ACCOUNTS PAYABLE AUDIT

Finance Department

Internal Audit

Audit No. 2018-IAD0504-02FD
October 15, 2018

City of Lake Worth
Internal Audit Department

William Brown, CIA, CGAP
City Internal Auditor

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Internal Audit Department

7 North Dixie Highway
Lake Worth, FL 33460
561.586.1749

Re: Finance Department Accounts Payable Audit (2018-IAD0504-02FD)

City Commissioners,

Enclosed is the City of Lake Worth Internal Audit Department's (IAD) **Accounts Payable Audit Report**. This audit was approved as part of the IAD's 2018 Annual Audit Plan. The Finance Department is responsible for processing payments (the "accounts payable" process) to cover the financial obligations of the City. Payments are made to registered and approved vendors residing in the City's Vendor Master database.

The Finance Department is responsible for the policy & procedures, and other internal controls, to mitigate the risk for errors, theft, or fraud in the accounts payable process. The audit evaluated: a) compliance to Department Policy & Procedure, and b) effectiveness of current internal controls. The IAD thanks the Finance Department for their support and cooperation during this audit.

The audit uncovered: a) ten instances of duplicate (double) payments to vendors, b) multiple instances of unsupported paid invoices, c) multiple instances of overtime billed when only 30 hours of regular time was worked, and d) multiple deficiencies in the Vendor Master database.

The staff and management of the Finance Department have already taken positive actions to: a) recover duplicate payments (100% have been recovered, ~$32,641), b) address deficiencies in the access and maintenance of the Vendor Master database, and c) generally improve and update internal controls associated with the accounts payable process.

In order to ensure that all recommendations are implemented and internal controls are functioning as management intends, the IAD will perform a follow-up audit of the accounts payable process as part of the 2019 Annual Audit Plan.

If you required any additional information, please contact me at (561) 586-1749.

Sincerely,

William Brown, CIA, CGAP
Internal Auditor, City of Lake Worth
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Table of Contents

Background Page 1

Audit Scope & Audit Objectives Page 3

Methodology Page 4

Summary Findings & Recommendations Page 5

Summary Observations Page 6

Findings & Recommendations Page 7

- Finding 1 Page 7
- Recommendation 1 Page 9
- Finding 2 Page 10
- Recommendation 2 Page 12
- Finding 3 Page 13
- Recommendation 3 Page 16
- Finding 4 Page 17
- Recommendation 4 Page 20

Appendix Page 22

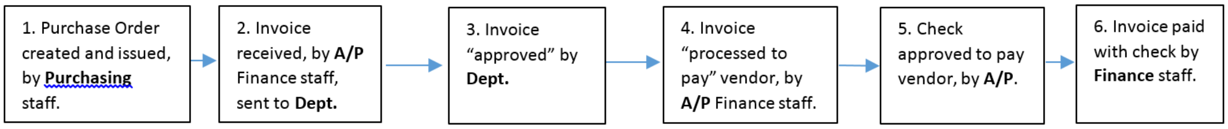
- Finance Department Management Response Page 23
- Observations (Voided Checks / Prompt Payment) Page 25
- Audit Testing Page 30
- Data Analytics Results Page 31
  - Duplicate Payments to City Vendors Page 31
  - Check Sequence Gaps Page 33
  - Vendors with the Same Federal Tax ID Page 35
  - Vendors with the same Address Page 37
  - Vendors with Missing Federal Tax ID Page 41
  - Vendors Deleted without Documented Reason & Authorization Page 43
  - Voided Check Analysis (detail) Page 46

Background

The City of Lake Worth's Accounts Payable Process (A/P) is centered in the City's Finance Department. The City of Lake Worth disburses over $126 million in payments to vendors, employees, and other agencies. Disbursements methods primarily include check, and wire transfer. The City reviews all invoices for contractual compliance (if applicable), accuracy and authorizing signatures, prior to payment processing and posting to Superion Naviline database system.

A detail flowchart of the staff activities involved in the Accounts Payable Process can be found in the Appendix of this report. The general stages of the Accounts Payable Process can be depicted as follows:

Accounts Payable Process



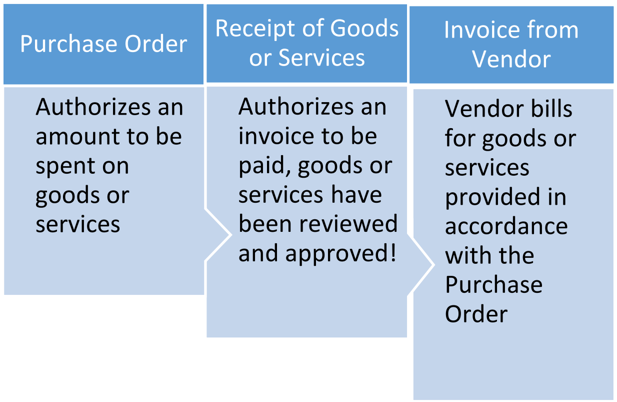
1. Purchase Order created and issued, by **Purchasing** staff.
2. Invoice received, by **A/P** Finance staff, sent to **Dept.**
3. Invoice "approved" by **Dept.**
4. Invoice "processed to pay" vendor, by **A/P** Finance staff.
5. Check approved to pay vendor, by **A/P.**
6. Invoice paid with check by **Finance** staff.

Audit Period: October 1, 2015 through March 31, 2018

Accounts Payable Process

In the example illustrated above, purchasing staff initiate the eventual need to process a payment by issuing a Purchase Order - City vendors are authorized to provide goods or services when a Purchase Order (PO) is issued. When the service or goods are received by the user department, an authorized staff of the user department "receives" the PO in the City's Naviline system. This serves as authorization to pay the vendor.

The Rule of 3-Way Match of Accounts Payable occurs when the records of: a) Purchase Order (PO), b) Receipt of Goods, and c) Invoice, all match in perfect harmony!



Purchase Order	Receipt of Goods or Services	Invoice from Vendor
Authorizes an amount to be spent on goods or services	Authorizes an invoice to be paid, goods or services have been reviewed and approved!	Vendor bills for goods or services provided in accordance with the Purchase Order

The City’s Accounts Payable Process can involve up to five staff, with principle responsibilities performed by the Accounts Payable Accountant I - responsible for receiving the vendor invoice, validating the invoice has been authorized for payment by the user department, and then processing the payment. Another important role is performed by the Vendor Clerk, responsible for accuracy and security of the Vendor Master database.

City Vendors (suppliers) are instructed to forward invoices to the Accounts Payable (A/P) section of the Finance Department. The vendor’s invoice is received, generally via US Post although invoices are also received via email. The mailed invoice is opened by the Finance Department’s Administrative Assistant. The invoice is then forwarded to the A/P Manager for processing. The A/P Manager only processes invoices that: a) have been received in Naviline by the user department (“authorization”), and b) are for a complete PO (no partial orders are paid).

Internal Controls Statement

Ideally, internal controls[1] work to assure: a) the reliability and integrity of information, b) compliance with Policy and Procedures, and laws, c) the safeguarding of assets, and d) the efficient use of resources. Internal controls prevent and/or detect situations that cause risk for the City (theft, fraud, employee errors). This report’s recommendations are intended to improve the internal control of the Accounts Payable Process.

Department Management

Management is responsible for implementing recommendations. It is the responsibility of Department Management to implement accounts payable controls designed to ensure the accuracy and appropriateness of payments (for example, to prevent the occurrence of duplicate payments). As with any A/P process, management should strive to create and implement internal controls designed to assure the following:

a) Staff accurately documents all transactions,
b) Transactional documentation can be audited,
c) Transactional reporting exists for effective oversight, ensuring accountability,
d) Any part of the A/P process not conforming to policy, procedure, proper bookkeeping, and accounting standards should be detected and corrected in a timely manner.

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[1] Examples of internal controls: policy and procedure, exception reporting, documented process monitoring, and management information systems (data field access and logic controls).

Audit Objectives & Audit Scope

The Accounts Payable process was selected for the Internal Audit Department's Annual Audit Plan. As part of the City's Annual Risk Assessment Process, the former Finance Department Director expressed concerns with duplicate payments to vendors. Following the departure of the Finance Department Director, the audit objectives were determined based on discussions with the Department's Assistant Director. The Internal Audit Department developed an audit program designed to meet the following objectives:

Audit Objectives

Audit Objective 1: To determine Accounts Payable (A/P) Process compliance to the following:

a) Finance Department Policy and Procedures
b) Laws, statutes, etc. for processing payments
c) A/P "industry" best practices

Audit Objective 2: To evaluate current internal controls, and overall efficiency and effectiveness, associated with the various stages of the A/P Process, namely: receipt and review of invoices, processing invoices for payment, and authorization of payment. The Internal Audit Department will test for historical occurrences of:

a) Duplicate invoices/payments
b) Correctness/accuracy of payments
c) Timeliness of payments

The **scope** is the boundary of the audit, directly tied to the audit objectives. The scope defines the: a) subject matter that the internal auditor will evaluate, assess and report on, b) period of time reviewed, and c) areas or locations that will be included.

The **scope** of this audit includes an examination of the internal controls employed by the Finance Department in the Accounts Payable Process. Included in the scope are business processes and systems related to **vendor payments** and the **vendor maintenance** process. The audit covered the period from **October 1, 2015 through March 31, 2018**. The audit period was determined in order to provide the amount of transactional data to provide adequate assurance that each audit objective would be achieved.

Methodology

This audit was conducted in accordance with generally accepted government auditing standards. Those standards require that the Internal Audit Department (IAD) plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on the audit objectives. The IAD believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on the audit objectives.

The methodology developed for this audit included an assessment of Internal controls placed by management to provide: a) effective and efficient accounts payable operations, b) reliable financial and performance reporting, and c) compliance with applicable laws and regulations. The IAD seeks to provide reasonable assurance that internal controls are operating as management intends.

Internal controls include the processes and procedures for organizing, managing, and processing account payables (A/P) - including: receiving and verifying invoices are accurate, authorizing services are performed and products are received, and paying vendors in a timely manner.

During the audit planning stages, the Internal Audit Department (IAD) reviewed documents pertinent to the audit objectives, including: a) the Finance Department Policy and Procedures, b) Finance Department A/P directives memorandum, c) City of Lake Worth Procurement Code, d) Florida Prompt Payment, and e) the external audit financial audit Finance Department's CAFR.

The Internal Audit Department (IAD) utilized staff and management interviews, and observations, to obtain an understanding of the current process. The A/P Process was flowcharted with the following details: a) staff activities, b) staff decisions, and c) current internal controls. Following a review of pertinent resources, the IAD established **criteria** such as the steps put in place by management to safeguard the A/P Process, as well as legal requirements, such as the Florida Prompt Payment Statute, etc.**,** developed testing protocols, and documented an audit program designed to meet the audit objectives.

The IAD conducted a review of electronic and hardcopy A/P records, this included performing extensive data analytics designed to indicate the **condition** of the current A/P internal controls (including the ability of the A/P Process to prevent and/or detect duplicate payments). The resulting gaps between **criteria** ("what is desired") and **condition** ("what actually exists") yielded the **findings** and **recommendations** contained within this report.

The audit's systematic approach enabled the IAD to fully achieve the audit objectives, this included assessing the risk that abuse or illegal acts *could occur* and go undetected, or that unintentional errors could otherwise impede the department's ability to efficiently and effectively process account payables.

As defined by Government Auditing Standards, the City of Lake Worth Internal Audit Department (IAD) is free from organizational impairments to independence. We report directly and are accountable to the City Commission. Organizationally, the IAD is outside the staff or line management function of the units that we audit. We report the results of our audits to the City Commission, City Manager, and the Auditee. Audit Reports are available to the public.

Summary Findings

The IAD strives to assure management that internal controls are in place and functioning as Department management intends, or conversely, to identify where internal controls are not working as management has intended. The audit of the accounts payable area of the Finance Department identified the following areas for improved internal control:

1. The audit identified 10 duplicate payments for the audit period. “Double payments” were made to ten different vendors, payments were authorized by five different departments. resulting in **overpayments of $32,641.57**. Seven of the ten payments had not been detected or recovered.

2. The audit uncovered 5 payments totaling over $60,737.39 to a vendor without the contractually required support documentation. Additionally, instances were observed where the vendor’s support documentation *differed from* the amount invoiced, for example: several instances were observed where the invoiced hours worked were **40 hours** *more than was listed on supporting timesheets* - the invoice was approved and paid.

3. The audit uncovered deficiencies in the Vendor Database including: a) undocumented/ unmonitored updates to vendor records - including deleted vendor records, b) the same vendor operating under multiple City Vendor Numbers, and c) Active City vendors without required documentation, such as a Federal Identification Number.

4. The audit identified instances where staff performed duties incompatible with their primary job responsibilities, and in conflict with the department’s stated segregation-of-duties (SoD) controls.

Summary Recommendations

The IAD makes the following recommendations in the spirit of assisting the Finance Department improve internal controls, increase staff efficiency, and advance process effectiveness.

1. To address the internal control deficiencies contributing to the occurrence of duplicate payments, the Finance Department should ensure that **preventive** and **detective controls** are in place, monitored, and reported. This recommendation includes the following:
    a. The Finance Department should work with user departments, and vendors, to document the cause of the duplicate payments. Communicating causes to all concerned/ contributing parties.
    b. The Finance Department should develop and implement consistent Policy and Procedure to address the causes of the duplicate payments identified. For each of the three components of the “Rule of 3-Way Match” (Purchase Order, Receiving, and Invoice), identify roles, responsibilities, and control templates for user agencies and vendors alike.

    c. The Finance Department should work cooperatively with the IT Department to explore additional Naviline application controls and/or exception reporting that could detect possible duplicate payments for analysis.

2. The Finance Department should ensure that user departments reconcile and document the accuracy of a vendor's hourly labor invoices.

   The Finance Department should work with user departments to develop and implement consistent Policy and Procedure for the verification of labor hour invoices – document the staff roles and responsibilities *required* to review and reconcile timesheets to invoices for hourly labor.

3. The Finance Department should develop policy that specifically addresses the perceived deficiencies of vendors being assigned multiple City Vendor Numbers - identifying accepted practice for City vendors and the department staff assigned to monitor the Vendor Master.
    a. The Finance Department should "clean up" the existing vendor master database according to developed policy, to address the current observed conditions: vendors with the same Tax Identification Number (TIN), same address, no TIN, etc.
    b. Vendor identification information (TIN, address, etc.) should be verified at SunBiz prior to adding vendors to the Vendor Master database.

4. The Finance Department, working cooperatively with the IT Department, should develop policy and procedures for the Vendor master database - specifically establishing access controls, authorization levels, and access/change management reporting.

Summary Observations

During an audit, the IAD notes observations to bring to department management's attention. The observations summarized below do not specifically fit into an identified Finding; however, the issues observed do have an associated risk that Department management should consider mitigating. In some cases, the risk is associated with the efficiency of staff, while others could deal with a financial liability.

1. The audit identified what appears to be a high occurrence of voided payments, the majority of which were occurrences of "$0" checks (570) and "void and reissue" checks (200). Due to the time associated with check voiding activities, if the occurrence of check voids can be decreased, staff efficiency should increase.
2. The audit found that the Accounts Payable Process complies with the state's Prompt Payment Statute 88-92% of the time.[2]

Additional detail supporting the observations can be found in the Appendix of this report.

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[2] Exact compliance was not measurable due to the data recorded in the Accounts Payable Process.

Findings and Recommendations

The Internal Audit Department (IAD) performs audit work as an independent, outside observer for the purpose of providing assurance that internal controls are in place and functioning as intended to mitigate risk. Management's internal controls should promote honest, efficient, effective, and accountable operations. The following findings and recommendations have been developed in an impartial manner, based on sufficient and appropriate evidence, free from personal or organizational impairment. A response to each recommendation was provided by the management of the Finance Department. Selected text from the response is provided following each recommendation. The full Finance Department response is included in the Appendix of this report.

The Internal Audit Department (IAD) evaluated each audited area by first establishing evaluation *criteria* (listed for each Finding Statement). Then through interviews, observations, data analysis, and various testing methods, the IAD documented the current *condition* of the Finance Department's Accounts Payable Process. The audit resulted in the findings and recommendations presented within this section of the report. A **Finding** statement is followed by: a) the **Criteria** used to evaluate the area, b) the **Condition** found to exist during the audit, c) Cause & Effect, d) **Recommendations** aimed to address the Finding**,** and, d) the Finance Department's **Management Response**.

1. Finding: Ten instances of duplicate payments to vendors, including 7 previously undetected "double payments" were identified.

The audit found 10 duplicate payments to ten different vendors, resulting in overpayments of $32,641.57 of which seven payments totaling $13,694.55 had not been detected and recovered. At the date of audit publication, all duplicate payments had been recovered.

Criteria:

The generally accepted internal control for processing account payables is referred to as the Rule of 3-Way Match. In short, this internal control seeks to prevent the occurrence of a duplicate payment by requiring three *independent* matches of the following records (processing source documents by different people):

Purchase Order	Receipt of Goods or Services	Invoice from Vendor
Authorizes an amount to be spent on goods or services	Receiving documentation authorizes an invoice to be paid, goods or services have been received and approved!	Vendor bills for goods or services provided in accordance with the Purchase Order

To further ensure accuracy in accounts payable processing, the City's accounts payable system (Naviline) is designed with a control that identifies if a vendor invoice number currently being processed has already been paid, for example, if a vendor submits invoice #1234 this week and it is paid, then if the vendor submits the same invoice #1234 in 3 weeks, the system should identify that the invoice number has already been paid.

Condition:

Through data analytics performed on the accounts payable database (Naviline), duplicate payments to vendors were discovered. The duplicate payments were reviewed and verified by the user departments and the Finance Department. The following duplicate payment characteristics were observed:

- Duplicate payments ranged from $18.70 to $18,422.02
- Of the ten duplicate payments discovered, 8 (80%) had associated Purchase Orders, the remaining two originated from Check Requests.
- Duplicate payments were from five City Departments; this indicates that the control deficiencies are not isolated.

Additionally, the IAD observed that the current A/P Process does not follow the written procedure, namely, that the Clerk of the Court is no longer involved in the check printing part of the A/P Process.

Cause:

To facilitate transparency and partnership the Internal Audit Department (IAD) shared preliminary findings with the Finance Department, as well as the user departments involved. Both parties worked diligently to determine the cause of the duplicate payments. The results of this coordinated investigation yielded the following causes:

- Human error in Accounts Payable (for example: data entry error, miss-keying the invoice number)
- Human error in the User Departments (for example: data entry or receiving errors; submitting a check request, then also submitting a PO, for vendor payment)
- Vendor Error
    - Repeatedly submitting the same invoice, often week after week, and then sometimes months apart
    - Submitting different numbered invoices for the same work (against the same PO – a blanket PO)

Effect:

An unnecessary risk exists when the "3-way match" is not fully implemented, documented, *and monitored.* As evidenced by the audit results, current internal controls have not been sufficient to prevent duplicate payments. Relying on vendors to detect duplicate payments is not sufficient.

Recommendation 1

Recommendation 1. To address the internal control deficiencies contributing to the occurrence of duplicate payments, the Finance Department should ensure that preventive and detective controls are in place, documented, and reported.

- The Finance Department should systematically analyze the root cause of the human error contributing to the duplicate payments identified, both in accounts payable activities and in user department activities.
- The Finance Department should implement internal controls to prevent the duplicate payment of vendor invoices, and in the rare case that a duplicate payment is made, internal controls should be put in place to detect the duplicate payment. The City should not rely on "honest" vendors returning duplicate payments as a primary detective control.
- The Finance Department should update Policy & Procedures to reflect the current A/P Process.
- The Finance Department, in concert with the IT Department, should analyze the Naviline system application controls to determine and correct any configuration deficiencies found, and to explore additional functionality that is not currently being used.
- The Finance Department, along with the IT Department, should explore "automation solutions" for the highly manual activities currently performed in the Accounts Payable Process.
    - Explore e-invoicing: receive invoices electronically
    - Explore e-payables: ePayables allows the City to transfer payments onto a reloadable Bank of America card for vendors who choose to take advantage of this option. This option results in a decrease in cost (ink, paper, envelopes, postage) and increased efficiencies for both the City staff (printing time, stuffing envelopes, check pick-up and distribution, voiding, reissuing misplaced checks) and the Vendor.

Potential outcomes of the above recommended course of action might be, additional training at User Departments, implementing "a second set of eyes" strategy, performing periodic data analysis, and the development of a Naviline reporting capabilities.

Management Response:

This issue falls into the high priority category and is being addressed immediately. The department is working diligently to recover the duplicate payments. Internal controls are being evaluated as well as updating the policies and procedures to reflect the current A/P processes and to incorporate detective measures to identify duplicate payments. Finance will be providing additional training to the user departments and providing policy and procedures that will outline the department responsibilities and potential fraud risks. The department is currently working with Central Square and Bank of America to streamline the current EFT process and exploring e-payables.

Estimated date for Implementation: March 29th, 2019

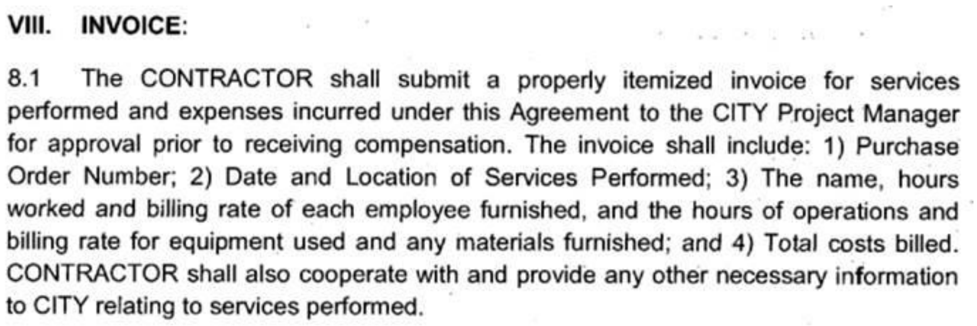
2. Finding: Instances of unsupported and/or inaccurate vendor invoices- resulting in improperly supported payments to a City vendor were observed.

To determine whether the Accounts Payable Process paid for goods and services received and authorized *properly* by user departments, the IAD reviewed invoice and required supporting documentation from a vendor of the Electric Utility Department (EUD).

Criteria:

The City's **Procurement Code (Sec. 2-111-19)** identifies the code's primary purpose as "to encourage greater competition, ensure purchasing integrity and maximize the acquisition value of public funds." Additionally, the Code stipulates that the Procurement Division, "shall have authority to suspend…from participation in procurement…" - presumably when a person or entity works to undermine the stated primary purpose.

The Electric Utility Department's contractor responsibilities (audit criteria) are specified in the following section of their City contract:



VIII. INVOICE:

8.1 The CONTRACTOR shall submit a properly itemized invoice for services performed and expenses incurred under this Agreement to the CITY Project Manager for approval prior to receiving compensation. The invoice shall include: 1) Purchase Order Number; 2) Date and Location of Services Performed; 3) The name, hours worked and billing rate of each employee furnished, and the hours of operations and billing rate for equipment used and any materials furnished; and 4) Total costs billed. CONTRACTOR shall also cooperate with and provide any other necessary information to CITY relating to services performed.

The Electric Utility Department is given the responsibility to monitor the accuracy of the invoice and supporting documentation supplied by the contractor.

Condition:

Based on Finance Department staff interviews, the A/P Manager performs the specific activities below prior to processing a payment:

1. Verifies the User Department has received the invoice in the City's Naviline system
2. Verifies the invoice $ equal Purchase Order $

Instances where an invoice is paid without the required supporting information and monitoring by the user department should be considered an "overpayment." The overpayments, or unsupported payments, identified below relate to work performed by contractors of the Electric Utility Department.

The contract with the Supplier of Electric Utility labor stipulates that timesheets (hours worked per employee) are to be provided along with each invoice. This did not happen, yet the Electric Utility Department (EUD) "received" the invoice into the Naviline system - this action authorized the Accounts Payable Accountant I in the Finance Department to pay the invoice.

The vendor had normally provided timesheets, and in fact, the EUD normally forwarded timesheets to the Accounts Payable Accountant I. In the instances uncovered, the following occurred:

- The Electric Utility Department did not receive timesheets to support the Supplier's Invoice, but went ahead and received the invoice against an Open PO, and
- The Accounts Payable Accountant I processed the payment for the invoice without the customary supporting timesheets (although department procedure/practice requires only the receipt by the user department and that the Invoiced dollar amount matches the Purchase Order dollar amount).

Please note that the majority of invoices processed by the Accounts Payable Accountant I *do not* have supporting documentation other than the invoice, and in fact, Finance Department Policy & Procedures do not address the particular situation identified.

The Internal Audit Department reviewed a judgmental sample of invoices and supporting documentation from the EUD vendor. The following table lists **unsupported** invoices processed through the Accounts Payable Process. Indications, based upon subsequent investigation by the EUD, are that the work invoiced to the EUD did take place; however, at the time the EUD approved the invoices for payment, the required timesheet evidence to support the billings had not been provided.

Table A: Unsupported Invoices

Invoice #	**Week-Ending**	**Check #**	**Check Amount ($)**
911841489	9/9/17	283047	**$ 6,509.32**
911814067	9/16/17	283047	**$17,882.56**
911814184	9/16/17	283047	**$ 2,200.76**
911799710	9/23/17	283047	**$12,942.53**
911813934	9/23/17	283047	**$ 2,601.68**
911814065	9/23/17	283047	**$ 5,636.15**
Total			**$ 47,773.00**

As previously mentioned, the practice of the EUD vendor was, in fact, to supply timesheet documentation in support of invoiced work. The IAD's review of a judgmental sample of these timesheets also found **discrepancies** in the labor hours invoiced versus labor hours documented on the provided timesheets. **Table D** illustrates these observations.

Table B: Invoices with Discrepancies in Supporting Timesheets

Invoice # (unsupported)	**Week-Ending**	**Invoiced Hours**	**Timesheet Hours**	**Check #**	**Check Amount ($)**	**Estimated Discrepancy ($)**
911798869	9/30/17	580	530	283414	$15,595.10	$768.50
913068262	9/23/17	three	occurs of	reg30 +	25 OT	$250
911984350	11/24/17	520	480	282829	$13,985.60	$1,000
911798858	9/2/17	550	510	284935	$14,375.80	$1,000
911909793	11/4/17	584	546	283047	$16,780.89	$1,000
Estimated $	overpaid				$60,737.39	$4,000.00

The Internal Audit Department alerted the Electric Utility Department (EUD) to the unsupported invoices issue and to the discrepancies between invoices and the timesheets supporting the invoices. The department immediately made inquiries to the vendor, requesting supporting timesheets, refunds of invoice payments not supported by timesheets, etc. At the time of audit report publication, the EUD had received the supporting timesheets for the invoices identified in **Table A**, and had received credits of over $700 for incorrect invoices that the City had paid. At the time of report publication, the EUD had inquired without resolution into: a) improper overtime charges, and b) overcharges based discrepancies between hours billed, but not supported – the EUD's investigation is ongoing.

To the department's credit, the EUD took swift action to address the perceived shortcomings of the contracted Supplier, hiring a part time field employee to monitor the accuracy of the invoices/ timesheets submitted by the Supplier in question.

Cause:

The "receipt and approval" of invoices with deficient supporting documentation is attributed to human error, but circumstances also seem to have played a role. The deficiencies coincided with the occurrence of a major hurricane in the area. The vendor supported the City's efforts pre and post storm. In this busy time, it appears the controls that were present at other times of the year, were simply not followed during this period.

Unfortunately, fraudulent players are often attracted to times of emergency and emergency response. In these times, internal controls should be most stringently followed, or mitigating controls must be put in place, such as follow-up monitoring of invoices processed during the time period in question.

Effect:

When contractually required documentation supporting invoiced labor is allowed to go unfurnished, and when provided supporting documentation is not reconciled with what is invoiced, the risk for over-payment significantly increases.

When specific procedural guidance, reviewing with staff their responsibilities, and then monitoring performance to those expectations, is not in place, the likelihood that errors or fraud can occur and not be detected significantly increases.

Recommendation 2

Recommendation 2. The Finance Department should ensure that user departments reconcile and document the accuracy of a vendor's hourly labor invoices.

For example, the following could be developed by the Finance Department:

- Guide the Electric Utility Department to develop specific policy and procedure, including staff roles and responsibilities, for verification of labor hour invoices (to include: documentation of the review and reconciliation of timesheets produced to support hourly work).
- Required documentation from user departments, provided to the A/P Manager, verifying that timesheets and invoices have been reconciled. This should be received by A/P prior to

vendor payment processing. Periodically A/P could validate the reconciliations have taken place.

Management Response:

The Electric Utility department responded immediately to this deficiency by hiring a part time field employee to monitor the accuracy of the invoices/timesheets submitted by the supplier in question. In recognition that this occurred during an emergency, the Finance department is working with the Electric utility to establish written policies and procedures that fully documents current procedures and will be updating the finance departments policies and procedures to include periodic validation of reconciliations. We will be updating the policy and procedures to include monitoring the accuracy of invoices processed during an emergency situation.

Estimated date for Implementation: March 29th, 2019

3. Finding: The Vendor Master Database includes vendor records that increase the risk for fraudulent behavior.

3a. The audit identified instances where a *singular* vendor (same Tax Identification Number) has *two or more* City vendor numbers.

3b. The audit found vendors with *different* Federal Tax Identification Numbers (TIN) but operating out of the *same* address.

3c. The audit found vendors deleted from the Vendor Master database without documented reason or authorization.

There is a perceived, if not real, risk that a single vendor with multiple City vendor numbers could either: a) gain a competitive advantage over other City vendors, or b) work with a department to circumvent City Procurement Code purchasing thresholds by splitting the cost of the purchase among two or more seemingly different vendors (numbers).

Criteria:

The City's Procurement Code (Sec. 2-111-19) identifies the code's primary purpose as "to encourage greater competition, ensure purchasing integrity and maximize the acquisition value of public funds." Additionally, the Code stipulates that the Procurement Division, "shall have authority to suspend…from participation in procurement…" presumably when a person or entity works to undermine the primary purpose.

The Vendor Clerk responsible for vendor file maintenance stated that all vendors are required to provide the following information:

- Vendor Name
- Address
- Remit to Address
- Fed Tax ID Number (TIN) or in cases of individuals, their social security number

The Vendor Clerk then inputs the information into the Vendor Master database (Naviline).

After the initial vendor record has been created in the Vendor Master database, if changes are required, the Vendor Clerk requires the vendor to submit a formal "Request to Update." The Vendor Clerk receives the request, performs the database update, and then files the request.

The Vendor Clerk stated that when vendors are added to the Vendor Master database, the system assigns the vendor the next sequential Vendor Number. This process was observed by the IAD. The Vendor Clerk indicated that she had never deleted a vendor from the database (for the past ~12 months). The Assistant Department Director could not remember an occurrence where a vendor record was deleted.

The IAD reviewed the following Finance Department-supplied policy and procedures to establish current expectations and existing criteria:

- Procedure: How to Enter a New Vendor into Naviline
- Procedure: Vendor W-9 Form Procedures
- Vendor Registration Form
- Finance Department Director Directive to City of Lake Worth Vendors regarding Vendor Registration Requirements (dated October 11, 2011)

The Department Directive referenced above, contained the following:

"Federal law requires us to obtain a vendor's TIN, for a business entity, or the social security number, of an individual or sole proprietor, prior to releasing vendor payments. This information is collected from vendors through form W-9, *Request for Taxpayer Identification Number and Certification*. W-9 must contain the business name, as it appears on tax return, address, Employer Identification Number (EIN) and type of entity.

NOTE: If we do not have a current w-9 form on file by November 15, 2011, according to IRS guidelines, the City can and will withhold 28% of payments due to the vendor until the W-9 information is received. This withholding is sent to the IRS; therefore, it will be your responsibility to retrieve the withheld amounts from the IRS. Also, if the provided information cannot be certified accurate, the IRS may impose a penalty."

Condition:

The Vendor Clerk reviews the Vendor Registration packet, and then if the packet is complete, the manager inputs the new vendor records into the Vendor Master database. The Vendor Clerk noted that she was unaware of any recent assessment or evaluation of the Vendor Master database. Likewise, due primarily to staffing constraints, the Vendor Clerk indicated that information contained on Vendor Registration forms is not verified by the department, for example: the vendor's Tax Identification Number and address are not validated by confirming their accuracy on the State's SunBiz website.

The IAD performed Data Analytics on over 4,400 vendors in the Vendor Master database resulting in the following observations:

- **13 Pairs of Vendors** have the ***same*** **Federal Tax ID #,** yet they have **unique City Vendor Numbers** - this calls into question whether these are actually unique vendor entities.

- **48 Sets of Vendors** have the ***same*** **address,** yet they have **unique City Vendor Numbers** - this calls into question whether these vendors are actually unique vendor entities.

- The audit identified **65 vendors** residing in the vendor database **without the required Federal Tax ID Number** (or acceptable substitute, such as social security number).

The IAD performed data analytics testing on Vendor Master databased, focused on the Naviline Vendor Master field: **Vendor Number**. The IAD anticipated a long string of sequential vendor numbers since the Naviline system assigns vendor numbers sequentially, and there were no indications that vendors were deleted from the database. The following results were returned:

- **117 vendors have been deleted** from the Vendor Master Database, 26 vendors had been deleted during the audit period (since Oct 2015)
- Vendors have been deleted **without documented reasoning or authorization**
- Neither the Finance nor the IT Department **maintains a Change Log** for the Vendor Master database; neither could provide a list of the vendors that have been deleted
- Deleted vendor records cannot be recovered (the name of the vendor deleted, what staff performed the deletion, etc.)

Cause:

The Finance Department has not developed specific, written Policy & Procedures pertaining to the appropriateness of the circumstances described above. Likewise, the department has not routinely performed vendor database maintenance.

Effect:

When the Vendor Master Database (dB) can be accessed and changed by multiple staff without changes being authorized, documented, and monitored, then fraudulent use of the dB can be perpetrated and covered up, for example changing the “pay to address” of a vendor to a fraudulent one, then changing the address back following the fraud.

An “unauthorized” vendor could be created, could be used for fraudulent purposes (to process a payment for services *not* performed), then the record deleted as a means to cover up the fraud. The IAD identified the following possible impacts associated with the data analytics results:

Risk: If a vendor is listed multiple times in the Vendor Master dB – with multiple, unique vendor #s - (especially for the same service), then they would be “approved and authorized” to submit multiple quotes, bids, for the same work. Interview responses suggest that the department does not monitor for this occurrence, and the department-supplied Policy and Procedures do not address this issue; therefore, vendors could conceivably receive a competitive advantage over other vendors, they would know what the “other “competitive quotes would be, because the singular vendor, operating under three City vendor numbers submitted them!

Risk: If a vendor is listed multiple times, a department could be in a position to fraudulently steer work towards a particular vendor - all three quotes could come from the same entity operating one business under three different (fraudulent) business names, circumventing the City's Procurement Code intent to have 3 different, independent quotes.

Risk: If a vendor has multiple vendor numbers, a department could circumvent procurement thresholds by steering work, in increments under procurement thresholds to one company operating under two or three different vendor numbers, circumventing the need to advertise for the sum of the incremental work, essentially "splitting" a single job amongst two or three vendors who are actually the same company, all while skirting the competitive bid process.

The IAD reviewed a judgmental sample of the "duplicate vendor records" identified above and found no indications of fraudulent behavior, such as attempts at "rigging" the quote or bidding process.

The IAD sampled the identified vendor purchasing records and did not find any evidence of improprieties; however, with the 61 situations identified above, there is elevated risk that the City's Procurement Code could be circumvented and not easily discovered. Examples of the risk associated with a vendor performing work for the City under two or three unique vendor numbers includes:

- The entity could fraudulently bid on, or supply quotes as, multiple unique vendors
- The vendor entity can circumvent purchasing thresholds, by performing work as "Vendor A" up to the purchasing threshold, then perform work as "Vendor Z" up to the threshold a second time, etc.

Additionally, the IAD compared employee address records with the "pay to" addresses of City vendors to identify possible fraud. No address matches were uncovered; no employee fraud was indicated.

Recommendation 3

Recommendation 3. The Finance Department should develop policy that specifically address the circumstances noted above, identifying accepted practice for City vendors, and for the department staff assigned to monitor the Vendor Master.

The Finance Department should "clean up" the existing vendor master database according to developed policy, to address the observed current condition.

Vendor identification information (TIN, address, etc.) should be verified at SunBiz prior to adding vendors to the Vendor Master database.

The Vendor Master database should be periodically monitored for the issues identified in this Finding. The results of the monitoring should be documented. The following steps should be undertaken by the Finance Department. Develop specific policy and procedure for periodic review of the Vendor database, reviewing for duplicate vendors by Federal ID number and by vendor address.

Management Response:

The crux of this issue is the combination of lack of staff, lack of staff with the proper training and lack of well-designed written procedures. We have hired additional staff with responsibilities of updating policy and procedures which would include the periodic review of the vendor data base. We will be working with Central square to determine if there are any additional internal controls in the software that we should be utilizing as well as working with the IT department to develop reports that can detect the issues identified above. The staffing access to the vendor data base has been updated to ensure that there are no-conflicts of interest and the ability to remove a vendor has already been disabled in the system.

Estimated date for Implementation: March 29th, 2019

4. Finding: Segregation-of-Duties (SoD) conflicts were observed - staff other than the person identified as the Vendor Clerk,[3] made changes/updates to the Vendor Master database.

Criteria:

According to the current Vendor Clerk, access to the Vendor Master dB (and the ability to change or delete vendor information) is restricted to job appropriate users, for example: accounts payable and purchasing staff have no access to the Vendor Master, because of their interaction/relationships with vendors. The access rights described by the Vendor Clerk follow appropriate Segregation-of-Duties principles (SoD); however, this is not specifically addressed in the policy or procedure that was provided by the Finance Department.

Although not specifically addressed in written Policy & Procedure, the Vendor Clerk indicated that responsibility for: a) adding new vendors, b) making requested changes or updates to the Vendor Master, and c) filing Vendor Registration Forms, and vendor change requests is the primary responsibility of the Vendor Clerk. There was indication that the Assistant Finance Department Manager also had access privileges to the vendor master, and in the absence of the Vendor Clerk, might occasionally update or add vendor files.

Segregation-of-Duties (SoD): SoD is an internal control intended to prevent or decrease both the occurrence of innocent errors and intentional fraud. This is done by ensuring that no single individual performs any two of the following duties: transaction authorization (“ok” a Purchase Order, authorize payment for the order), receive custody of an asset (receive the order into inventory), transaction record keeping (the ability to alter purchasing or vendor records), and transaction reconciliation (ensuring the amount ordered matches the amount received). In other words, no one person has control of two or more of these responsibilities.

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[3] The term Vendor Clerk is used to for the staff person designated by the Finance Department as having the principle task of maintain the Vendor Master database.

The risk associated with Segregation-of-Duties conflicts is increased when mitigating controls are not in place. Examples of mitigating controls include: a system that records a historical change record (or "audit trail"), that is a "field change record" that can be accessed to provide a history of "who changed what."

Condition:

The IAD requested a list of Finance Department staff authorized to make changes to the Vendor Master database during the audit period, Oct. 1, 2015 to March 31, 2018. The Vendor Clerk provided a **list of staff authorized to access** the **Vendor Master database** to make changes/update the vendor information. A list of staff names, title, and dates of authorized access were provided.

Finance Department List

Table C: Vendor Master Database - Authorized Access Table

Staff Name	Job Title	Dates of Authorized Access	Potential SoD Conflict
Lynn Sexton	Executive Assistant	2015 - 2017	
Hurit Darge	Purchasing Agent	2015 - 2017	X
Sharee Dyer	Budget Analyst/Fiscal Manager	2017	
Melicia Wilson	Executive Assistant	2017	
Corinne Elliott	Assistant Director	2017 – Current	
Cherokee Merlo	Executive Assistant	2017 – Current	
Jerry Kelly	Grants Analyst	2018 – Current	X

Source: Finance Department Vendor Clerk (email from 09/05/2018)

Potential SoD Conflicts include:

- Purchasing Agent having access to make changes/updates to the Vendor database
- Grants Analyst having access to make changes/updates to the Vendor database

IT Department System Access List

On 08/21/2018 the IT Department provided *current* access rights (the ability to make changes) to the Vendor Master database. The access rights are found in the table below:

Table D: Vendor Master Database- Authorized Access Table

Staff Name	Job Title	User Group	Potential SoD Conflict
Jerry Kelly	Grants Analyst	GM Vendor Maintenance	X
Cherokee Merlo	Executive Assistant	GM Vendor Maintenance	
Melicia Wilson	Purchasing Department	GM Vendor Maintenance	X
Rebecca Reed	Purchasing Department	GM Vendor Maintenance	X
Corinne Elliott	Assistant Director	GM Full Access Limited File Maintenance	
Sharon Gostnell	Sr. Accountant	GM Full Access Limited File Maintenance	X

Source: IT Assistant Department Director

Potential SoD Conflicts include:

- Purchasing staff having access to make changes/updates to the Vendor database
- Grants Analyst having access to make changes/updates to the Vendor database
- Sr. Accountant having access to make changes/updates to the Vendor database

Using the Department-supplied criteria, as well as, evaluating Vendor Master access based on what staff are assigned the primary responsibility for Vendor Master file maintenance, the IAD concludes that: a) Segregation-of-Duties conflicts exist, and b) the current "access rights" believed by the department to be in place, differs from the *actual* access rights (supplied by the IT Department).

Data Analytics: Segregation-of-Duties Conflicts

Based on the conclusion above, the IAD performed data analytics testing on the Vendor Master database, focused on the Naviline Vendor Master fields: **User ID** and **Last Date Updated**. The IAD sought to document whether staff having incompatible job duties, had actually accessed and updated the Vendor Master database. During the audit period, Purchasing staff USER IDs are listed as performing changes/updates to the Vendor Master database.

An exception or field change report is not currently being used by management to review Vendor Master database changes – not having this capability, coupled with staff in incompatible roles having access, increases the risk of fraudulent use of the Vendor Master.

Although Data Analytics performed on the Vendor Master database **found no indicators of fraud or misuse of the database**, the following observations were made:

- Nine staff, some identified in the tables above as having SoD conflicts, have accessed and made unverifiable changes to the Vendor Master dB over the audit period (30 months).
- In just one 45-day period, between 01/6/2017 and 02/23/2017 four individual Finance Department staff performed updates to the Vendor Master database. This includes three different people in January, and three different people in February.
- There appear to be several "Vendors" listed in the database whereby either: a) the public purpose of the products or services offered could be debatable, or b) the use of the "vendor" could be called into question (see "PCard Miscellaneous #2836" or "Generic Vendor #2255"). Each reinforcing the need of additional evaluation and maintenance of the existing Vendor Master database (reference: 3. Finding).

Cause:

Based on the condition documented above, the Finance Department has not effectively documented, nor monitored, access and changes to the Vendor Master database. Written policy and procedure has not addressed the issues of access, authorization, and change management to the Vendor Master database. This is evidenced by the condition found during the audit period, namely: the authorized access list supplied by the department, *does not match* the list supplied by the IT Department, *does not match* the list identified through data analytics.

Effect:

Although there is no evidence of fraudulent use of the vendor database, vendor record manipulation and collusion are possible areas of significant risk. As such, this Finding warrants focused attention.

Recommendation 4

Recommendation 4. The Finance Department, working cooperatively with the IT Department, should develop policy and procedures for the Vendor Master database - specifically establishing access controls, authorization levels, and access/change management reporting.

Policy and procedures should clearly establish access controls and authorization levels for Finance Department staff (and IT staff with purchasing authority!). Vendor maintenance should be performed by staff outside of those with Accounts Payable and Purchasing responsibilities – only staff with the primary responsibility of vendor maintenance (the Vendor Clerk, etc.) should access the Vendor Master database.

The department should explore developing and implementing the following:

A. Approved levels of access to the Vendor Master database (staff Title X, Y, Z authorized to make update types 1, 2, 3, example types of updates: 1. add new vendors, 2. update existing vendor payment address, 3. change status active/inactive, 4. delete Vendor, etc.).

B. A listing of Staff Name, Job Title, Dates for Approved Access.

C. Method used for department management to communicate access rights to the IT Department (to add access, and then to delete access once someone no longer is authorized to access the database, etc.).

D. Method that department management will use to ensure policy and procedure are being followed, ie. Monitor access and authorization levels.

E. Vendor Change Log clearly identifying: 1. who made the change, 2. what change was made, (“data field X changed from: Y to Z”), 3. what initiated the change, etc.

F. Method to provide a periodic verification of the field changes made, ie. Monitor that only changes specified on the change log were made.

G. The use of the Active / Inactive vendor designations found in the Vendor Master, and the documentation of its use.

H. The use of the Delete Vendor Record capability and the documentation of its use.

Management Response:

The crux of this issue is the combination of lack of staff, lack of staff with the proper training and lack of well-designed written procedures. We have hired additional staff with responsibilities of updating policy and procedures that will specifically address all of the recommendations mentioned. The staffing access to the vendor data base has been updated to ensure that there are no-conflicts of interest and the ability to remove a vendor has already been disabled in the system.

Estimated date for Implementation: March 29th, 2019

Appendix

[*Available upon request*]