



GARLAND

INTERNAL AUDIT

Accounts Payable - Vendor Master File Audit

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Authorization

We have conducted an audit of the Accounts Payable. This audit was conducted under the authority of Article VII, Section 5 of the Garland City Charter and in accordance with the Annual Audit Plan approved by the Garland City Council.

Objective

Determine if adequate controls exist and are operating effectively over the Vendor Master File.

Scope and Methodology

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Our audit scope covered all Permanent, Deactivated and One-Time vendors listed in the Vendor Master File as of October 2012. On October 29, 2012, the Vendor Master File contained the following number of records:

Vendor Type	No. of Records
Deactivated (D)	134,902
Permanent (P)	10,430
One-Time (O)	189
Total No. of Records	145,521

Source: Vendor Master File from Cayenta

To adequately address the audit objective, we:

- Reviewed directives, policies and procedure as well as other regulations.
- Reviewed Accounts Payable Best Practices ⁽¹⁾.
- Examined vendors to ensure appropriateness of 1099 reporting.
- Ensured vendors are submitting a W-9 with their vendor applications and that verification through the Internal Revenue Service (IRS) online verification system was completed appropriately.
- Tested the integrity of computer generated data derived from the Finance system regarding the Vendor Master File as well as ePersonality to ensure accuracy and reliability of the data by reviewing physical documentation and comparing to each database.

- Verified employee access rights to the Vendor Master File to determine if there was a conflict of interest.
- Randomly sampled 50 active (Vendor Type = P) vendors out of recent vendor applications to ensure vendor information data entry was complete and accurate (See Exhibit A).
- Verified appropriate approvals were in place and documentation was on file.
- Performed a gap analysis on a sample of 4,005 vendor numbers generated within the previous five years to determine if there were significant gaps in numbering (See Exhibit A).
- Reviewed employee vendors and tested for conflicts of interest by comparing the following:
 - Employee Name to Contact Name
 - Employee Name to Vendor Name
 - Employee Address to Vendor Address
 - Employee Bank Info to Vendor Bank Info
 - Employee Phone number to Vendor phone number
 - Employee fax number to vendor fax number
 - Employee tax identification number (TIN) to vendor TIN.
- Ensured vendors are deactivated within an appropriate timeframe.
- Reviewed the Vendor Master File to ensure that regular cleanup was performed
- Tested the Finance system's functionality regarding:
 - Vendor deactivations and deletions.
 - Duplicate vendors to ensure the Finance system upgrade was performing effectively.
 - One-Time vendors deactivation once a check is printed.
- Reviewed naming conventions for the letters A, E, I and R to ensure compliance with current policies and procedures and consistent application of vendor names (Ex: Global, Inc. vs. Global Incorporated or Smith, John vs. John Smith).

As part of the Audit Program, we were required to test for Debarred Vendors. However, upon discussions with the Accounts Payable Supervisor and the Director of the Purchasing, we determined that testing for Debarred Vendors was not applicable to the Vendor Master File because the Purchasing Department is currently responsible for checking vendors for debarment.

⁽¹⁾ Schaeffer, Mary S. (2004) Accounts Payable Best Practices.

Overall Conclusion

The Financial System was upgraded in October of 2011 to enhance the current controls regarding the Vendor Master File. We believe that the Finance system controls for the Vendor Master File are sufficient. However, additional controls need to be in place to reduce the risk of human errors and enhance communication between departments.

Our recommended improvements are as follows:

- Ensure One-Time vendors are regularly reviewed and deactivated.
- Add a reconciliation process by management to ensure the risk of fraudulent activity is reduced.
- Ensure that vendors setup correctly and a mechanism is developed to update employee's 1099 status in the Finance system.
- Review for duplicate vendors and ensure deactivation as necessary.
- Update current policies and procedures for Vendor Master File maintenance and clean-up.

Background

The Vendor Master file is an essential element of the Accounts Payable process. As such, it contains vital information about the City's vendors which can be used for fraudulent activity if not properly maintained.

Since the City of Garland's Accounts Payable process is a decentralized process, departments often provide a new vendor with a vendor application and Form W-9 in order to obtain the information required for the Vendor Setup in the Finance system. The vendor or the department then faxes the application and W-9 to the Accounts Payable Department where it is reviewed and verified by the Accounting Supervisor. Once the vendor has been verified through the IRS's online verification system, the vendor information is then entered into the Finance System by an Accounting Technician for immediate use. Vendors notify the Accounts Payable Department of any updates or changes to their profile.

There are three different types of vendors in the Finance System: Permanent, One-Time and Deactivated. Permanent vendors are those vendors used on a repetitive basis while One-Time vendors are used only once. Deactivated vendors are those vendors whose status is changed to "Deleted" due to five years of inactivity.

Some best practices in maintaining the Vendor Master File are as follows ⁽¹⁾:

- Limit Vendor Maintenance to very few individuals.
- Ensure appropriate segregation of duties exist between Vendor Maintenance and A/P Invoice entry.
- Apply consistent naming conventions (Ex: Global, Inc. vs. Global Incorporated or Smith, John vs. John Smith).
- Prevent duplicate vendors.
- Vendor Master Cleanup should be performed on a consistent and regular basis.
- Management should review reports regarding additions/changes/deletions to the Vendor Master file on a regular basis.

The City's Finance system provides some features to prevent fraudulent activity by searching the Vendor Master file for the TIN that is entered in the system. If it recognizes the TIN entered, it notifies the user at which point the user will seek approval to continue with the creation of the vendor. The system also assigns vendor numbers in numerical order outside of the control of the user and a user cannot delete a vendor that has any previous activity.

When issuing refunds, Customer Service and the Courts Departments each compile a file of individuals who should receive a refund to the Accounting Supervisor. The Accounting Supervisor then uploads the file into the Finance System which causes the system to automatically create One-Time vendors. Once a check is cut to these vendors the system then automatically deactivates them preventing future use. These vendors can be manually reactivated if a check is lost in the mail or the check is never cashed. One-Time vendors are also created for payments to claims filed against the City by the Risk Management Department. However, this is a manual process.

⁽¹⁾ Schaeffer, Mary S. (2004) Accounts Payable Best Practices.

Opportunities for Improvement

During our audit we identified certain areas for improvement. Our audit was not designed or intended to be a detailed study of every relevant system, procedure, and transaction. Accordingly, the Opportunities for Improvement section presented in this report may not be all-inclusive of areas where improvement might be needed.

Finding # 1

Condition (The way it is)

One-Time vendors are created for refunds and other purposes through entry into the Finance system. The Finance system is programmed to automatically deactivate these vendors once a check has been printed.

Our review of the deactivation status of processed One-Time Vendors revealed the following:

- A. 106 unauthorized One-Time vendors were created and found to be active in the system as a result of IT's testing in the production environment of the Finance system versus the testing environment.
- B. Another One-Time vendor number created as a result of a claim was found to be active in the System after a check that was issued was voided.

Criteria (The way it should be)

- A. Unauthorized One-Time vendors should not be created and left active in the production environment.
- B. One-Time vendors should be deactivated once a check is printed.

Effect (So what?)

- A. Testing in the production environment rather than the testing environment results in an increased chance for errors. In this case, 106 unauthorized One-Time Vendors were created and remained active in the system.
- B. Active unauthorized One-Time Vendors in the Vendor Master File is an opportunity for fraudulent payment activity.

Cause (Difference between condition & criteria)

- A. The IT Department was testing the new interface upload system with Banner in the Finance system's production environment rather than the testing environment. The same batch was uploaded on July 27 and August 7, 2012 resulting in 53 One-Time vendors on each day. While both batches were immediately canceled, the system was unable to complete the deactivation process because a check was not printed for each of the vendors leaving them active in the Finance system.

B. A check was initially issued under the wrong name. Once discovered, the department issued a new vendor number and a new check under the correct name. The Finance Department had to reactivate the original vendor number to void the check and did not deactivate it after the process was complete.

Recommendation

Management should ensure:

- A. The 106 unauthorized One-Time Vendors are immediately deactivated in the system.
- B. Review and monitor One-Time Vendors monthly to ensure that vendors are deactivated.

Management Response

Concur

Action Plan

The 106 one-time vendors that were created by IT testing on 07/27/12 and 08/07/12 have been deactivated in the Cayenta system as of 11/12/12. The A/P Supervisor will run a monthly query on new one-time vendors that are created. The one-time vendor list will be reviewed to ensure that one-time vendors are correctly deactivated.

Implementation Date

December 15, 2012

Finding # 2

Condition (The way it is)

Certain employees are allocated specific access rights to perform different functions within the Finance System. In the area of Vendor Maintenance, we found that one employee had access to Vendor File Maintenance (vendor setup) as well as Approval of Invoices in the Finance System. In our review, we determined that there was no reconciliation between vendor setup and invoices approved by this particular individual to alleviate possible fraudulent activity.

Criteria (The way it should be)

Vendor Master File maintenance should be segregated from Invoice Entry and Approval.

Effect (So what?)

Allowing an individual to maintain the Vendor Master File as well as approve invoices in the system without mitigating controls could increase the risk of fraudulent activity.

Cause (Difference between condition & criteria)

Management did not consider mitigating controls to sufficiently compensate for the possibility of fraudulent activity.

Recommendation

To reduce the risk of fraudulent activity, Management should reconcile vendors setup by the individual with invoices approved to verify legitimacy.

Management Response

Concur

Action Plan

Invoices will not be approved for payment by the same individual that set-up the vendor. This will be verified by the A/P supervisor with each approved batch.

Implementation Date

Immediately

Finding # 3

Condition (The way it is)

The City is required to report taxable income to vendors in amounts that exceed \$600 to the IRS. When vendors are setup in the Finance System, Accounts Payable indicates whether or not each entity should receive a 1099 based upon the vendor's organizational structure.

During our review, we found the following issues:

- A. One tax exempt organization was scheduled to receive a 1099 for the 2012 tax year.
- B. 14 active city employees were setup to receive a 1099 for the tax year 2012. Further inquiry of these employees revealed:
 - 1. Eight were previously contract employees.
 - 2. One of the previous eight received expense reimbursements totaling \$1,104.99 in tax year 2012 and would have received a 1099.
 - 3. The remaining six were setup incorrectly.

Finance immediately corrected these errors upon notification.

Criteria (The way it should be)

- A. Tax exempt organizations should not be setup to receive a 1099.
- B. Once an individual's employment status changes from contract to permanent, their 1099 status should be evaluated and updated at the beginning of the next tax year.

Effect (So what?)

- A. The City would have incorrectly reported invoice payments to a tax exempt organization.
- B. The City would have reported employee expense payments as taxable income to the IRS.

Cause (Difference between condition & criteria)

- A. Vendor was incorrectly setup in the Finance system.
- B. Notification is not provided to the Finance Department when a contract employee is hired as permanent.

Recommendation

Management should ensure:

- A. Vendors are setup correctly according to the organizational structure.

B. A mechanism is developed to notify Finance when contract employees are hired to a permanent position with the City.

C. Employee 1099 status should be evaluated and updated at the beginning of the next tax year.

Management Response

Concur

Action Plan

Caution will be taken to properly evaluate the 1099 status for every vendor application at the time of set-up by referencing the applicant's W-9 form.

Human Resources has committed to providing a list of contract employees that have transitioned to full time before year-end 1099s are issued.

The 1099 status of each IRS reportable vendor is reviewed every December prior to transmission to the IRS.

Implementation Date

Immediately

Finding # 4

Condition (The way it is)

The Vendor Master File has a combination of Active, Deactivated and One-Time vendors. Vendors may be listed more than once if the addresses differ. Due to an upgrade of the Finance System in October 2011, the system searches for the TIN and returns an error message if it finds a match during the vendor setup process. The user can continue with the vendor setup if authorized by the Accounting Supervisor.

In our review of active vendors in the Vendor Master File, we found 83 active duplicated vendors with the same address created prior to the October 2011 system upgrade.

Criteria (The way it should be)

Vendors should not be duplicated in the Vendor Master File.

Effect (So what?)

Duplicate vendors could lead to fraudulent payments and/or duplicate invoice payments.

Cause (Difference between condition & criteria)

Prior to the October 2011 system upgrade, there was no process in place to flag the creation of duplicate vendors during the setup process.

Recommendation

Management should ensure:

- Duplicated vendors are deactivated.
- Monitor the Vendor Master File for duplicated vendors on an annual basis.

Management Response

Concur

Action Plan

The duplicated vendors are currently being researched and deleted as required. Going forward, Finance will run a query at year-end to identify and remove duplicated vendor numbers.

Implementation Date

Immediately

Finding # 5

Condition (The way it is)

Internal audit obtained and reviewed the Finance Department's Policies and Procedures for Vendor Master File Maintenance. We found that many aspects of Vendor File Maintenance was addressed (such as 1099s, Deactivation of Vendors, Naming Conventions and One-time Vendors). However, we noted that Approval of new vendors, verification of vendors through the IRS website, Vendor Master File Clean-up and Segregation of Duties were not appropriately addressed in these Policies and Procedures.

Criteria (The way it should be)

Best practices dictate that Policies and Procedures covering every aspect of the vendor file maintenance should be in place. These Policies and Procedures should address the following:

1. Approval of vendors for setup.
2. Verification of Vendor through the IRS website.
3. Restrict access to the master vendor file so that only one person plus a backup can set up or change vendor records.
4. Obtain a W-9 or equivalent from prior to vendor set-up and payment.
5. Validate the TIN and vendor name using the free IRS TIN Matching system.
6. Check vendor against the Federal Bureau of Industry and Security's lists of excluded persons and companies.
7. Establish and enforce a policy for data entry formats.
8. Purge Vendors with no activity on a regular basis (Deactivation is recommended after 12 to 60 months of inactivity.)

Effect (So what?)

Inability to establish clearly defined policies and procedures could lead to departmental confusion, inconsistent application and unnecessary errors. Defining appropriate review and approvals prevents fraudulent vendor activity.

Cause (Difference between condition & criteria)

Approval of new vendors, verification of vendors through the IRS website, Master File Clean-up and Segregation of Duties were not appropriately addressed in the current Policies and Procedures.

Recommendation

Management should:

- Revise the current Policies and Procedures to include Approval of new vendors, verification of vendors through the IRS website, Vendor Master File Clean-up and Segregation of Duties. The policies and procedures will guide employee's decisions involving the Vendor Maintenance File, ensure consistent application and relieve unnecessary confusion or errors.

- Periodically review and update the policy when new processes are added or changed.

Management Response

Concur

Action Plan

The Finance department's New Vendor Set-up Standard Operating Procedures will be updated to include:

- Approval of Vendors for set-up,
- Restricting access to vendor master maintenance
- Verification of vendors through the IRS website,
- Vendor Master review for obsolete vendors that are inactive for 5 years,
- Deactivation of terminated City Council members,
- Deactivation of contract employees,
- The review for duplicate vendors,
- Segregation of Duties.
- Deactivation of one-time vendors
- Regulate data entry formats

Implementation Date

February 15, 2013

Exhibit A

Sampling Methodology

Complete and Accurate Vendor Information

We randomly selected 50 applications to review against the vendor master file. Because the Vendor Master File is so large, we developed a test population of active vendors from which to draw our sample. Our total test population consisted of 2,000 active vendors because these were created within the past two years and applications were found in the Finance Department. This sample was split in half using two different methodologies: (1) 25 computer generated vendors randomly selected using ActiveData's Sampling function and (2) 25 vendor applications randomly selecting from each file folder located in Finance's Vendor files. We used a random methodology for simplicity and objective sampling. We reviewed physical documentation in each test and found only one missing application. The missing application represented 2% of the 50 applications reviewed.

On October 29, 2012, there were 10,430 active vendors listed in the Vendor Master File. These results would represent approximately 208 out of 10,430 active vendors. We do not believe this to be significant since the one missing application was related to an insurance claim file and was a repetitively used vendor.

Gap Analysis

In addition, we performed a gap analysis which required a sampling methodology as well. Because the Vendor Master File is so large, we developed another test population from which to draw our sample. We chose to select 4,126 vendor numbers from vendors with numbers starting with 33000 to the last vendor number listed during the test which was 37126. We selected this range because we believed that it represented vendors created within the previous five years during the time of the test. Because the Finance system's assigns vendor numbers sequentially, we incorporated all deactivated and active vendors to ensure sequential data was present.

Out of 4,126 vendor numbers tested, we found 122 gaps. We believe that the percentage of gaps represents approximately 3% of the total population in the vendor master file which would equate to approximately 4,366 gaps out of 145,521 records. The Finance system allows users to delete vendors with no activity which results in a gap between sequentially assigned numbers. Because of this, we do not believe the gaps detected are a significant issue with the Vendor Master File.

Source: Vendor Master File in Cayenta.