



November 25, 2008

Brian Haines, County Manager
Don Bullard, Purchasing Manager
Nasreen Nelson, Controller

Audit Report on Purchasing, Accounts Payable and Payroll

The Internal Audit Department (IAD) performed an audit of Purchasing, Accounts Payable and Payroll departments to determine if controls associated with purchase order processing, vendor selection, approval hierarchy, system access, vendor payments and segregation of duties were operating and effective. Policies and procedures were reviewed to determine the adequacy of internal controls and to ensure that processes are documented and effective.

The audit covered the fourth quarter of fiscal year 2008 and the first quarter of fiscal year 2009.

The areas impacted by this audit were Purchasing, Finance, IT, and Accounts Payable.

The detailed audit report is included on the following pages. There were a total of 54 tests performed of which 15 were operational and 39 were financial tests. There were 11 findings as detailed in this report. There were five additional operational observations.

IAD appreciated the cooperation and assistance provided by each department's management and staff during the course of the audit.

M. A. Duran

Milton A. Duran
Director of Internal Audit

cc:
Internal Audit Committee
Board of County Commissioners
Debbie Gray-Kriegel Gray and Co.

Audit Report on Purchasing and Accounts Payable

Objectives and Scope

The objectives of the audit were to determine if internal controls are adequate to ensure that:

- policies and procedures for cash outflows are documented accurately and are operating,
- purchase order processing is effective,
- vendor evaluation and selection is comprehensive and objective,
- the approval hierarchy is reviewed and accurately maintained,
- accounts payable processing of vendor invoices are effective and efficient,
- expenditure process for approved invoices and payroll is appropriate and effective,
- system access is appropriate for personnel in all related areas,
- segregation of duties is appropriate and effective for related areas.

The audit covered the fourth quarter of fiscal year 2008 and the first quarter of fiscal year 2009.

The auditor who performed the audit was Milton Duran from the internal audit department.

Prior Audit Issues and Follow Up

There were no audit reports issued in Purchasing and/or Accounts Payable areas in the prior year by the Internal Audit Department. There were no Financial Type I internal control deficiencies relating to Purchasing and/ or Accounts Payable reported by Kriegel, Gray and Co's, independent public accountants for the fiscal year 2007.

Findings Classifications and Grading Levels of Operational Comments

Internal audit has published a definition of financial findings and operational comment grades in a separate communication. The two scales are summarized as follows:

Internal Audit defines *INTERNAL CONTROL findings* according to the Government Auditing Standards definition of deficiencies.

- Type I - an internal control deficiency
- Type II - a significant deficiency
- Type III - a material weakness

Internal Audit defines *operational comments* according to the following scale

- I. Strong – operations are adequate and efficient
- II. Satisfactory – there are a few issues management needs to address
- III. Unsatisfactory – there are many issues management needs to address
- IV. Not Acceptable – there are many issues management needs to address in a high priority manner.

FINDINGS

FINDINGS #1 THROUGH #4 ARE TYPE II FINDINGS

Finding #1-Review and approval of system queues by department heads is needed for Purchasing, Finance and Payroll. Changes are periodically reviewed for varying levels of authority aligned to reflect current departmental staff requirements.

*#1 Recommendation:-*Several system changes to levels of system access authority were identified for adjustment. Changes were documented and accepted for immediate implementation. Defined access rights review is a key control.

#1 Management response by Don Bullard, Purchasing Manager. The system referred to in this finding is the Purchasing Shared Drive (G:). Although I do not believe this to be a major finding, I will review this system annually for necessary changes. An IT work order was entered for their review of security settings on the file server.

Finding #2-Banner access listing was reviewed with Purchasing Manager. We identified several required edits. The Purchasing Manager and Banner administrator to meet and issue work orders for corrections. Changes to varying levels of authority should be aligned to reflect current staffing compliment and employee work requirements.

#2Recommendation: Departmental review and approval of Banner access listing should be maintained and documented.

#2 Management response by Purchasing Department and Finance Department. Banner access listing and approval authorities have been reviewed with Banner administrator and an IT work order to change and update authority has been entered. The approval levels within Banner will be reviewed periodically and adjusted when necessary. The Finance Department will review Banner access rights annually and will make changes if necessary.

Finding #3- The receiving process currently provides that upon receipt of invoices, the A/P department sends a Banner pre-formed receiver to the requesting parties (Requisition originator) to confirm receipt of goods. Requestor confirms receipt by completing the electronic receiving report and returning to AP, and there upon payment is authorized by AP. Affirmation of receipt by the requesting party does not constitute appropriate independent verification. The receiving department does not act as a fully authorized receiving department. The duties assigned to the Receiving department were changed several years ago but currently provides no service to the county departments confirming receipts.

#3 Recommendation: It is recommend the receiving function be established separate from the purchasing and accounting departments. Confirmation of receipt of goods and services should be documented by a party independent from the requesting party. They should confirm goods are received, complete, and to extent possible free of any damages. Process should include distributed copies of purchase orders to requesting department and designated receiving party. This will provide receiving party advanced knowledge about the order and expected receipt of the items. This is a key control for outflow of funds to protect against vendor overpayments.

#3 Management response by Nasreen Nelson, Controller - The Department Directors should delegate the receiving responsibility to one employee of their department independent of the person requesting the goods or services. The establishment of an independent receiving department might be a good idea in theory and is common for manufacturing companies. An independent receiving department could not verify receipt of services. The auditor has not determined if the requesting person and the receiving person for major purchases is the same in all departments of the County. The creation of a receiving function is a major policy change which requires senior management review.

Finding #4-Returns are noted on a Banner internal form and records are reconciled to vendor credits. There is no documented evidence of returns when initiated by departments for credit memos to ensure vendor overpayment has not occurred.

#4 Recommendation: It is recommended a credit/ return notice form be established to report vendor returns through the receiving department. The form should be drafted to provide the returning department approval and acknowledgement of the return receipt by the vendor when processed by the Receiving Department. The credit memo copy should be attached to invoice payments to ensure proper credit has been recorded. Internal documentation of authorized returns is a key control to protect against vendor overpayments.

#4 Management response by Nasreen Nelson, Controller. A/P has no objection of receiving credit memo copies from other departments. The establishment of a major receiving department requires major funding and senior management approval.. A/P receives information for returns via e-mails from other departments and the information is documented in banner.

FINDINGS #5 THROUGH #11 ARE TYPE I FINDINGS

Finding #5-All vendor checks for invoices are sent the Clerks office for signature. They are returned to AP for mailing. Mailing should independent of the AP function.

#5 Recommendation: There is a lack of segregation of duties between processing of accounts payable invoices and check preparation and mailing. Mailing of checks should be performed by other than preparers in AP.

#5 Management response by Nasreen Nelson, Controller. A/P mails all remittance stubs from invoices and registration forms with checks. The checks have to be matched to the invoices that they are paying. The invoices are attached to the carbon copies of checks that remain in A/P. A/P is aware of which vendors pick up their checks. The employees have to sign their per diem advance forms at time of pick ups. Finance could arrange that mailing of checks to be done by other employees.

Finding #6-A selected sample of employee's original documents was tested in the HR department. Sample checklist forms are used for new and terminated employees by HR as a guide to ensure proper documentation. The guide is also used to ensure surrender of previously assigned equipment for terminated employees. Files tested were complete as to reviewed documents except for the absence of background checks.

#6 Recommendation: Employees for DASO and Detention currently have criminal background checks prior to employment. We recommend employees in high risk positions undergo a criminal background check. Many employees have direct contact with elderly, children and adults outside of controlled environments. The protection of the county's assets and the County's customers must be ensured by ascertaining employee backgrounds an employment condition. This is a reputation and legal risk that must be mitigated.

#6 Management response per Kathe Starke. Background checks for high risk employees/ departments will be recommended to senior management for consideration.

Finding #7-Entry of employees' worked time. Input sheets are reviewed and approved by departments. Some exceptions noted.

#7 Recommendation: Certain departments are not responsive in returning department head approved time summaries. It is recommended that notices on non-compliance departments be issued to the department heads. Any non-compliant departments should be reported to Senior Management. Accuracy of time sheets is the overall responsibility of each department. Acknowledgement of this responsibility is required. Documented approvals by department heads are key control for time and staffing report validation.

#7 Management response by Nasreen Nelson, Controller and Maggie Cedillo, Payroll Manager. Department heads have been advised to document review and approval of their employee's time sheets. The department heads and management will be advised on non compliance.

Finding #8-The purchasing department's review of Banner access was not reviewed by Department Management. There is no evidence of senior review and approval.

#8 Recommendation: Department management's review and approval of Banner access rights should be performed at least annually and documented.

#8 Management response by Nasreen Nelson, Controller. The Controller is and has been responsible for the Purchasing Department for the last few months and will review Banner access rights annually.

Finding # 9-Segregation of duties evaluators run on key purchasing and A/P personnel. Several conflicts were noted and resolved through mitigating controls. Key management reviews will be initiated on purchase order changes and General Ledger edits. Hierarchy revisions are to be made to mitigate the balance of segregation conflicts between preparers and approvers.

#9 Recommendation: Non-routine Journal Entries to all master accounts fixed assets, payroll master files, profiles, requiring changes should be made only by approved parties within Banner and only senior financial persons should approve entries. Hierarchy should to be modified.

#9 Management response by Nasreen Nelson, Controller. Approvals of all non-routine journal entries within Banner are done by the Controller. Fixed assets are not accounted for in Banner. Banner access rights will be reviewed annually and modification will be done as necessary.

Finding # 10-The responses for requests for related party disclosures have been poor in both FY 08 and FY 09. Management has noted no follow up has been performed to obtain disclosures and some key parties have refused to submit the disclosures. Significant deficiencies noted, preventing Purchasing department from identifying, monitoring and evaluating the related party transactions.

#10 Recommendations: A) Management should initiate a new effort to obtain Disclosures from all appropriate parties to provide purchasing the ability to monitor and report significant related party procurement issues. Follow up on non-compliant parties must be made and reported to Senior Management and the BOCC. B) Disclosure forms including Disbarment and Conflict of Interest should be obtained from all new contractor/vendors and annually from new or recurring vendors as new contracts are awarded.

#10 Management response by Legal department. A mandated re-write of Related Party Disclosures is scheduled for January, 2009. Implementation and monitoring will follow.

Management response by Nasreen Nelson, Controller. The Purchasing Department has included in all Competitive Sealed Bid, Request for Proposals and New Vendor Set up Packet, a Related Party Disclosure Form, Certification Regarding Debarment, Suspension, and other Responsibility Matters Form and a Non-Collusion Affidavit Form since November 17, 2008.

Finding #11-Pay and benefit calculations are recorded and reconciled to entry without final departmental review. There was no evidence of departmental supervisory review of supporting documents.

#11 Recommendation: It is recommended a senior departmental review of final pay hours be made and documented.

#11 Management response by Nasreen Nelson, Controller and Maggie Cedillo, Payroll Manager. The Report of Hours is sent to each department to review and return to Finance. Finance will implement a policy that makes it mandatory to have these reports reviewed and returned to Finance timely. The review of time entries by various departments is their responsibility. The Human Resources department is responsible for all salary and benefit changes and their employees enter all changes. If there is any need for programming in P/R, it is done by IT. A large file of action request forms, time entries, etc., for the County is reviewed by P/R and the Controller during each pay period. The Finance Department is hiring another P/R employee which will make it easier for additional departmental review.