



Office of the City Manager

INFORMATION CALENDAR

December 13, 2005

To: Honorable Mayor and
Members of the City Council

From: *PK* Phil Kamlarz, City Manager

Submitted by: Fran David, Director, Finance Department

Subject: Accounts Payable Audit – Status Report (*CF18-05*)

SUMMARY

The City Auditor's Office conducted an Accounts Payable Audit with the objective of identifying duplicate payments made to vendors during FY 2003, and submitted its report to Council in December 2003. Finance provided status reports on implementation of the Auditor's recommendations on October 19, 2004 and April 19, 2005, and this report updates the implementation of outstanding recommendations from the Audit. As originally reported, "the audit did not identify any significant loss of money from duplicate vendor payments," and most of the audit recommendations have been previously implemented. The remaining issues are being considered in the context of a larger report on outstanding Audit findings and recommendations, to be submitted at a later date. Finance will provide a status report in June 2006 on the currently unimplemented recommendations.

The full Accounts Payable Audit, including the text of all findings and recommendations, can be found on the City's website at: <http://www.cityofberkeley.info/auditor/currentaudits.htm>, and the previous updates can be found at: http://www.cityofberkeley.info/citycouncil/agenda_main.htm.

CURRENT SITUATION AND ITS EFFECTS

The following provides an update on the implementation of recommendations since the status report in April 2005. Concurrent with addressing the recommendations of the Audit, Finance is updating Administrative Regulations that have a bearing on implementation, as well as on the written procedures mentioned in these recommendations. Except for recommendation 2.2, these recommendations are for Finance, although departments Citywide are part of the invoice procedures incorporated with most of the implementation.

Finding 1 – Use of Incorrect Purchase Orders To Pay Vendors Could be Reduced

Auditor's Recommendation: We recommend that Finance follow-through with their plan and have the first accounts payable training class within six months from the date this report is issued. Also within six months, Finance should present all City departments with written accounts payable procedure guidelines. The class and written guidelines should address the importance of providing Finance – Accounts Payable (AP) with the correct PO number each time

an invoice is submitted for payment. Consideration should also be given to establishing guidelines that provide Finance-AP staff with sufficient time to follow Finance-AP entry procedures. In addition, management should reiterate to Finance-AP staff the importance of following the written procedures.

Department Response: Partially implemented. As previously reported, the Finance Department conducted Accounts Payable training in January 2004, and while the Department remains committed to providing additional Citywide training, there are not sufficient knowledgeable training resources to do so. City staff who attended the January 2004 training received Accounts Payable Training manuals and electronic files of written procedures. In addition, City staff involved with this year's annual year-end process attended the orientation and training for the FY05 Year End Process this spring, which included accounts payable procedures.

Management has continued to reinforce the importance of following written procedures to Finance – Accounts Payable staff, and has conveyed changes to existing internal AP procedures to AP staff on an individual, in-person basis. Edited updates of the internal AP written procedures are expected to be ready by the end of April 2006.

Updates of external AP procedures are incorporated in these revised Administrative Regulations:

- AR 3.2 Stipend and Reimbursement in Lieu of Expenses for Members of Certain Boards, Commissions and Committees;
- AR 3.9 Policies and Procedures for Payment of Conference and Meeting Attendance;
- AR 3.14 Voucher Processing;
- AR 7.2 Use of Private Vehicles, as regards mileage, parking, and toll reimbursement; and
- AR 3.19 Mileage Reimbursement, a new AR currently under development.

Finding 2 – Accounts Payable Staff Sometimes Knowingly Overpay Vendors

Sometimes Finance-AP staff made a conscious decision to send vendors checks that erroneously included a payment for another vendor's invoice. Finance-AP staff stated that instead of voiding the check, they would pay the vendor incorrectly instead of not paying the vendor at all. In addition to paying the incorrect amount to the incorrect vendor, they would also pay the correct vendor the correct amount, thereby knowingly overpaying one vendor and processing a duplicate payment. In this situation Finance-AP staff would request a credit or refund from the erroneously paid vendor, or apply the overpayment to one of their unpaid invoices.

This procedure increases the risk to the City that the overpayment will not be returned to the City. The AP supervisor stated that checks for the incorrect amount should always be void. However, she further stated that this procedure was not discussed with her staff and there were no written policies and procedures addressing how payment errors were to be handled.

It appears that this condition may exist in part because Finance-AP staff do not have authorization to correct their input errors directly in the Purchasing (PI) Module. It appears granting this authorization may also give them the authorization to create a purchase order (PO),

an incompatible function. Instances were found where Finance-AP staff had just completed entering a payment to an incorrect vendor, identified the error, but the PI Module would not allow any of the staff to correct the entry. Finance-AP staff are supposed to request an Accounting Office Specialist III (AOSIII) in Finance Accounting to reverse out these errors. Few requests are made, about four to six each year.

Auditor's Recommendation 2.1: Update written policies and procedures in Finance-AP to:

- Require that vendor checks, when known to be for the incorrect amount or payable to an incorrect vendor, always be void.
- Identify how Finance-AP staff are to correct, or have others correct, known Finance-AP input errors.

Department Response: Alternative procedure partially implemented. AP has not knowingly sent checks for an incorrect amount or payable to an incorrect vendor since July 2004. Errors are usually caught during the balancing process, before AP batches (in FUNDS) are submitted to Accounting for update, prior to issuing checks. When an error is caught, either by AP or Accounting staff (this is usually an invoice number keying error), AP works with Finance staff responsible for Encumbrance Reconciliation, an AOSIII who does not have FUNDS authorization for either PI or AP modules, to reverse the transaction and correct the entry. If a check with overpayment is authorized and found by AP staff before mailing, it will be brought to the Finance Director to determine whether, for that specific instance, it is more efficient to void the check and reprocess the payment, or work with the vendor for credit on a subsequent payment. Written procedures will be updated to reflect these changes and will be completed in April 2006.

Auditor's Recommendation 2.2 for Finance and Information Technology: Work with HTE (FUNDS provider) to determine whether AP staff can be given the ability to correct their own input errors without also giving them other FUNDS authorization they should not have.

Department Response: Not implemented. The FUNDS upgrade (version 3.0) was installed in November 2005, and AP staff has to complete testing to confirm implementation.

Finding 7 – A Duplicate Payment Log is Not Maintained

Auditor's Recommendation: Finance-AP staff should maintain a log to record each duplicate payment identified, and why it occurred. The AP supervisor should periodically review this log and update written procedures as needed to reduce the reoccurring or high risk causes of duplicate payments. Written policies and procedures should include the procedure for the maintenance of the log.

Department Response: Partially implemented. This log is maintained and reviewed monthly by the AP Supervisor. The updated procedures, expected in April 2006, will reflect this process.

Finding 9 – Discount Feature in PI Module is Not Being Used

Auditor's Recommendation for Finance and Information Technology: Implement use of the FUNDS feature that provides for automatic payment of invoices within the discount period. Formally request HTE to address any problems that prohibit implementation of this recommendation.

Department Response: Will not implement at this time. As previously reported, testing of this discount feature in FUNDS\$ concluded that it was not fully functional, and changing the City's current invoice payment process would not be cost effective. Vendor discounts are taken to the extent possible, and where departments fully participate to meet requirements. In addition, General Services – Purchasing increased its efforts to secure the best pricing and discounts on the procurement of goods and services. Finance will reassess whether this feature is functional and effective to implement after the current HTE upgrade (version 3.0) is completed. An update will be provided on June 20, 2006.

Finding 12 – No Written Policies and Procedures for Obtaining Reimbursement From Vendors for Overpayments or Processing Vendor Refund Checks

Auditor's Recommendation: Develop written policies and procedures that address how management wants Finance-AP staff to obtain reimbursement from vendors for overpayments, how they want this activity documented, and how management will oversee that this procedure is being followed. Additionally, written procedures should be developed that provide a reasonable assurance that vendor refund checks are timely deposited and properly accounted for. These procedures should be sufficiently detailed so that an Office Specialist II outside of Finance-AP could follow the procedures and complete the tasks as management wants them completed without any further guidance.

Department Response: Partially implemented. Management is satisfied with the current procedure used by AP to obtain reimbursement from vendors for overpayment. If a check with overpayment is authorized and found by AP staff before mailing, it will be brought to the Finance Director to determine whether, for that specific instance, it is more efficient to void the check and reprocess the payment, or work with the vendor for credit on a subsequent payment. If a check with overpayment is issued to an active vendor with routine business transactions, staff contacts the vendor and establishes a credit to the City on a subsequent invoice. If a check for the wrong amount is issued to a vendor that has 1-time or intermittent invoices, staff arranges for a refund, and instructs the vendor to send the refund check to AP staff, who will deliver the check to Treasury for deposit. Updated written procedures will reflect these procedures and will be completed in April 2006.

POSSIBLE FUTURE ACTION

Implementation is restricted by limitations of available personnel resources, including those for training, will be revisited as staffing and other demands on workload allow. In the meantime, existing written procedures will be used, internal procedures for AP staff will be updated as noted, and Administrative Regulations for external AP procedures will be completed. Finance will submit a status report on outstanding recommendations by June 20, 2006.

FISCAL IMPACTS OF POSSIBLE FUTURE ACTION

Staffing to address recommendations not currently implemented would have budgetary impacts.

CONTACT PERSON

Stacey Marston, Accounts Payable Supervisor, Finance 981-7309