommend that the City Commission:

- 1) Accept the City Auditor's report and the City Manager's response; and
- 2) Instruct the City Auditor to follow-up on recommendations made and report the results to the Audit and Finance Committee.

EXPLANATION

In accordance with our Fiscal Year 2003 Annual Audit Plan, we have completed our review of internal controls over the General Government Procurement Card Program. Our review was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States. Our report and the City Manager's response are attached for your review.

We request the Committee recommend that the City Commission accept our report and the City Manager's response. Also, in accordance with City Commission Resolution 970187, Section 10, Responsibilities for Follow-up on Audits, we request that the Committee recommend the City Commission instruct the City Auditor to follow-up on recommendations made and report the results to the Audit and Finance Committee.

City of
Gainesville

Inter-Office Communication

October 1, 2003

TO: Wayne Bowers, City Manager

FROM: Alan D. Ash, City Auditor

SUBJECT: Review of Internal Controls Over General Government's Procurement Card Program

In accordance with our FY 2003 Annual Audit Plan, we performed a review of internal controls over the General Government Procurement Card Program.

We conducted our review in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States. The primary objective of our review was to determine that controls over procurement card (ProCard) purchases are adequate and that purchases comply with City policies and procedures. Our procedures generally consisted of interviewing key personnel, reviewing financial and other information and testing management controls.

We have completed our review and prepared the attached report with recommendations for improvement in management controls. We concluded that the system of internal controls is generally adequate except for several areas that need improvement to ensure proper monitoring of purchase card expenditures. Department managers play a critical oversight role and need to be more diligent in monitoring compliance. Several suggestions for improving administrative procedures and controls were reviewed with Purchasing Manager Aleta Cozart and Finance Director Mark Benton. In accordance with Commission Resolution R970187, Section 9, please submit your written response to the recommendations presented in the report within 30 days and indicate an actual or expected date of implementation. Our report and your response will then be submitted to the City Commission's Audit and Finance Committee for review and approval.

We would like to thank all Purchasing staff for their cooperation during our review. They are to be commended for efforts in implementing and overseeing this program. Please let me know if you have any comments or questions.

cc: Glenda Currie, Administrative Services Director
Mark Benton, Finance Director
Aleta Cozart, Purchasing Manager
Ralph Wisco, Senior Buyer

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OBJECTIVES, SCOPE AND METHODOLOGY

The FY 2003 Annual Audit Plan included a review of the City of Gainesville's Procurement Card (ProCard) program for General Government. The objective of our review was to evaluate the adequacy of management controls currently in effect over the program and determine whether procurement card purchases are proper and in compliance with City policies and procedures. Management is responsible for establishing and maintaining effective controls that, in the broadest sense, include the plan of organization, methods and procedures to ensure that goals are met. Management controls contain the processes for planning, organizing, directing and controlling program operations, including systems for measuring, reporting and monitoring program performance. The scope of our review was generally for the period January 2002 through September 2003.

Our review was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and accordingly included such tests of records and such other auditing procedures as we considered necessary under the circumstances. Our procedures included interviewing staff, reviewing and analyzing internal controls, selecting samples of ProCard transactions and related supporting documentation and assessing compliance with City policies and procedures. Our test of transactions included both statistical sampling and non-representative testing to evaluate the effectiveness of internal controls. Statistical sampling uses selections representative of a population to project with quantifiable accuracy to the entire population. Non-representative selections are not representative of or projectable to a population and usually include data extraction techniques that identify transactions or patterns of activity exhibiting predetermined characteristics or sequences (e.g., transactions greater than \$1,000). Our sample tests were selected and designed to determine whether:

- ProCard purchases were made properly, approved and documented;
- Cardholder spending and transaction limits were appropriate for the cardholder's position;
- Purchases were made from vendors with restricted Merchant Category Codes as defined by the City;
- ProCards were being shared among employees; and
- Multiple transactions occurred on the same day with the same vendor.

SUMMARY AND BACKGROUND

The Procurement Card

The ProCard program is a credit card based method for the purchase and payment of goods and services for the City. Individual credit cards are issued to City employees with the cards embossed with names of both the City of Gainesville and the employee. Only that employee may use the card for official purchases in accordance with City policies and procedures. The ProCard differs from a conventional credit card in that it incorporates unique management controls and reporting features that help ensure that the card is used only for specific purposes and within specific spending limits. The program does not change the department's purchase authorization, payment or competition requirements, and each department remains responsible for monitoring and ensuring compliance with City purchasing policies and procedures. The ProCard system allows user defined,

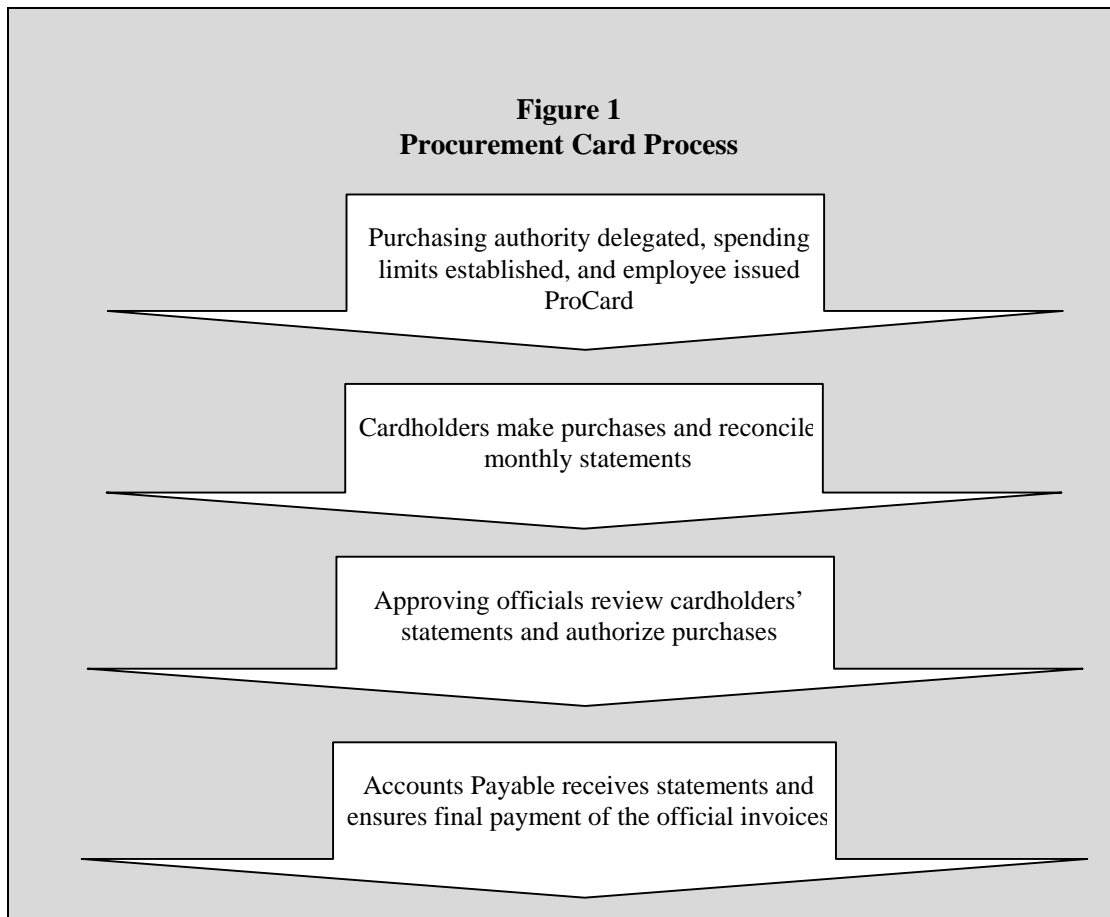
individualized limits to be imposed on the use of the card, and the system will not pre-authorize transactions outside of these limits. Specific limits established are as follows:

- Maximum dollar limits for a single purchase
- Maximum credit limit per monthly statement cycle
- Restrictions for type of purchases (e.g., cash advances) or merchants (e.g., bars)

The program is administered and monitored by the General Government Finance Department's Purchasing Division. Purchasing provides service and advice to operating departments, facilitates the purchasing process and monitors the progress of the program. The initial goals of the ProCard program were to streamline the traditional purchasing process for small dollar, non-inventory and non-capital purchases with the intent to:

- Reduce process costs
- Increase process efficiency
- Increase convenience for employees
- Reduce time and effort for obtaining goods/services
- Reduce number of paperwork errors in the purchasing process
- Reduce delays in physically acquiring small purchase items
- Reduce paperwork requirements (purchases orders, invoices and checks)

Figure 1 depicts the overall procurement card process.



ProCard Spending

As shown in the chart below, General Government ProCard purchases increased significantly in the last five years with annual spending now approaching \$2.3 million.

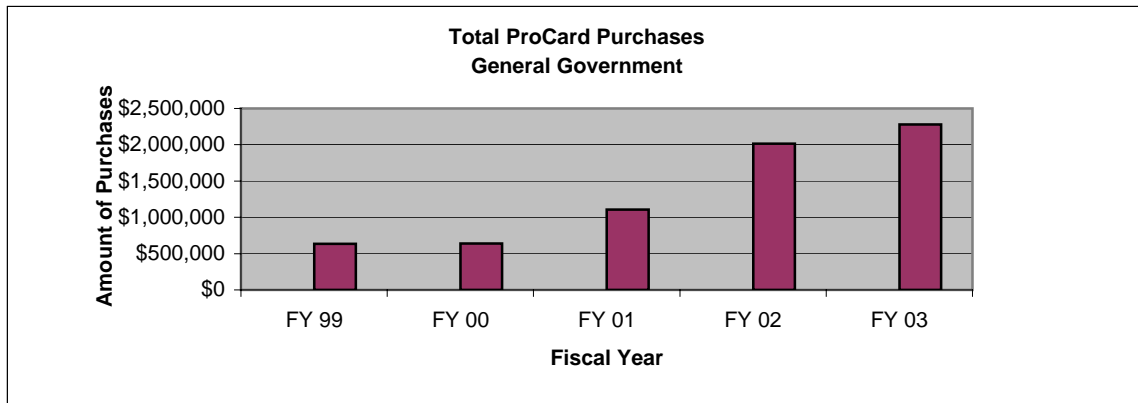


TABLE 1 shows the distribution of FY 2003 purchases by department, including number of cards and average transaction size.

TABLE 1
FY 2003 ProCard Purchases by Department

Department	Purchase Amount	Number Of Cardholders	Average Transaction Size
Public Works	\$424,566	45	\$197
GPD	332,248	24	204
Recreation & Parks	293,453	43	112
Fleet Management	220,766	7	188
Human Resources	157,860	18	90
Facilities Management	144,556	15	113
Fire Rescue	130,351	23	141
Cultural Affairs	123,217	14	195
Community Development	75,997	20	105
Finance	52,327	9	176
Computer Services	42,670	2	206
RTS	40,426	6	58
Clerk of Commission	37,742	3	210
Risk Management	33,404	4	318
City Attorney	31,676	9	140
Bldg. Inspection	19,894	1	172
Equal Opportunity	14,730	1	199
OMB	13,388	2	139
City Manager	10,995	2	164
Administrative Services	7,796	2	124
Small Business Develop.	6,110	1	165
Economic Development	5,939	1	97
City Auditor	5,588	1	112
	\$2,225,699	253	\$158

New ProCard Goals

Finance has been successful in increasing annual ProCard spending and achieving the initial program goals of increasing efficiency and convenience and reducing processing costs, time and paperwork. However, advances in technology have progressed rapidly and created more opportunities for goals related to procurement card spending. Goals can now be established to obtain better data about spending, increase control over spending and leverage spending to reduce prices. Opportunities are available to streamline the process even further through on-line applications for reconciling, summarizing, recording and paying for purchase card transactions. Research has shown that purchasing cards have moved from a “best practice” to a “common practice” for both public and private sector organizations.

The Finance Department is embarking on an expansion program and exploring further cost saving opportunities. Technological advances will be implemented in the upcoming year that will expand the use of purchasing cards by increasing the percentage of commodities and services captured on the cards and seeking new categories of commodities and services. Performance benchmarks will be needed to effectively manage and monitor program activity and ensure continued success.

Results, Conclusions and Recommendations

Although our testing indicated that some improvements could still be made in the ProCard Program, we believe that in general the Purchasing Division has established an effective system of internal control. For example, management has established:

- A positive control environment that supports a positive attitude toward internal control.
- Adequate control activities in the form of policies and procedures that enforce management’s directives and help ensure that actions are taken to address risks. Specific control activities such as approvals, authorizations, verifications, reconciliations and reviews.
- Adequate avenues of information and communications that ensure managers and cardholders receive timely information.
- Ongoing monitoring activities for reviewing and analyzing reports and assessing compliance with policies and procedures. Management uses software that can identify instances of potential misuse or lack of adherence to policies and procedures.

In order to build upon this existing foundation, we have made several suggestions to improve administrative controls that are described in the attached report. We believe that management is committed to doing everything necessary to minimize risk. Our recommendations for improved supervisory review, benchmarking and technological advances should assist management in these efforts.

In addition, the City Auditor’s Office will include hours for auditing ProCard transactions on a periodic basis in our Annual Audit Plan for Fiscal Year 2003-04.

Issue #1

Internal Controls For Supervisory Review Need Strengthening To Ensure Purchase Limits Are Not Exceeded And Supporting Documentation Is Adequate

Discussion

The City's Purchasing Division has a dual function of service and control in the procurement card (ProCard) program. The Division provides service and advice to operating departments, facilitates the purchasing process and monitors the progress of the procurement program. However, department heads maintain responsibility for ensuring that policies and procedures are understood and complied with by staff as well as monitoring purchases to prevent and detect non-compliance. Since the initial pilot program in 1996, the Purchasing Division has continually developed procedures and implemented various initiatives to strengthen the procurement process. The issues noted below will help ensure that departments are more aware of management directives related to the ProCard process.

The results of our testing of ProCard purchases indicate several areas where departments need to improve supervisory review to ensure compliance with procurement policies and procedures. We found that cardholders circumvented card purchase limits by splitting transactions into two or more segments to stay within their single purchase limit, avoid competitive bidding requirements or purchase capital items. We also found that cardholders did not always provide adequate receipts to support purchases. We found no evidence in these instances that approving officials performed required reviews to adequately detect these departures from policy and procedure.

Split Transactions

Purchasing procedures specifically prohibit the splitting of transactions and require bid quotes if a purchase exceeds \$2,000. The purpose of single purchase limits is to require that purchases above established limits be subject to additional controls to ensure they are properly reviewed and approved before the City obligates funds. In our sample, we found numerous instances of split transactions totaling nearly \$38,000. For example, one cardholder with a \$2,000 single purchase limit rented equipment totaling \$5,738 by splitting the transaction into three payments. Most split transactions observed exceeded the \$2,000 competitive bidding requirement. The splitting was accomplished in various ways, but usually required vendor assistance in issuing several invoices. For example, we observed where the time and date stamp of credit card machines recorded transactions literally just minutes apart in issuing different invoices or faxing a series of invoices.

Splitting purchases to avoid purchase card limits is not permissible, and cardholders should not arbitrarily decide to exceed the limit. Cardholders should follow procedures and seek other alternatives such as finding someone else in the department with a higher limit, preparing a purchase order or requesting a higher limit on either a temporary or permanent basis.

Capital Purchases

The ProCard is designed to improve efficiency in purchasing and paying for goods and services not exceeding \$2,000 per purchase. Our testing identified two purchases of equipment totaling nearly \$8,400 not within established purchasing parameters. The purchases were initiated by using two ProCards for \$2,000 deposits; final payments were then made by check via split invoices issued in amounts below the \$2,000 capital limit. Since the equipment was coded as supplies, the items were not properly capitalized for depreciation purposes and were not properly tagged as City property. Purchasing policy and procedures required written bid quotes and purchase orders. Although the purchase of one piece of equipment may have been related to fulfilling an immediate need, better efforts were needed to comply with policy on the acquisition.

Insufficient Documentation

Cardholders are responsible for collecting and saving all sales receipts, and procedures require the cardholder to obtain receipts that sufficiently indicate the date of purchase, cost and description of the merchandise or service. We found numerous instances where receipts were not provided to adequately document the purchase. For example, we observed rental car fees totaling \$2,505 related to employee travel to city-wide summer program locations that lacked sufficient details of the leasing arrangement, mileage and cost benefit analysis. We also noted \$2,435 of rental equipment without detail lists of equipment. The absence of adequate documentation hinders the control process to properly verify, authorize and record purchase transactions.

Conclusion

In our opinion, cardholders did not always follow proper procedure in observing single purchase limits, competitive bidding and capitalization requirements in the use of ProCards. Supervisory review or further follow up reviews did not detect the weaknesses. We believe there is a higher than acceptable risk that cardholders will continue to circumvent purchasing limits without stricter supervisory review and continuous monitoring.

Purchasing is currently pursuing web-based software that will enhance the ProCard process and produce an assortment of monitoring reports that may better detect non-compliance issues. Purchasing can assist departments in monitoring by conducting periodic reviews to ensure controls remain intact. Since the ProCard data will be readily available, the City Auditor's Office believes that we can initiate a continuous monitoring program similar to our payroll payoffs and petty cash programs to also ensure that controls remain in place and followed.

Recommendation

We believe management should implement the following administrative improvements:

1. Issue communications to or conduct training sessions for cardholders and approving officials re-emphasizing ProCard procedures, purchase limits, approval process, performing adequate reviews of supporting documentation and the need for strict compliance; and
2. Conduct periodic monitoring reviews in addition to the City Auditor's monitoring efforts.

Management Response

Management concurs with the City Auditor's recommendation. It should be noted that prohibitions related to splitting transactions to circumvent procedural thresholds exist not only for procurement card transactions, but all expenditure transactions. The same is true for verifying that adequate supporting documentation is present in the form of invoices or sales receipts prior to approval of payment. These procedures are well documented and long-standing tenets of Finance policy and procedures that operating departments are or should be familiar with. Nevertheless, management will by the end of the calendar year send out a memo to each individual cardholder and their respective approvers emphasizing the rules regarding splitting transactions, capital limits and required documentation.

It is management's intent to expand the monitoring process currently in place over the procurement card program. An Internet based program, *Works Payment Manager*, has been acquired to assist management in this process. This is a program that will provide 24 hour, 7 day a week access to individual card accounts. Some of the specific capabilities of this program are extolled in the body of the City Auditor's discussion in issue number three of this report. In short, the program will allow staff to automate existing card oversight procedures and administer the procurement card program on a real-time basis. The systems software was installed on October 13, 2003, and additional monitoring will be in place by March 31, 2004.

Issue #2

Performance Benchmarks Are Needed To Effectively Manage And Monitor Program Activity, Identify Areas Of Improvement And Ensure Continued Success

Discussion

An effective management system includes not only a plan of organization and procedures to ensure established goals are met, but also methods for measuring, reporting and monitoring program performance. Although Finance has goals and objectives included in their program plan related to the ProCard program, the only benchmark established for measuring progress is that of total organizational spending. Although Finance has been successful in increasing annual ProCard spending, we believe that additional performance measures are needed to effectively manage and monitor performance related to more specific goals. For instance, if the goal is to increase the number of active cards, then the performance measure for this goal could be the number of ProCards issued divided by the number of employees in the organization.

Performance benchmarks can help determine the relative efficiency and effectiveness of the ProCard program by comparing the City's activities to those of other organizations. Benchmarking is a useful tool and can help the City:

- Increase accountability;
- Maximize benefits received from using ProCards;
- Provide information for planning and resource allocation;
- Measure success;
- Identify opportunities for improved performance;
- Keep abreast of current trends; and
- Prepare projections of future trends and opportunities.

Benchmark data for cities and counties is readily available for helping management track performance. According to *The 2003 Purchasing Card Benchmark Survey Results*¹ published by RPMG Research Corporation, three key performance indicators for cardholder activity are:

- Number of transactions per card
- Amount spent per transaction
- Number of active organizational cards

Other performance statistics listed in the survey that may assist in measuring and monitoring purchasing card goals include:

- Monthly organizational spending
- Average monthly spending
- Percentage of employees with cards
- Percentage of employees using cards
- Monthly spending per card

Significant cost and efficiency benefits can be achieved through a ProCard program. The City started using ProCards in 1996 as a “best practice” strategy to reduce paperwork and increase efficiency associated with low dollar, high volume goods. However, the ProCard market has

¹A survey of 579 organizations using purchasing cards written by Professor Richard J. Palmer, Eastern Illinois University and Professor Mahendra Gupta, Washington University in St. Louis.

steadily grown and is now considered more of a common practice than a best practice. In the last few years, the City's program has grown significantly from approximately 55 cardholders to 253 cardholders with annual spending now approaching \$2.3 million. New opportunities for growth remain available to increase spending using this payment method by issuing more cards, increasing limits or opening the range of commodities and services. However, continued success will need more methods of measurement than currently used. Performance measures of differing sets of operational or financial data are useful for analyzing the success of programs, identifying problem areas, facilitating action plans and identifying the effectiveness of corrective actions.

Conclusion

In our opinion, management has no method of measuring performance that links to a specific strategic plan. The establishment of measurable goals and objectives for program inputs, operations and outputs is critical to assessing and evaluating the effectiveness of the program. The inability to assess the program adequately may lead to:

- Missed goals
- Lack of accountability
- Inefficient use of resources
- Poor decisions regarding program modifications

Recommendation

We recommend that Management develop and implement an overall action plan and performance measurement system for ProCards that identifies appropriate goals and quantifiable objectives in a continual effort to improve the effectiveness and success of the program.

Management Response

Management concurs with the City Auditor's recommendation. The procurement card program was initiated as a "pilot program" to determine if processing costs could be reduced and other processing efficiencies recognized through utilization of the card. As indicated in the Summary and Background section of the City Auditor's report, usage of the card has increased year after year to a currently significant dollar level. In FY 2003, over 14,000 transactions were processed through the procurement card. A recent 2003 benchmark study by Palmer Company imputed a national savings per transaction of \$69 for each procurement card transaction versus the cost of generating the same transaction through the entire purchase order process (requisition, purchase order, invoice through accounts payable). Of course, not all of the City's 14,000 transactions were of such a nature to require the full-blown purchase order process, but the potential for savings is significant nonetheless.

It is management's assessment that the program has sufficiently demonstrated its worth to merit its continuation as a permanent part of the City's acquisition process. Management agrees that it is appropriate at this point to develop goals and quantifiable objectives for the program. It is our intent to work in concert with the benchmarking program currently administered by the Office of Management and Budget to develop these goals and objectives for the procurement card program. These goals, objectives and performance standards will be in place by March 31, 2004.

Issue #3

Technological Advances In Card Data Transmission And Integration Will Improve Controls And Efficiency And Reduce Costs

Discussion

We observed that opportunities exist to increase efficiency and streamline the ProCard process. Currently, over 14,000 purchase card transactions per year are processed, and the current system for reconciling, summarizing and posting those transactions is done manually. In addition, payment of transactions to the card issuer is done with paper check. Although the purchase card process has improved purchasing efficiency and reduced paperwork related to issuing purchase orders, purchasing card technology has progressed rapidly and more opportunities are available to streamline the process even further. For instance, on-line applications are available that will assist the reconciling, summarizing, recording and even payment of purchase card transactions. Hours of data entry can be eliminated.

The purchasing card has been accepted as a means of streamlining the traditional purchase order and payment processes for low value, high volume transactions. This is because the cost of making payments using the traditional process is the same regardless of the dollar amount of the item purchased. In other words, it costs the same to process the paperwork for a \$100 item as it does a \$10,000 item. Thus, the payment cost could possibly exceed the value of the item being acquired if for example it costs \$100 to acquire a \$25 tool. The purchasing card simplifies the process and reduces the cost.

However, technology is now available for providing further cost savings by improving controls, transmitting data faster, interfacing data with the general ledger and making payment electronically. These types of technological advances move the card system toward a broader commerce card rather than just for low dollar, high volume items.

The Finance Department should be recognized for being proactive on this issue and having the foresight in exploring cost saving opportunities. The Finance Department has identified specific ways to improve the City's card program and is actively pursuing technological advances that will expand use of purchasing cards by increasing the percentage of commodities and services captured on the cards and seeking new categories of commodities and services. We have reviewed and discussed the features and controls of this new technology with Finance. We have been requested to provide input on controls and increase audit activity.

Finance has selected the application *Works Payment Manager*. *Works Payment Manager* is a web-based application that is connected to the SunTrust Visa payment network and will enable the City to automate existing manual payment policies and procedures and administer the credit card program on a real-time basis. Expected improvements from *Works Payment Manager* include:

More Efficient Card Administration – Finance will be able to better manage users and vendor pricing, update organizational approvals, automate enforcement of spending policies and credit limit controls, disable/cancel cards, modify spending limits, obtain access to information on card

spending approvals/declines, obtain customized notifications of potential unauthorized spending and order new cards.

Enhanced Spending Oversight by Managers – Managers will be able to track credit card spending against specific financial targets such as projects, blanket POs, or encumbered funds, receive customized notifications and have real-time views of transactions for more visibility into departmental spending as it occurs and reduce the risk of overspending.

Streamlined Data Transmission, Reconciliation and Integration - Faster data transmission will enable cardholders to obtain transaction data on the day of closing, have the ability to electronically summarize transactions and complete the reconciliation process faster. Data integration into the general ledger accounting system will be automated and save hours of data input.

Enhanced Reporting – Real time reports will allow access to spending information and reports will have extensive drill-down, graphic and data extraction capabilities.

Better Audit Capabilities and Fraud Controls – Managers, administrators and auditors will have real-time access to transactions and better monitoring of program compliance and safeguarding against fraud and employee misuse. Data extraction techniques will be enhanced and provide a mechanism for continuous monitoring.

Conclusion

We reviewed the issues with management and agree there is a need to increase efficiency and save costs by streamlining the purchasing card processing and payment cycles. The application selected by management has control features that will facilitate plans for securely moving more spending onto ProCards, reduce costs and streamline the purchase card process.

The City Auditor's Office will continue to work with management on this issue throughout Fiscal Year 2003-04 and schedule periodic audits to enhance program monitoring.

Recommendation

We recommend that management:

- 1) Complete the implementation of *Works Payment Manager* to streamline the purchasing card processing and payment cycles;
- 2) Develop a monitoring program to ensure program compliance; and
- 3) Continue to work with the City Auditor's Office as we develop an audit plan that will include auditing ProCard transactions on a periodic basis.

Management Response

Management concurs with the City Auditor's recommendation. As indicated in the response to issues number one and two of this report, management implemented the *Works Payment Manager* program on October 13, 2003 and intends to develop a monitoring program to ensure program compliance by March 31, 2004. Management is committed to continuing to work with the City Auditor's office as they develop and implement an audit plan to review procurement card transactions on a periodic basis.

**REVIEW OF GENERAL GOVERNMENT
PROCUREMENT CARD PROGRAM
NOVEMBER 2003**



**CITY AUDITOR'S OFFICE
CITY OF GAINESVILLE, FLORIDA**