Audit of Vendor Master File

July 2013

City of Tempe Internal Audit Office

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I. INTRODUCTION

Background

The Vendor Master File (VMF) is a foundational element of the Accounts Payable and Procurement processes. The VMF contains vital information about the City's vendors and facilitates their engagement in transactions with the City for the procurement of goods and services.

It is essential to effectively maintain this file in order to avoid unauthorized or inappropriate activity, duplicate payments, and inefficiencies.

In order to ensure the safeguarding of City resources over the procurement of goods and services, certain mechanisms should be in place. These mechanisms should support the assertion that only valid vendors exist to provide quality goods and services at competitive prices in a timely manner in order to meet the stated business objectives of the various Departments and Divisions of the City.

The majority of the City's vendor input and validation process is centralized in Finance with the exception of the Housing and Engineering Divisions who are responsible for entering and approving their respective vendors with no independent review. These Divisions require a W-9 prior to setting up a vendor in the PeopleSoft System. Engineering also verifies contractor licenses with the Arizona Registrar of Contractors. Finance requires a W-9 only for vendors that are subject to withholding per the Internal Revenue Service (IRS).

There are three different types of vendors in the PeopleSoft System: permanent, one-time and inactivated. Permanent vendors are those vendors used on a repetitive basis while one-time vendors are used only once. Inactivated vendors are those vendors whose status is changed to inactive due to three years of no procurement activity.

Customer Service, Housing and Courts have separate systems that are uploaded to PeopleSoft bi-weekly. The PeopleSoft Financial System automatically assigns vendor numbers in sequential order for refunds processed through these subsystems. These vendors ultimately become one-time vendors. PeopleSoft does not automatically inactivate these vendors after payment.

Purpose, Policies & Procedures

Purpose Statements

Purpose statements of the Finance Division and the Procurement Office follow:

Finance Division

"We provide excellent financial services and promote financial sustainability through sound fiscal administration, transparency, integrity, accountability and superior customer service."

Procurement Office

"To provide our customer with exceptional service in acquiring needed resources in a highly ethical and code compliant manner

that encourages fair and open competition among suppliers while maximizing tax payer value."

Policies and Procedures

Policies and procedures that govern management of the VMF are currently under revision; they have been in draft form since 2010. Engineering and Housing also utilize these draft procedures for vendor set up and maintenance. Generally, these policies are understood by users; although they are not in a final approved format. Formal, approved, effectively communicated policies and procedures are essential to prevent misunderstandings.

II. AUDIT SCOPE

Audit Initiation

The audit of the VMF was performed as part of the Internal Audit Office's annual audit plan. The inherent nature of operations and other risk factors ranked the VMF relatively high on the list of cross-functional operations developed during our overall citywide risk assessment.

Objectives

Our objectives were to determine whether:

1. Adequate preventative internal controls are in place over vendor validation, setup, modification, and maintenance processes to ensure the prevention of unauthorized, erroneous, or duplicate payments.

2. Finance is in compliance with relevant ARS and IRS statutes and regulations, and related departmental policies and procedures.

Methodology

During the course of this audit we performed the following:

- Reviewed existing procedures/practices for new vendor validation and set up and the modification and maintenance of vendors in the master file.
- Reviewed vendor naming conventions.
- Interviewed management and staff.
- Performed detailed testing on samples of vendors from the master file and evaluated compliance with departmental policies.
- Validated existence of a sample of vendors with PO Boxes by reviewing the Corporation Commission, online sources and TIN numbers as applicable.
- Compared all existing active vendor addresses to employee addresses for potential duplications.
- Reviewed a sample of vendors to compare the remittance address in PeopleSoft to the address on the invoice.
- Reviewed the reasonableness of controls over multiple addresses for same vendor.
- Determined whether the vendor master file is periodically reviewed for one-time vendors, duplicate vendors and if accounts are updated and/or purged on a timely basis.

- Reviewed whether system access capabilities were commensurate with employee job duties.
- Reviewed a sample of 1099s filed to determine proper and timely filing with the IRS.

Roles and Responsibilities

The Internal Audit Office strives to assist managers with the effective discharge of their responsibilities to achieve departmental goals and contribute to the City's mission. Internal Audit promotes effective controls and furnishes management with an independent appraisal and recommendations related to the activities reviewed. Our role is vital to maintaining the public's trust that the City's resources are used effectively and efficiently.

Finance and Technology Department management is ultimately responsible for, and must assume ownership of, their internal control system. Internal controls are used by managers to provide reasonable assurance that their objectives will be achieved. Internal controls are also the primary method for deterring and detecting fraud.

To summarize, management is responsible for establishing and maintaining adequate internal controls. Internal Audit must use due care in examining and evaluating the effectiveness of internal controls and to understand the related exposures and risks. Due care does not require a detailed audit of all transactions. Therefore, internal auditors cannot give absolute assurance that all noncompliance and fraud will be detected.

Follow-Up

Internal Audit follows up on the status of all recommendations approximately 6 months to 1 year after audit completion to assess the status of implementation efforts.

III. CONCLUSION

Overall, we determined that there are generally adequate internal controls in place over vendor validation, setup, modification, and maintenance processes to ensure the prevention of unauthorized, erroneous and duplicate payments.

We also found substantial compliance with relevant ARS and IRS statutes and regulations, and related departmental policies and procedures.

We did identify a few exceptions related to segregation of duties, conflict of interest disclosure, access controls and system integration capabilities.

We also identified opportunities for Finance to increase the efficiency and effectiveness of their vendor master file and strengthen their internal control structure.

Management and staff made significant efforts to address issues identified by Internal Audit as they surfaced during the course of this audit. They either took immediate corrective action or initiated research into the issues to find solutions.

We truly appreciate the time, effort and assistance granted to the Internal Audit Office during the course of this audit by management and staff of the Finance and Technology Department, the Housing Division of Community Development and Engineering Division of the Public Works Department.

IV. DETAILED OBSERVATIONS

Section 1 - Vendor Validation & Setup

The Finance Department's Accounts Payable Desktop Draft Procedures address Vendor Setup as follows:

Vendors are created by the Financial Services Techs, Purchasing Buyers, Engineering and Housing Accountant. Requisitions relating to new vendors that are above $5,000 are automatically electronically routed to Purchasing for vendor set up. Requisitions relating to new vendors that are below $5,000 are routed to the appropriate Financial Services Techs. When establishing a vendor, ensure the following items are recorded in the system:

- *Vendor Name (as stated on the invoices or W-9, if applicable)*
- *Vendor Remit address*
- *1099 Information – if applicable*
- *Terms (system will default to "Net 30")*
- *Phone Number*
- *Payment Handling Code (Internal, customer service, engineering, remittance due & regular).*

Upon saving the vendor, the system will assign the vendor the next available sequential number."

A vendor validation process is intended to ensure that vendors are legitimate entities by confirming their existence. This process helps an organization avoid making inappropriate payments to fabricated or fraudulent entities and reduces the risk of issuing inaccurate annual tax statements to vendors. Finance's existing policies and procedures do not fully address vendor validation.

1. New vendors are not adequately validated prior to inclusion in the Vendor Master File.

Procedures for entering new vendors in PeopleSoft do not include a process for validation. Various available mechanisms to validate vendors are not utilized:

- A W-9 is not required unless the vendor is subject to 1099 withholding.
- A physical address is not required when a PO Box is provided as the primary address.
- Vendors are not validated via the corporation commission (as applicable) or the Internet.
- Due to the IRS requiring personal information and tax records, Finance does not validate the TIN numbers using the IRS TIN matching system.

- Vendors are not checked against the Federal Bureau of Industry and Security's list of excluded persons and companies.

A sample of 94 active vendors was selected and the following validation procedures were performed as follows:

Corporation Commission Website
- 22% were registered
- 64% were not registered (they may or may not be corporations)
- 8% were registered with the Office of the Secretary of State, and
- 6% were not applicable

Internet Validation
- 93% addresses were validated,
- 5% were employees (reimbursments)
- 2% could not be validated as the address listed was a PO Box and there was no physical address in PeopleSoft. (Further review indicated these vendors only had one payment for a refund).

Federal Bureau of Industry and Security's list of excluded persons or companies:
- None of the 94 vendors were on the list.

There were no significant exceptions noted. Despite this, validating vendors prior to set up in PeopleSoft is an important preventative control and the most effective against the potential inclusion of fictitious or unacceptable vendors. Due diligence of vendor verification and validation should occur prior to placement on the approved Vendor Master List.

Finance staff indicated that existing levels of staffing preclude extensive vendor validation prior to set up. Additionally, vendor input is not centralized; other departments such as Housing and Engineering are also entering new vendors.

Recommendations

1.1 A vendor verification process that adds reasonable assurance of the validity of new vendors is fundamental to the integrity of the Vendor Master File. Compensating controls could be implemented where preventative controls are not reasonably accessible. The following detailed procedures could be utilized for new vendor set up and validation:

- Segregation of duties for employees involved in vendor set up and approval.
- Verification of vendor through the Corporation Commission (if applicable).
- Require a W-9 or equivalent prior to set-up.
- Require a physical address for those providing only a PO Box.
- Validate vendors address and phone number (e.g. Corporation Commission, Google, online Phone directory, Better Business Bureau, Contractor License, etc.). Document and maintain where information was gathered to validate the vendor.

- Check vendors against the Federal Bureau of Industry and Security's list of excluded persons or companies.
- Research alternative ways of validating Tax Identification Numbers (TIN) on the IRS website without having to provide personal information.
- Consider establishing a new vendor set up form maintained electronically or in a hard-copy file that includes:
  - Requester and approver of the vendor,
  - A checklist verifying that a W-9 has been received, vendor verification and validation has been completed (including the means used to validate vendor existence.)

The above verification procedures could also be performed on random samples of vendors recently added.

Alternatively, management could routinely review an existing PeopleSoft report that lists new vendors recently added for reasonableness including: the name and address of the vendor, who set up the vendor, who approved the vendor set up, and any other information that would warrant further review.

1.2 Adopted procedures to verify vendors in the set-up process require inclusion in established formal policies and procedures.

Management Response

1.1 *Management of the Finance & Technology Department concurs with the following recommendations (and related observations) unless otherwise noted below. Follow up responsibility (position title) and estimated completion dates follow each bullet-pointed response below.*

- *Management will review current segregation of duties and make improvements where possible given current resources. We believe that, currently, appropriate control is substantially achieved through the segregation of vendor approval from voucher entry. (Those with vendor approval authority do not have the ability to enter vouchers.)*

Responsible Party: *Deputy Finance & Technology Director*

Implementation Date: *January 2014*

- *A good portion of our vendors are determined to be valid based on the fact that they are required to go through our formal procurement process (vendor registration, public solicitations, reference checks, provision of evidence of certifications, licenses, insurances, etc.). For vendors not subject to this process, management will review what steps realistically can be taken to enhance verification.*

Responsible Party:
Cash Management Supervisor (AP Supervisor)

Implementation Date: *April 2014*

- *Not all vendors are subject to the 1099 reporting requirement (i.e., corporations). For those that are subject to that reporting, we will update our procedures to require the receipt of a W-9 prior to vendor approval. We will explore the pros and cons of requiring a W-9 from all vendors.*

Responsible Party:
Cash Management Supervisor (AP Supervisor)

Implementation Date: *April 2014*

- *Accounting will continue to research ways of validating taxpayer identification numbers (TIN). This validation currently occurs after the 1099's are filed and we receive notification from the IRS of an incorrect TIN.*

Responsible Party:
Cash Management Supervisor (AP Supervisor)

Implementation Date: *April 2014*

- *We will seek to obtain street addresses for all vendors.*

Responsible Party:
Cash Management Supervisor (AP Supervisor)

Implementation Date: *April 2014*

- *No electronically-routed vendor set up form exists within PeopleSoft. Management will explore the development and use of a manual form or checklist.*

Responsible Party:
Cash Management Supervisor (AP Supervisor)

Implementation Date: *April 2014*

- *Management will develop for periodic review a PeopleSoft query/report that lists all new vendors entered into the system.*

Responsible Party:
Cash Management Supervisor (AP Supervisor)

Implementation Date: *April 2014*

1.2 *Accounting management will include an appropriate vendor verification process (taking cost/benefit into consideration) in our financial policies and procedures.*

Responsible Party:
Cash Management Supervisor (AP Supervisor)

Implementation Date: *April 2014*

2. The upload of new vendors from the Customer Care and Billing (CC&B) subsystem does not comply with established naming conventions.

Finance's AP Draft Desktop Procedures related to Vendor Naming Conventions follows:

The following states the standard naming convention for both the vendor name and the vendor short name to be used when established vendors under the Maintain Vendors panel.

Vendor Name (Name 1 field)

- *Only use abbreviations if it is the company's legal name.*
- *Record an individual's first name first (i.e. John Doe should be entered as "John Doe" and not "Doe, John").*
- *Set up a company's name as the Vendor Name instead of the individual's name (if need to have individual's name on check write the individual's name on payment alternate name, in the vendor panel).*
- *Spell out acronyms (i.e. GFOA should be spelled out as Government Finance Officers Association).*
- *Use editing characters in vendor name only (not in the short name).*
- *Use spaces in the vendor name (as appropriate)*

If a second name needs to appear on the check, record the name on the "Address 1" line instead of the "Name 2" line. The "Name 2" does not print on the check. Use that field to document any vendor name notes. Record the first line of the address on the "Address 2" line (note: "Address 3" line and "Address 4" also do not print on the check).

A listing of approved vendors was reviewed to determine compliance with the established naming convention. The naming convention is followed for vendors directly entered into the PeopleSoft System; however, vendors uploaded from the CC&B System have the last name listed first, not the first name as required by policy.

Finance believes this is happening because the parameters of the CC&B system have not been set up to comply with PeopleSoft vendor naming conventions.

Consistency with naming conventions is essential to prevent setting up duplicate or invalid vendors. Efficiencies are also experienced with a cohesive set of naming rules. Consistent, well-chosen naming conventions serve to aid users in navigating large amounts of data in the vendor master file.

Recommendation

2.1 Finance and IT should work together to assess the situation and determine if system parameters can be changed in the CC&B System to effectively interface with PeopleSoft to comply with established naming conventions.

Management Response

The Customer Service Division will work with our IT Division to determine whether the interface between PeopleSoft Accounts Payable and CC&B can be programmed to comply with established naming conventions in PeopleSoft.

Responsible Party:
Deputy Finance & Technology Director

Implementation Date: *January 2014*

Section 2- Vendor Modification & Maintenance

At the onset of this audit, there were a total of 49,898 permanent active vendors listed in the Vendor Master File. (Vendors with multiple addresses were counted as separate vendors). In addition to active authorized vendors, this list also included: duplicate vendors, vendors with incomplete data (missing address or TIN), and City employees that had reimbursement claims.

Finance purged approximately 20,000 vendors that had no activity in the last 5 years as a result of our review. After this purge and vendors with multiple addresses were consolidated, approximately 7,700 active vendors remained in the VMF.

Vendor master files require ongoing maintenance to ensure the file's integrity is protected. Internal controls and procedures to effectively maintain the VMF are essential. File size should be effectively managed by inactivating unused vendors, and errors require identification and correction including periodic checks for errors and duplicates. Missing data also needs to be addressed.

Effective VMF management will help guard against duplicate payments, IRS notices and fines; may increase recognition of trade discounts, and can result in fewer opportunities to become a victim of fraud.

3. The Vendor Master File is not frequently maintained.

The Finance Department's Accounts Payable Desktop Draft Procedures address Vendor Modification and Maintenance as follows:

At calendar year end, vendors that have not been utilized for three years should be programmatically inactivated by ITD. A query called AP_Active Vendors_WO Payment (located under the query panel) should be run to create the list. Purchasing will review the list and ensure vendors can be inactivated. A vendor that has to be retained for contract purposes should be highlighted in the query. The review query should be returned to AP Supervisor who will coordinate with ITD for the inactivation of the vendors. Any vendors inactivated can be reactivated by changing the persistence field in the Maintain Vendors panel to Active.

Finance has not been consistently reviewing the vendor master list at calendar year end (in accordance with their policy) with the exception of 1099 vendors. Annually the VMF is reviewed for 1099 vendors to identify potential duplicate tax payer identification (TIN) numbers and/or other errors.

Frequent maintenance is essential to ensure the integrity of the Vendor Master File. Finance is currently purposing to review the VMF every 3 years including a purge/inactivation of vendors with no activity. Industry best practice is to inactivate vendors with no activity every 15 months.

Having inactive vendors in the active vendor file poses a risk. By not inactivating and reviewing the master file, vendor payments could go to incorrect vendors and/or addresses or duplicate payments can be made. Finance is being proactive and has started meeting with IT to determine what system functions can be utilized to maintain the VMF more efficiently and effectively.

Recommendation

3.1 To mitigate risk, Finance could review the VMF at year end to ensure vendors with no activity are purged/inactivated, duplicate vendor records are corrected, and the accuracy of vendor information is adequate and authorized. This review should be performed by management or staff independent of those involved in vendor setup.

Opportunities to enhance the PeopleSoft Financial System's functionality to create "Required Fields" in the process of entering a new vendor could be pursued. System requirements of entry of a complete address and/or Federal Tax ID number (as applicable) prior to the creation of a new vendor could prove beneficial.

Management Response

The Finance Division will work with ITD to purge/inactivate unutilized vendors (with no activity for the past 24 months) at each fiscal year-end; will also explore the use of "Required Fields." Duplicate vendor records are currently reviewed and corrected yearly in preparation of issuing 1099s'.

Responsible Party: *Controller*

Implementation Date: *April 2014*

4. Policies and procedures to automatically purge one-time use vendors have not been established.

In addition to permanent vendors, the Vendor Master File also includes one-time use vendors with whom the City does business to meet ad-hoc needs. These one-time vendors also include those uploaded through the CC&B system, typically for refunds. These one-time use vendors are not purged after the business transactions are completed and the vendors remain in the active master vendor list.

There is no active purge module within the PeopleSoft system's VMF; therefore, no purge criterion has been developed by Finance to ensure one-time vendors are automatically purged or inactivated. Not automatically purging/inactivating these vendors allows these vendors to remain in and unnecessarily populate the VMF. As previously noted, this file is not frequently maintained.

Recommendation

4.1 Finance should work with IT to develop the PeopleSoft system's capacity to purge/inactivate outdated one-time vendors using pre-defined criteria to facilitate efficient VMF processing and clean up.

One-time vendors and vendors with refunds should be purged or inactivated once a check is printed.

Management Response

The Finance Division will work with our IT Division to explore the possibility of programming PeopleSoft to automatically purge or inactivate one-time vendors from the system after payment. If this change requires significant resources (or causes other problems i.e., check reissuance, restitution payments), we will *purge/inactivate unutilized vendors at fiscal year-end.*

Responsible Party: *Controller*

Implementation Date: *April 2014*

5. Risks associated with vendor inactivation and potential unauthorized vendor payments are not effectively mitigated.

There are a couple of anomalies within the PeopleSoft system that present the risk of unauthorized transactions:

1. **Unauthorized Vendor Name Changes**
   Under certain conditions, the system has the capability to process unauthorized name changes. To create a new vendor, the field Vendor Name I drives the whole process. If you change a vendor name in this identifying information panel, (Vendor Name I), the system will change all history (both vouchers and checks) relating to the vendor, effectively altering the vendor. Internal Audit was informed that vendor name changes are only authorized to be conducted by the Financial Analyst Supervisor and Cash Management Supervisor. This ability is tied directly to their user names.

   Under this set up, Vendor Name I can be altered and a check cut and distributed to the altered payee. Once the check has been released, the original name can be restored to Vendor Name I and there will be no history of the transaction taking place.

   Internal Audit met with IT's Business Systems Analyst, Sr. Program Analyst and Program Analyst Trainee in April 2013, to determine if the system settings can be changed to prevent a vendor from being altered. IT is currently working to resolve this issue. There have been patches to PeopleSoft that IT thought would fix this problem; however, they have not yet been successful. Upcoming patches will hopefully correct this issue.

2. **Payee Name Change**
   The name of the payee on a check can be changed before distribution, but after it has gone through the entire approval process. The PeopleSoft system allows the entry of an entirely different vendor and invoice numbers for check payments than the initial vendor and invoice numbers set up, processed and approved for payment. Any employee with access to enter vouchers can facilitate these changes, which are not subject to independent review.

   This capability is required because some vendors are subject to tax levies. If a tax is levied, it will be recorded under the vendor ID but the check is actually sent to the IRS. The system report does show the Vendor ID and where the check was sent.

   The Finance Department's Accounts Payable Desktop Draft Procedures address requests from vendors to pay a different remit as follows:

On occasion a check must be remitted to a vendor other then who is noted on the invoice. These situations usually occur if the vendor has put on consignment their Accounts Receivable or the IRS has taken control of a vendor's assets. Once the City has obtained a written request form the vendor or an IRS levy notice, then enter the voucher with the original vendor number but record the new remit vendor number as the remit vendor on the Schedule Payment panel. The remit vendor will need to be established as an approved vendor. Document in the Payment Message icon (located on the Schedule Payments panel) the original vendor name. The payment message will print the vendor's name on the remittance. This documentation will clarify for the remit vendor which vendor the payment is regarding.

Recommendations

5.1 Finance and IT should continue to work together to mitigate the risks associated with the ability to alter vendors. Access controls should be routinely reviewed to ensure that the capacity to change vendor names is restricted to only a few key employees that require this ability.

5.2 Monthly, as part of the month end close out process, the system report that details the Vendor ID and where the check was sent could be reviewed by someone independent of the employees that process the vouchers to ensure payments are only made to authorized vendors, or have been changed only for legitimate reasons such as IRS tax levies.

Management Response

5.1 *Technically, you can't delete vendors, only change their names. We will continue our current practice of limiting the ability to change vendor names in the PeopleSoft system to two Financial Services supervisory employees, who do not have voucher entry or voucher approval authorization. Management will periodically monitor the system to ensure that only authorized employees have this ability. An audit trail has been established to track any changes made.*

Responsible Party: *Controller*

Implementation Date: *April 2014*

5.2 *Our current practice is necessary in order to direct payments to the proper party. The process is controlled and authorization is properly limited to selected employees. There is another built-in control – if an invoice is entered and approved and the payment is diverted to another party, the vendor expecting payment will contact the department that initiated the purchase, which would trigger an investigation* *into the status of the payment request. A diverted payment would be discovered during this process. As an additional check, we will have the AP Supervisor review the system report monthly to ensure that payments were made only to authorized vendors.*

Responsible Party:
Cash Management Supervisor (AP Supervisor)

Implementation Date: *April 2014*

Section 3- Access Controls

Access controls over the Vendor Master File should be appropriately restricted. The creation and maintenance of the Vendor Master File should be assigned and restricted to only a few key personnel to ensure that only authorized individuals have the ability to make changes, deletions or additions to the VMF.

The duties of these key personnel should also be segregated. Segregating incompatible duties is a basic internal control for ensuring that no employee is in a position to commit an irregularity and then conceal the irregularity. A single individual should not be able to authorize a transaction, record the transaction in the accounting records, and take custody of the asset resulting from the transaction. In a financial process having proper segregation of duties, it is expected that at least one individual involved in the process will identify and/or prevent a transaction processing error, misappropriation, or fraud from occurring.

6. System access controls need strengthening.

Internal Audit reviewed a current list of all users of the PeopleSoft Accounts Payable and Purchasing system to determine if system capabilities, including access levels were commensurate with employee job duties.

The following table illustrates capabilities by employee position:

Title	Number of Employees	Enter, Approve & Inactivate Vendors	Add/Update Purchase Orders	Enter & Approve Requisitions
FIT Controller	**1**	✓	✓	✓
FIT Central Services Manager	**1**	✓	✓	✓
FIT Procurement Specialists	**3**	✓	✓	
FIT Procurement Officers	**3**	✓	✓	
FIT Accountant	**1**	✓	✓	
FIT Financial Report Analyst Supervisor	**1**	✓	✓	
FIT Financial Services Tech II	**1**	✓	✓	
FIT Cash Management Supervisor	**1**	✓	✓	
Public Works Engineering Contracts Supervisor	**1**	✓	✓ ***(Engineering Only)***	
Public Works Engineering Tech. II	**1**	✓	✓ ***(Engineering Only)***	
Community Development Neighborhood Grant Analyst	**1**	✓		✓
Community Development (Temp Employee)	**1**	✓		

The Finance Department's Accounts Payable Desktop Draft Procedures address vendor approval as follows:

"For internal purposes, the vendor approval capabilities are separated from those responsible for creating the vouchers. The vendor approval is restricted to the AP Supervisor, AP Accountant, Housing Accountant, Engineering and Purchasing Buyers. The supporting documentation (invoice, e-mail requests from Housing, etc.) should be given to one of the individuals with vendor approval capabilities. After approval of the vendor, any invoices used as support should be given to the appropriate Financial Service Tech."

Vendor approval is not restricted to the AP Supervisor, AP Accountant, Housing Accountant, Engineering and Purchasing Buyers. Additionally, vendor approval capabilities are not separated from those authorized to add/update purchase orders.

There appears to be inadequate segregation of duties related to vendor set up and approval. There are currently 18 employees (including 2 IT personnel) authorized to enter and approve vendors. Three employees (including 1 of the IT personnel) have the capability of completing the entire purchasing process with no independent review or approval. (The IT personnel are not listed in the above table as they are considered System Administrators.)

If a single person can carry out and conceal errors and/or irregularities in the course of performing their day-to-day activities, they have generally been assigned or allowed access to incompatible duties or responsibilities. Segregation of duties is critical to effective internal controls because it reduces the risk of mistakes and inappropriate actions.. When incompatible functions cannot be segregated, a detailed supervisory review of related activities can serve as a compensating control activity.

Allowing more than one individual to enter and approve vendors may result in duplicate vendor entries within the Master Vendor File which increases the risk of duplicate payments to vendors. Authorizing access to enter, approve and inactivate vendors as well as enter and approve requisitions, add/update POs allows one individual to complete the entire purchasing process with no independent review or approval. Purchase requisitions should be reviewed and approved by someone other than the employee initiating the requisitions.

Recommendations

6.1 Authorization to enter vendors could be restricted to as few as 2 employees with an additional back-up. Employees setting up and adding the new vendors should not be able to approve the vendor. There should be an independent review and approval process.

6.2 PeopleSoft access should support proper segregation of duties and adequate compensating controls in the form of management review. No employee should be able to complete the entire purchasing process with no independent review.

6.3 In order to minimize the workload of the Finance Department, two Divisions (Engineering and Housing) were granted access to enter and approve vendors. Routine monitoring and review of related activities could be performed by Finance as a compensating control.

Management Response

6.1 *Management of the Finance Division will review current vendor creation and approval authorization and recommend changes to enhance appropriate segregation of duties. Segregation of entry and approval might not be necessary if the payment processing function is segregated.*

Responsible Party:
Deputy Finance & Technology Director

Implementation Date: *January 2014*

6.2 *We will review all employee access/functions to ensure no single employee has the ability to complete the entire purchasing process through vendor payment without independent review.*

Responsible Party:
Deputy Finance & Technology Director

Implementation Date: *January 2014*

6.3 *The Finance Division will work with ITD to develop a query/report that can be run periodically and will reflect any new vendors established by Engineering and Housing. This report will be reviewed on a monthly basis by the AP Supervisor and/or Controller.*

Responsible Party:
Cash Management Supervisor (AP Supervisor)

Implementation Date: *April 2014*

7. User accounts are not effectively processed upon employee transfers.

The process of authorizing system access for new employees and removing system access for employees that leave the city or transfer to other city departments was reviewed.

Financial system access requests are processed through email requests; Payroll system access requires completion of an authorized access form.

When an employee leaves the city, a Personnel Action Request (PAR) is processed. After HR's final approval of the action, an email is automatically sent to the IT Helpdesk and to PeopleSoft to deactivate the account. This process happens over night after the employee's last day of employment. Even before the PeopleSoft deactivation is processed, the employee's HRMS and network account (Active Directory) is locked automatically so they cannot access PeopleSoft.

Internal transfers are not as clear cut. IT is not notified of employee transfers in PeopleSoft like they are for terminations. Typically IT is notified via email from the area (copying a manager or director) that needs an access update. It's not automatically generated by the system as for terminations. Additionally, IT ensures all activity has ceased on a user's account before its deleted.

There are two different areas in the system that have to be populated (security role and vendor panel) in order to perform vendor administrative functions; employees must be activated in both of these areas in order to modify vendors.
We found 2 instances where it *appeared* employees' access to the Financial System had not been appropriately updated in a timely manner. The security role was removed for the 2 employees at time of transfer; however, the vendor panel had not

been removed making it appear that the two employees still had access, where in fact they did not. At the prompt of Internal Audit inquiry on March 21, 2013, access for the two employees was modified to remove the vendor panel option as only the security role was removed on date of transfer.

Properly removing access within the system is essential to ensure that the data contains accurate information.

Recommendation

7.1 System capabilities should be explored to automatically default access parameters for employees that transfer to basic access levels until such time as a formal request for specific access is received.

Additionally, when access is removed for employees ensure it is removed in both the security role and the function panels.

Management Response

Management in the Financial Services Division will work with the IT Division to explore alternatives (i.e., HR employee separation checklist) for appropriately limiting system access for employees who change positions.

Responsible Party:
Deputy Finance & Technology Director

Implementation Date: *January 2014*

8. IT Administrator IDs were not accurately named.

We identified a situation where an IT Department employee (responsible for system administration), who retired in December 2012, still *appeared* to have access with 3 separate user IDs to add/update purchase orders. This employee's financial account was kept active (although locked) in order for IT staff to continue to use it to review and run control parameters as these user IDs are embedded in PeopleSoft code and cannot be removed. The former employee's accounts were locked and passwords were changed, but the access description still identified him as a user. At the prompt of Internal Audit, the three user accounts were amended to IT Administrator accounts and no longer name the former employee as a user.

When accounts are linked to a specific IT user, it is imperative that the user ID roles be changed within the system to prevent the appearance of unauthorized employees remaining on the user list.

Recommendation

This issue has been corrected by IT; no further action is needed.

9. Vendor modifications are not subject to independent review.

A sample of 95 inactive vendors was selected to test for proper authorization and to determine the last time business was conducted with the vendor. For the sample selected, all vendors were inactivated and approved by the same authorized employees. There is no independent review of the changes. The absence of an independent review of vendor modifications presents a risk that inappropriate or unauthorized changes will go undetected.

Recommendation

9.1 Ideally, an employee independent of the individual making changes to vendors should approve the changes to ensure the modifications are initiated only by authorized employees and the changes are valid and warranted. Should this not prove to be practical given current staffing levels, management could routinely review vendor modifications for reasonableness as a compensating control.

Management Response

This appears to be the same as recommendation 6.1 – segregate the functions of vendor set-up and vendor approval. With limited staff in Financial Services, this recommendation might not offer sufficient improvement to internal controls to justify the use of resources. If we limit the number of employees who are able to update the vendor file and segregate that duty from payment processing duties, we will have achieved a high level of duty-segregation to guard against the processing of improper payments.

Responsible Party:
Deputy Finance & Technology Director

Implementation Date: *January 2014*

Section 4- Compliance with IRS & ARS

Arizona Revised Statutes (ARS) have been established to govern transactions with relatives of public agency employees and with the employees themselves. As detailed in the specific ARS sections below, employees with conflict of interest situations must disclose the conflict, refrain from participating in or influencing the transactions, and specific competitive standards must be met.

The IRS requires organizations to file Form 1099-MISC, Miscellaneous Income, for each person to whom they have paid during the year as follows:

- •At least $10 in royalties or broker payments in lieu of dividends or tax-exempt interest;
- •At least $600 in rents, services (including parts and materials), prizes and awards, other income payments, medical and health care payments, crop insurance proceeds, cash payments for fish (or other aquatic life) you purchase from anyone engaged in the trade or business of catching fish, or, generally, the cash paid from a notional principal contract to an individual, partnership, or estate;
- •Any fishing boat proceeds; or
- •Gross proceeds of $600 or more paid to an attorney.

The Form 1099-Misc Copy B, must be furnished to the recipient by January 31, the due date is extended to February 18, if you are reporting payments in boxes 8 or 14. Copy A of this form must be filed with the IRS by February 28. If you file electronically, the due date is March 31.

Penalties are imposed for late filings of 1099s as follows: $30 penalty for filing a 1099 no more than 30 days late; $60 penalty for filing a 1099 more than 30 days late and before August 1; $100 penalty for filing on or after August 1 and a $250 penalty for intentional failure to file.

The City is averaging approximately 843 1099s annually. Therefore, it is imperative that the 1099s are filed timely to prevent imposed penalties.

10. Failure to disclose conflicts of interest created violations of the City's policies and a risk of violation of the Arizona Revised Statutes (ARS).

The following sections of ARS 38-503 relate to conflict of interest:

a. *Any public officer or employee of a public agency who has, or whose relative has, a substantial interest in any contract, sale, purchase or service to such public agency shall make known that interest in the official records of such public agency and shall refrain from voting upon or otherwise* *participating in any manner as an officer or employee in such contract, sale or purchase.*

c. … *No public officer or employee of a public agency shall supply to such public agency and equipment, material, supplies or services, unless pursuant to an award or contract let after public competitive bidding...*

We found four issues related to conflict of interest (COI) requirements. There were three instances which created a risk of violation of the Arizona Revised Statutes (ARS) and one purchase which failed to follow the Procurement Office's practice of requiring three quotations for transactions with vendors who have identified conflicts.

The following details the four findings:

Community Relations:

The Community Relations and Public Works departments have purchased approximately $16,000 in goods from R&M Dezines since 2010. This business is owned by the spouse of a Community Relations employee. The employee filed a conflict of interest disclosure form with Procurement on February 19, 2010. There is no evidence that the employee influenced or was involved in the Procurement from R&M (the employee was not the requestor or approver of the requisitions). Even though this business is spouse-owned and not employee-owned (thus not subject to ARS 38-503c), Procurement's practice is that three quotes should be obtained and reviewed by the Procurement Officer even if the purchase is under $5,000. The Procurement Office communicated this to the employee, but not to staff doing the purchasing from R&M. Therefore, Community Relations staff was not getting the required three quotes. Once we alerted Procurement, they sent instruction to staff purchasing from R&M stating the three quote requirement.

Social Services:

The Social Services Division of Community Services paid approximately $6,000 in FY 2011-1012 for contracted Diversion Counseling services provided by an employee's spouse. The employee works in a separate division of Community Services. The employee did not disclose this conflict. It does not appear that the employee had any influence on the decision to contract with her husband. The former (now retired) supervisor of Counseling compiled a list of Counselors that met the qualifications and licensing requirements, and selected the employee's spouse.

Fire Department:

The Fire Department has purchased approximately $9,000 of supplies (stickers, locker magnets, etc.) from Frontline Signs, LLC since 2003. A City Fire Engineer is an owner of this company. Although the employee has not filed a COI disclosure form with Procurement, it does not appear that the employee had any influence on the purchasing decisions. The administrative function of purchasing is a separate division within the Fire Department. This was confirmed with management. It also does not appear that the Fire Department allowed for public competitive bidding for purchases from entities owned by employees. Pricing was evaluated over 10 years ago between

Frontline and another vendor, and Frontline has been used since then. It is Procurement's practice to require three quotes on purchases from vendors where conflicts have been identified (even when less than $5,000), and the quotes must be reviewed by a Procurement Officer.

Transit:

On 7/22/2010, the City's History Museum paid a vendor $600 to do face painting at an event. At the time, the vendor was the wife of a City employee from the Transit Division. The employee did not disclose this conflict. The Museum Director had no idea that the vendor was related to a City employee and there is no reason to believe based on the documentation reviewed that the employee influenced the decision to procure services from this vendor. The Procurement Office requires three quotes in these cases, even if the dollar amount is less than $5,000, which the Museum staff did not obtain because they were not aware of the conflict.

Recommendations

10.1 Employees with conflicts of interest should immediately file a COI disclosure form with the Procurement Office.

10.2 Supervisors in areas purchasing goods from vendors with identified conflicts should be monitoring purchases from these vendors to ensure that the employee with the conflict is not influencing or involved in the purchasing decision. Mechanisms should be put into place to ensure that supervisors are aware of identified conflicts.

Management Response

10.1 *Management of the Finance Division agrees with your statement. Procurement recently began providing a "Procurement 101" course in which employee responsibility to file a COI is covered as part of the ethics section. This training is not mandatory, but provided upon request or determination of need by the Procurement Office. This information is also posted on the Procurement intranet. Additionally, during each public solicitation process, employee participants are advised of COI requirements.*

Responsible Party:
Central Services Manager
Implementation Date: *Ongoing*

10.2 *Procurement recently began providing a "Procurement 101" course in which employee responsibility to file a COI is covered as part of the ethics section. Included in the course is information regarding the employee's (with a conflict) inability to participate in the purchasing decision. Additionally, Procurement will begin providing a copy of the submitted COI form to the employee's supervisor.*

Responsible Party:
Central Services Manager

Implementation Date: *Ongoing*

11. The PeopleSoft system included an amount not subject to tax withholding on a vendor's 1099 tax form reported to the IRS.

A sample of 94 vendor payments subject to 1099 tax withholding were selected to test for compliance with IRS reporting requirements for the calendar years 2008-2012. The amount paid to the vendor for the year was queried through the PeopleSoft System to determine if they agreed to amounts reported to IRS. One (1) of the 94 vendor1099s reviewed did not agree to the system total payments.

For this vendor, payments through the system totaled $16,908; however, the 1099 was filed in the amount of $63,466, a difference of $46,558. This variance was combined with a separate vendor number to correct the withholding. It appears this vendor has duplicate vendor numbers within the system; as a result the two vendor number totals had to be merged for the correct withholding and proper reporting to the IRS. This 1099 also included $36 of utility charges which are not subject to withholding per the following:

Internal Revenue Service (IRS) Form 1099-Misc Exceptions:
Some payments do not have to be reported on Form 1099-Misc, although they may be taxable to the recipient. Payments for which a Form 1099-Misc is not required include the following: Payments for merchandise, telegrams, telephone, freight, storage or similar items."

Taxes were not withheld for this amount, but the $36 payment was reflected unnecessarily on the 1099 form. This results in potentially inflating the vendor's taxable income. Although a small amount, this can be indicative of bigger issues. Finance wasn't sure why the system included the utilities. It appears there may be a system glitch and there may be other situations where amounts are being captured that are not subject to withholding.

Having the system capture information that is not subject to withholding may result in the wrong amount being reported to the IRS causing the tax payer to pay higher taxes than necessary.

Recommendation

11.1 Finance should work with IT to determine the cause for utilities being included and resolve this problem. Additionally, duplicate vendor numbers need to be inactivated to reduce the risk of incorrectly reporting tax withholdings.

Management Response

The Finance Division will work with the IT Division to determine if the one case of mis-reporting taxable income for a vendor by $36 was an isolated incident or a system issue. The recommendation regarding inactivating vendor numbers has been covered in recommendation #3.1. We will also explore the development of a query/report to more timely identify duplicate vendor numbers.

Responsible Party: *Controller*

Implementation Date: *April 2014*

Section 5- Policies and Procedures

Policies and Procedures are the strategic link between an organization's purpose and mission and day-to-day operations. Well written, consistent and effectively communicated policies and procedures allow employees to understand their roles and responsibilities. They allow management to guide operations without constant management intervention. Relying on 'understood' policies and practices runs the risk of misunderstandings and inconsistent treatment of similar transactions.

Policies and Procedures also help to create an internal control framework. It is this internal control framework that management will rely upon and that will ensure the company's objectives are being met.

12. Conflict of interest (COI) laws are not formally included in City procurement policies and employees are not adequately informed or trained on the subject matter.

The Procurement Office has a conflict of interest link on its webpage that includes excerpts from the applicable ARS section and a COI disclosure form. However, City employees are generally not made aware of the link.

In addition, Procurement has recently introduced "Procurement 101" classes to some departments, which include COI training, but this training is in the beginning stages and has not reached the majority of employees. Since the conflict of interest requirements have not been formalized, there is confusion on how employees should proceed with purchases from vendors with identified conflicts. In order to comply with ARS, Procurement requires that three quotes should be obtained and reviewed by a Procurement Officer when purchases are made from vendors with identified conflict, even when less than $5,000. This has not been communicated through written policies and procedures.

Unless communication and training improves, employees may not disclose conflict of interest situations, which place them in non-compliance with Arizona Revised Statutes. If policies are not formalized, there is confusion as to how employees are expected to handle conflict of interest matters.

Recommendations

12.1 Procurement should continue to provide COI training to as many employees as possible. Refresher courses could also be offered periodically.

12.2 Procurement should communicate information related to COI laws and disclosure requirements and related City policy citywide through various possible means such as posts to City Information and/or newsletters with periodic annual reminders to employees.

12.3 Procurement should formalize conflict of interest laws and requirements into written policies and procedures.

Management Response

12.1 *See response to 10.1 & 10.2. The Procurement Office will continue to provide procurement training to employees in City departments as requested or as determined necessary by Procurement. Additionally, we explore the inclusion of COI rules as part of the ethics training provided to new employees.*

Responsible Party:
Central Services Manager

Implementation Date: *Ongoing*

12.2 *See response to 10.1 & 10.2. The Procurement Office will continue to include conflict of interest laws and rules in the training provided to employees in City departments. This information is currently provided on the Procurement intranet. Procurement will at least annually send out email and/or newsletter reminders regarding COI rules.*

Responsible Party:
Central Services Manager

Implementation Date: *January 2014*

12.3 *The Procurement Office will ensure that the City's Procurement Code and/or Procurement Policies/Procedures include updated language regarding conflict of interest laws and rules.*

Responsible Party:
Central Services Manager

Implementation Date: *January 2014*

13. There is no process in place to flag vendors in PeopleSoft with declared conflicts of interest.

The Procurement Office does not have a process in place for the PeopleSoft system to flag vendors with declared conflicts of interest to ensure that related purchases are properly scrutinized for compliance with ARS and City practices.

ARS 38-503 states:
No public officer or employee of a public agency shall supply to such public agency and equipment, material, supplies or services, unless pursuant to an award or contract let after public competitive bidding.

Therefore, when an *employee* owns or has a substantial interest in a company used by the City as a vendor, there must be competitive bidding involved. Procurement requires that 3 quotes be obtained and reviewed by the Procurement Officer when employee owned vendor businesses are utilized, even when the amount is less than $5,000.

When an *employee's spouse or relative* owns or has a substantial interest in a company used as a vendor, it is Procurement's practice that the same three-quote standard apply, regardless of the amount of purchase.

Without system capacity to flag vendors with declared conflicts in PeopleSoft, Procurement does not know when these vendors are utilized for smaller purchases that are "direct pays" and don't come through a Procurement Officer.

Recommendation

13.1 Procurement should work with IT to develop a method in PeopleSoft to flag vendors with known conflicts. Payments should not be allowed to these vendors until the required quotes are obtained and reviewed by the Procurement Officer.

Management Response

Management of the Finance Division will work with our IT Division to determine if it is possible and practical to program an alert in PeopleSoft when vendors have been identified as having a conflict of interest.

Responsible Party:
Central Services Manager

Implementation Date: *April 2014*

14. Departmental purchasing related responsibilities should be reinforced.

A sample of 72 paid invoices were reviewed to determine whether remittance addresses in PeopleSoft were the same as reflected on invoices, supporting documentation evidenced receipt of the actual goods or services, and appropriate authorization for payment was evident. Documentation to support invoice billings is not always provided to Finance; it is maintained at the department level. As long as an invoice is authorized for payment by the appropriate department representative, Finance processes the payment. As a result, documentation was requested to support various purchases from multiple departments including: Fire, Risk Management, Housing, Courts and Water Utilities.

For 2 of 72 invoices, full documentary support was not available:

1. **Community Services:**
   Receiving documentation for a storage shed was not on file at the department. There was no evidence to support that the shed was actually received, and the invoice did not indicate where it was delivered to.

2. **Fire**
   An Intergovernmental Agreement (IGA) transferring Arizona Department of Homeland Security grant equipment to the City of Glendale was passed by Council Resolution (2013.39) on April 18, 2013. This equipment was purchased October 2012. The IGA between the City of Tempe and City of Glendale has yet to be signed; it is scheduled for signature August 2013. The purchase was made prior to council resolution and the agreement being signed by all parties. Despite this, Glendale took possession of the equipment approximately November 2012.

Reliance is placed on department employees for verification of the receipt of goods since receiving is not a centralized function of the City. It is their responsibility to perform a three-way match of the Purchase Order, Invoice, and receiving documentation (where applicable).

The AP Desktop Draft Procedures do not address the requirement that departments are responsible for maintaining documentation to support purchases. If the departments do not maintain this documentation, there will be no audit trail.

Recommendations

14.1 The AP Desktop procedures should address departmental responsibilities of performing a three-way match evidenced by approval for payment as well as maintenance of supporting documentation (invoices, receiving documentation, packing slips, etc.) for all purchases of goods and services. Confirmation of departmental responsibilities should be effectively communicated citywide.

14.2 Transfers of assets to third parties should not be made prior to signed agreements and acceptance of responsibility for the property. The feasibility of a system to detect these types of purchases warrants research.

Management Response

14.1 *The Financial Services Division will ensure that Accounts Payable Procedures clearly state departments' responsibilities for taking delivery of purchased equipment and maintaining proper documentation.*

Responsible Party:
Cash Management Supervisor (AP Supervisor)

Implementation Date: *April 2014*

14.2 Response from Fire Department:
Concur with observation.
Due to the size of the assets (mobile command centers) it was determined to be more efficient to have the asset delivered to the City of Glendale. Rather than take delivery at the City of Tempe and then ship to the City of Glendale. Generally, all equipment is delivered to the City of Tempe. Further, both the City of Glendale and City of Tempe had turnover in key positions which were in charge of processing and tracking the IGA. At the City of Tempe, turnover included the Fire Chief, the Assistant Chief and the Deputy Chief involved with this process. Lastly, the City of Glendale had no Council meeting in July to adopt/sign the IGA.

The City Attorney assigned to the Fire Department has suggested a holistic IGA which would encompass all future pass through grants purchases and the subsequent distribution of equipment to streamline the process. This IGA would be in accordance with ARS 11-951-through 11-954.

Responsible Party:
Fire Budget/Finance Supervisor and Assistant Fire Chief.

Implementation Date: *May 2014*

15. Accounts Payable Desktop Procedures are incomplete.

Policies and Procedures related to the VMF were requested from the three city areas that process vendors: Finance, Engineering and Housing.

Finance's Accounts Payable Desktop procedures were provided in draft form. These procedures have been undergoing revisions since 2010.

Engineering provided their Procurement and Contract Management procedures, which addresses how to enter a vendor into the PeopleSoft System. Housing is currently following Accounts Payable's draft procedures for entering vendors.

In addition to policies on Conflict of Interest, other policy deficiencies were noted throughout the course of this audit:

- The Accounts Payable Desktop Procedures are in draft format; they have been undergoing revisions since 2010.
- The policy does not address vendors with multiple addresses.
- The policy does not require a physical address when vendor provides only a PO Box.
- There are no procedures over vendor validation prior to set up (i.e. reviewing corporation commission, validating address and phone number via the Internet, checking against other online sources, etc.).
- Although segregation of duties is documented in the procedures, it was found that employees that enter vendors can also approve and inactive with no independent review.
- One-time vendors were once required per policy to be separately identified within PeopleSoft; however, that requirement has been removed. Regular and one-time vendors should be differentiated.
- Finance relies on departments to maintain supporting documentation (including receiving documents) in order for invoices to be paid; however, the policy does not address that departments are responsible for maintaining this documentation and ensuring all goods/services are received before approving invoices for payment.

Policies & procedures are required when there is a need for consistency in your day-to-day operational activities. Policies and procedures also provide clarity to the reader when dealing with accountability issues or activities that are of critical importance to the city, such as legal liabilities, regulatory requirements or issues that have serious consequences. Without approved policies, there is no set recourse for employees or management should an incident take place.

Recommendation

15.1 We encourage Finance to work on addressing identified policy deficiencies and pursue updating, finalizing and approving their draft policies and procedures. Management should consider obtaining feedback from employees and departments on any specific directives or requirements that need clarification or inclusion. The policy should also include consequences for non-adherence. The policies and procedures should be clearly communicated to employees across the City. They should also be evaluated for effectiveness and revision requirements on a continuous basis

Management Response

The Finance Division will complete the update of its Accounts Payable Desktop Procedures by June 2014 and take steps to communicate related policies to employees as applicable.

Responsible Party:
Cash Management Supervisor (AP Supervisor)

Implementation Date: *June 2014*