

Meeting Date: 1/12/2016

Report Type: Staff/Discussion

Report ID: 2016-00042

Title: City Auditor's Audit of the City's Master Vendor File

Location: Citywide

Recommendation: Pass a Motion accepting the City Auditor's Audit of the City's Master Vendor File.

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Presenter: Jorge Oseguera, City Auditor, (916) 808-7270, Office of the City Auditor

Department: Mayor/Council

Division: Office of the City Auditor

Dept ID: 01001201

Attachments:

1-Description/Analysis

2-Audit of the City's Master Vendor File

City Attorney Review

Approved as to Form

Sandra Talbott

1/5/2016 1:48:36 PM

Approvals/Acknowledgements

Department Director or Designee: Jorge Oseguera - 1/5/2016 9:00:48 AM

Description/Analysis

Issue Detail: This audit was approved as part of the 2014/2015 Audit Plan. According to City Code Chapter 2.18, the City Council should be kept apprised of the City Auditor's work. The Budget and Audit Committee shall receive, review, and forward to the full Council the City Auditor's updates and reports. This report documents the *Audit of the City's Master Vendor File*.

Policy Considerations: The City Auditor's presentation of the *Audit of the City's Master Vendor File* is consistent with the Mayor and the City Council's intent to have an independent audit function for the City of Sacramento.

Economic Impacts: None.

Environmental Considerations: None.

Sustainability: None.

Commission/Committee Action: Pass a motion approving the City Auditor's *Audit of the City's Master Vendor File*.

Rationale for Recommendation: The *Audit of the City's Master Vendor File* was unanimously approved by the Budget and Audit Committee on December 1, 2015. This audit includes four findings and makes nineteen recommendations aimed at improving City operations.

Financial Considerations: The costs of performing this audit were funded out of the FY2014/15 Office of the City Auditor budget.

Local Business Enterprise (LBE): Not applicable.

Audit of the City's Master Vendor File

Report # 2015-08 | December 2015

We identified instances of prompt payment discounts not being fully realized, employees failing to identify vendor billing errors, and questionable spending decisions by City Departments

City employees with incompatible duties had access to the Master Vendor File

The City should improve controls over the Master Vendor File to increase data integrity and prevent fraud

Prohibited vendors with potential conflicts of interest conducted business with the City



City of
SACRAMENTO
Office of the City Auditor

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Audit of the City's Master Vendor File

December, 2015

2015-08

RECOMMENDATIONS

We made several recommendations aimed at improving City operations and enhancing controls over the Master Vendor File. They include the following:

Improve Operations

- Develop an ongoing monitoring process to ensure the City realizes discounts for which they are eligible.
- Consider the residual value of assets when determining whether it is more cost effective to rent or purchase vehicles and equipment.
- Provide additional training to employees who review and approve invoices.

Update System Access Controls

- Enforce segregation of duties by restricting access.
- Revoke system access from employees that do not require it.
- Develop a process to review user accounts on a regular basis.
- Establish an access policy.

Enhance Master Vendor File Controls

- Verify the legitimacy of new vendors.
- Establish a documented process that records requests for additions or changes to the Master Vendor File.
- Develop a report that records changes to the Master Vendor File.
- Review the change reports on a regular basis.
- Require all TIN's be limited to 9 digits.
- Perform a TIN matching review on a regular basis.
- Restrict the use of special characters.
- Develop a standard naming convention.
- Develop Master Vendor File policies and procedures.

Restrict Prohibited Vendors

- Deactivate prohibited vendors.
- Improve monitoring for prohibited vendors.
- Provide training on City Code 2.16.01.

BACKGROUND

The Master Vendor File is a foundational element of the Accounts Payable process and contains vital information about vendors the City does business with. This file generally includes the vendor's name, address, contact information, and tax identification number. It is essential to effectively maintain this file in order to avoid unauthorized or inappropriate activity, prevent duplicate payments, and reduce inefficiencies. Inaccurate, incomplete, or unauthorized vendor records could have a negative effect on processing vendor payments and may increase the risk of fraud or abuse.

FINDINGS

We identified instances of prompt payment discounts not being fully realized, employees failing to identify vendor billing errors, and questionable spending decisions by City Departments including:

- The City forfeited nearly \$60,000 in prompt payment discounts;
- The City could have saved \$60,000 in Measure U funds by purchasing instead of renting vehicles; and
- Fleet failed to identify nearly \$1,300 in overpriced smog fees.

City employees with incompatible duties had access to the Master Vendor File

System access should be limited to only those employees that require it to complete their job duties. Incompatible duties and an excessive number of users with the ability to make changes could increase the risk of a fraudulent vendor being added to the Master Vendor File. When we reviewed system access to the Master Vendor File, we found:

- Three employees had access to both enter and approve vendors;
- Five individuals had unnecessary access;
- Lack of an ongoing process to monitor for changes to the system's access levels; and
- Lack of a formal process or policy to define who should have access to the Master Vendor File.

The City should improve controls over the Master Vendor File to increase data integrity and prevent fraud

When we reviewed the processes used to maintain the City's Master Vendor File we found the Finance Department:

- Does not regularly verify vendors before they are added to the Master Vendor File;
- Lacks adequate documentation to support Master Vendor File changes;
- Does not have a process in place to monitor changes to the Master Vendor File;
- Does not validate the tax identification numbers of all vendors on a regular basis; and
- Lacks formal guidance on how to maintain the Master Vendor File.

Prohibited vendors with potential conflicts of interest conducted business with the City

City employees are prohibited from conducting business with the City as this may present a conflict of interest. During the audit we found three employees that were providing services to the City as vendors. One of these City employees appears to also be running a consulting business using City resources. City employees are expressly prohibited from engaging in supplemental employment using City resources or allowing supplemental employment to interfere with their job duties.

Introduction

In accordance with the City Auditor’s 2014-15 Audit Plan, we have completed an *Audit of the City’s Master Vendor File*. 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.

The City Auditor’s Office would like to thank the Finance Department for their time and cooperation during the audit process.

Background

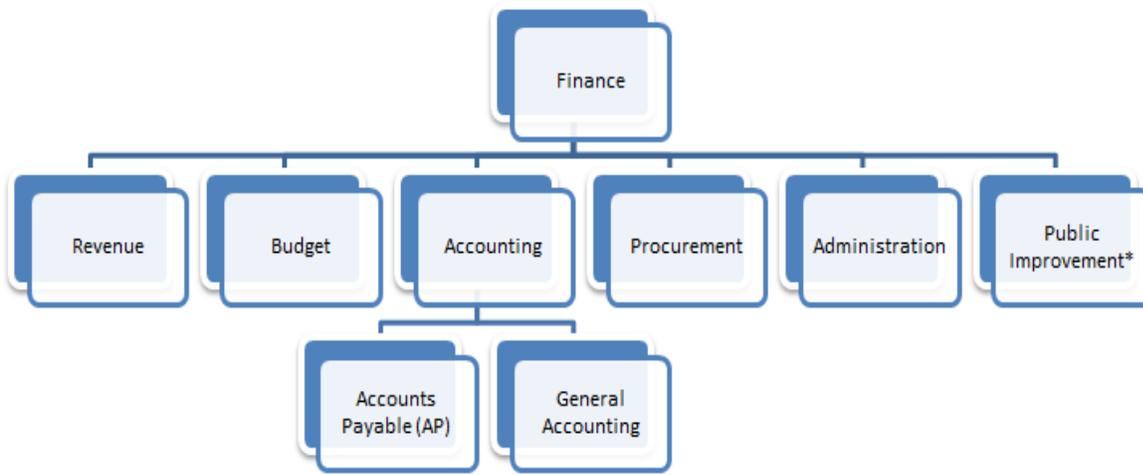
The Master Vendor File is a foundational element of the Accounts Payable process and contains vital information about vendors the City does business with. This file generally includes the vendor’s name, address, contact information, and tax identification number. The information is used to facilitate transactions and payments to vendors in the procurement of goods and services. It is essential to effectively maintain this file in order to avoid unauthorized or inappropriate activity, prevent duplicate payments, and reduce inefficiencies. Inaccurate, incomplete, or unauthorized vendor records could have a negative effect on processing vendor payments and may increase the risk of fraud or abuse. The City of Sacramento’s Master Vendor File is currently maintained by Accounts Payable (AP), a unit in the City’s Finance Department.

Accounts Payable

The majority of the City of Sacramento’s Master Vendor File input process is centralized within AP. General Accounting staff provide support in reviewing and approving the entries to the Master Vendor File made by AP in order to provide segregation of duties between entering and approving changes. As Figure 1 shows, both General Accounting and AP fall under the authority of the City’s Finance Department.

The Master Vendor File stores vital information about vendors the City does business with. This information is used to facilitate payments to those vendors in exchange for goods and services.

Figure 1: Organizational relationship of AP and General Accounting within the Finance Department



*The Public Improvement Finance Division, responsible for the formation and administration of special-purpose districts and finance plans, was added in the 2015/2016 approved City budget.

Source: Auditor generated based on a Finance Department Organizational Chart

Master Vendor File

No direct costs are associated with maintaining the Master Vendor File. The file is updated as part of AP staff’s normal daily operations which are primarily funded by the General Fund. The Master Vendor File is maintained in a database in the City’s financial and human resources enterprise software known as the Electronic Citywide Accounting and Personnel System (eCAPS). Vendors are classified in eCAPS into different categories based on their purpose and status.

The City’s Master Vendor File is maintained by Accounts Payable.

Vendor Count by Entity and Status

Vendors are classified in the Master Vendor File by a five character code or “Set ID” that represents the four entities the City provides accounting services for. These entities include Gifts to Share (GIFTS), City of Sacramento (SACTO), Sacramento Visitors Bureau (SACVB), and Sacramento City Employees Retirement System (SCERS). Figure 2 shows the count of vendors by status and entity as of March 2015. This audit primarily focuses on the vendors related to the City of Sacramento (SACTO); the data on the other entities is provided for informational purposes.

Figure 2: Count of Vendor ID's by Set ID and Status

| Status | GIFTS | SACTO | SACVB | SCERS | Grand Total |
|---------------------------|-------|--------|-------|-------|-------------|
| A (Approved) | 432 | 4,927 | 1,433 | 16 | 6,808 |
| E (Unapproved) | 1 | 29 | | | 30 |
| I (Inactive) | 304 | 17,590 | 871 | 37 | 18,802 |
| X (To be Archived) | | 3 | | | 3 |
| Grand Total | 737 | 22,549 | 2,304 | 53 | 25,643 |

Source: Auditor generated based on eCAPS data

The vendor "Status" field tells the user if the vendor is *Approved*, *Inactive*, *Unapproved*, or *To be Archived*. A general description of each of these status fields, as defined by the Finance Department, is outlined below.

A – Approved: this status is provided by the General Accounting staff after they have validated new vendor information. Vendors in *Approved* status are active and can be used to enter requisitions and vouchers and make payments.

E – Unapproved: this is the default status when new vendors are set up by AP staff. It is also the status that defaults when changes have been made to a vendor record by AP staff. Vendors in *Unapproved* status cannot be used to enter requisitions or vouchers or to make payments.

I – Inactive: this status is provided by the annual process to inactivate vendors with no activity for 18 months. This status can also be established by AP staff and is used to inactivate vendors that may be duplicate or have been set up incorrectly. Vendors in *Inactive* status cannot be used to enter requisitions or vouchers and no payments can be made to inactive vendors.

X – To be Archived: AP staff generally do not use this status because they do not have archive procedures in place. *To be Archived* vendors cannot be used to enter requisitions or vouchers and no payments can be made to these vendors.

As of March 3, 2015 there were 25,643 entities identified as vendors in the Master Vendor File. However, 18,802 of these vendors were inactive. There were 4,927 active vendors ID's associated with the City of Sacramento (SACTO).

Single Payment Vendors

Of the 4,927 individual active vendor ID's associated with the City of Sacramento noted above, approximately 40 of these are Single Payment Vendors. Single Payment Vendors are primarily used by AP to facilitate refunds and reimbursements. For example, one Vendor ID labeled "Ecaps Employee Reimbursement" is frequently used for City employee travel and expense reimbursements while another Vendor ID labeled "ULFT Rebate" is used to

reimburse residents when they qualify for high efficiency appliance rebates. The distinction as a Single Payment Vendor is significant because these vendors may include payments to multiple entities or individuals whereas typical vendor files generally only contain payments to a specific vendor.

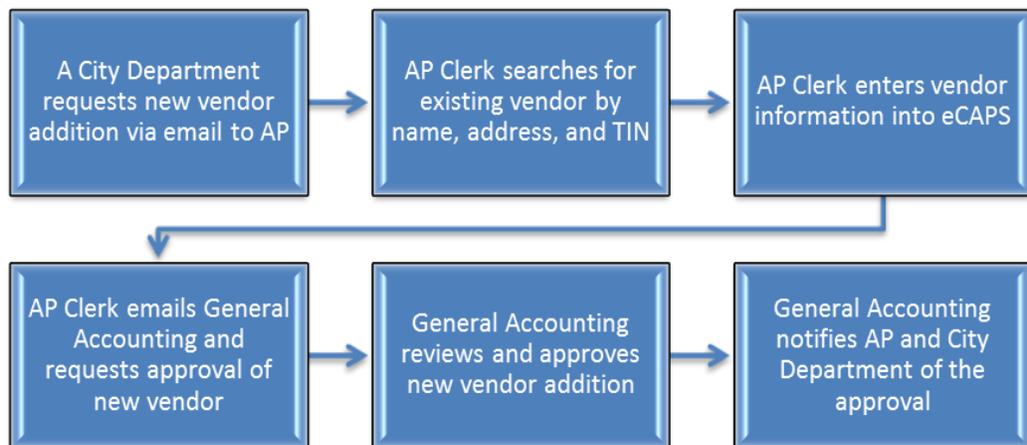
Process for Adding New Vendors to the Master Vendor File

It is important to note that the selection regarding which vendors the City does business with, and the gathering of information about those vendors, is a decentralized process. Other City departments make decisions about which vendors they want to use, generally through the City’s procurement and Request for Proposal (RFP) processes, and then forward their selections to AP along with the vendor’s information (Form W-9) by email.

When AP receives a request to add a new vendor to the Master Vendor File, the AP Clerk checks the Master Vendor File to make sure the vendor does not already exist under the name and tax identification number (TIN) provided. If the vendor does not already exist, the AP Clerk adds the vendor information to the system thus creating a new vendor file. If the vendor already exists, the AP Clerk simply updates the information on file. A General Accounting Clerk then approves the addition or change and notifies the AP Clerk that the change has been approved. If the General Accounting Clerk finds any errors in the entry, they notify the AP Clerk of the error so it can be corrected. Once this process is completed, and the vendor has been added to the system, the General Accounting notifies the City department that initially requested the vendor to let them know it has been added to the system. A high level overview of the process whereby the City adds new vendors to the Master Vendor File is provided below.

City Departments select which vendors they are going to use and then forward the vendors’ information to Accounts Payable for processing.

Figure 3: General Process for Adding New Vendors to the Master Vendor File



Source: Auditor generated based on interviews with Accounts Payable staff

This process has not been formalized in a policy, but is generally understood by Accounting staff.

Vendor Inactivation

To prevent the Master Vendor File from becoming unnecessarily cumbersome, idle vendors are regularly deactivated. The AP Supervisor purges the Master Vendor File approximately every 12 months. This process is accomplished through a query that identifies and deactivates vendors that have not been active in the prior 18 months. This process does not delete the vendors or the vendor records from the Master Vendor File; it simply switches them to an inert status in the database so that checks can no longer be issued under that vendor identification number.

Objective, Scope, and Methodology

The objective of the *Audit of the City's Master Vendor File* was to assess the controls over the Master Vendor File and identify areas of risk. Our scope included all entities identified as vendors by the eCAPS system and their respective payment information for fiscal years 2013 through 2015.

In performing our audit, we focused on the internal controls surrounding the accuracy and reliability of the Master Vendor File. In addition, we assessed the controls in place designed to deter and detect fraud. We conducted a search for industry best practices, interviewed department staff, observed staff entering data into the system, and performed analysis of vendor files and records. We also reviewed system access to the Master Vendor File to determine if there were incompatible duties present.

Finding 1: We identified instances of prompt payment discounts not being fully realized, employees failing to identify vendor billing errors, and questionable spending decisions by City Departments

The City's Master Vendor file is used to house information about the City's vendors in order to facilitate payments to those vendors. Due to this relationship, vendor payment processing is indirectly associated with the Master Vendor File. During our review we identified over \$120,000 in potential savings that could be achieved through enhancements in the City's vendor contracting and billing processes. Specifically, we found:

- The City forfeited nearly \$60,000 in prompt payment discounts in fiscal year 2014/2015;
- The City could have saved \$60,000 in Measure U funds by purchasing instead of renting vehicles; and
- Fleet failed to identify nearly \$1,300 in overpriced smog fees related to servicing City vehicles.

While the scope of our audit did not directly focus on the City's processes for vendor contracting and billing, we found that the items outlined above could result in inefficiencies and lost opportunities if left unchecked. Based on our review, increased attention to detail in processing invoices and more comprehensive cost/benefit analyses could potentially result in increased savings for the City when procuring goods or services.

The City forfeited nearly \$60,000 in prompt payment discounts in fiscal year 2014/2015

According to AccountingCoach.com, a website dedicated to helping people understand accounting, prompt payment discounts (also known as early payment discounts), are offered by vendors as a way to motivate customers to pay sooner. For example, a vendor doing business with the City may offer terms of *1/10, net 30*. This means that the City is allowed to deduct one percent of the amount owed on an invoice if payment is made within 10 days instead of the standard 30 days. In other words, the City saves one percent of the amount owed by paying 20 days early. To further illustrate how a prompt payment discount works, a \$1,000 invoice with terms of *1/10, net 30* will mean that the \$1,000 invoice could be settled in full for \$990 if paid within 10 days, thereby saving the City \$10. While a \$10 savings may not seem like a lot, consider that vendors receive millions of dollars per year in payments for good and services which would make one percent a more substantial amount.

The Finance Department could potentially capture more prompt payment discounts by identifying issues earlier.

In order to realize the prompt payment discount, AP relies on the City Department responsible for the invoice to submit the invoice in a timely manner. The City Department first reviews the invoice to verify the product or service was received, and then forwards the invoice to AP for payment. A lack of urgency or delays in processing by either party may result in a lost discount.

We queried the City's accounting system (eCAPS) and found the City was eligible for just over \$260,000 in prompt payment discounts in fiscal year 2014/2015. Of this total, the City did not realize almost \$60,000 (or 23%) of the discounts for which the City was eligible. These discounts were not realized because the payments were processed after the discount window had passed. When we reviewed the data to find out more about the missed discounts, two examples stood out. We found the City had missed out on over \$10,000 in discounts from just one vendor that had submitted 10 invoices related to security services that averaged over \$100,000 each. A second vendor that provides printing services for the City had 264 invoices paid over the same period with unrealized discounts totaling approximately \$13,500.

The two examples noted above illustrate both the importance of capturing discounts for large payments and for monitoring vendors with frequent small payments. While it may be unrealistic to expect the City to realize 100 percent of the prompt payment discounts, developing a reasonable performance measure and moving towards earning more of these discounts could help to reduce the amount the City pays for some goods and services. One way of accomplishing this would be to develop an eCAPS report that calculates the dollar amount and frequency of missed discounts on a regular basis. Having a report that details this information would allow the Finance Department to determine which discounts are being missed, provide an opportunity to research the root cause of the issue, and take corrective action. In our opinion, the Finance Department should develop controls to identify and take advantage of negotiated discounts.

RECOMMENDATION

We recommend the Finance Department:

1. Develop an ongoing monitoring process to ensure the City realizes discounts for which they are eligible.

The City could have saved \$60,000 in Measure U funds by purchasing instead of renting vehicles

Voters passed Measure U in November of 2012 which resulted in a temporary ½-cent sales tax increase designed to restore and protect City services. The

measure’s intent was to restore police and fire services, park maintenance and other essential services that were cut between 2008 and 2013. The sales tax took effect April 1, 2013 and will expire on March 31, 2019. During our review of payments made to vendors in the City’s Master Vendor file, we noted the City spent approximately \$115,000 of these Measure U funds to rent four utility trucks for the Parks and Recreation Department from July 2013 through June 2015. These vehicles were rented by the City’s Fleet Department on behalf of the Parks and Recreation Department. The tax and rental cost per truck was approximately \$1,200 a month. This appeared to us to be an above-average amount to spend on rental trucks for an extended period of time, so we obtained additional information from the Parks and Recreation Department on their rationale for renting instead of purchasing these vehicles.

Figure 4: Purchase vs. Rental Analysis Developed by the Parks and Recreation Department

| Cost of Truck - Purchase vs Rental (12 months & 7 months) | | | | | | | | | | |
|---|-------------|-------------------------------|----------------------------|-------------------|----------------------------|-------------------|---------------------|-----------------|-------------------|----------|
| | Purchase | | Rental for 12 months | | | | Rental for 7 months | | | |
| | Annual Cost | Cumulative Cost | Annual Cost (@ \$1,500/mo) | Cumulative Cost | Annual Cost (@ \$1,350/mo) | Cumulative Cost | Annual Cost | Cumulative Cost | | |
| Year 1 | \$32,840 | Purchase and O&M ¹ | \$32,840 | | \$18,000 | Rent ³ | \$18,000 | \$9,450 | Rent ⁴ | \$9,450 |
| Year 2 | \$2,247 | O&M ² | \$35,087 | Break even year 2 | \$18,000 | Rent | \$36,000 | \$9,450 | Rent | \$18,900 |
| Year 3 | \$2,247 | O&M | \$37,334 | | \$18,000 | Rent | \$54,000 | \$9,450 | Rent | \$28,350 |
| Year 4 | \$2,247 | O&M | \$39,581 | | \$18,000 | Rent | \$72,000 | \$9,450 | Rent | \$37,800 |
| Year 5 | \$2,247 | O&M | \$41,828 | | \$18,000 | Rent | \$90,000 | \$9,450 | Rent | \$47,250 |
| Year 6 | \$2,247 | O&M | \$44,075 | | \$18,000 | Rent | \$108,000 | \$9,450 | Rent | \$56,700 |

¹ O&M includes all costs of maintenance by Fleet and does not include cost of fuel to operate
² Annual cost (given by fleet) to Operate & Maintain truck is \$2,247
³ Cost of rental for 12 months is \$18,000 and includes 3,000 free miles. Extra mileage is \$.20/mile. Cost of fuel not included.
⁴ Cost of rental for 7 months is \$9,450 and includes 3,000 free miles. Extra mileage is \$.20/mile. Cost of fuel not included.

Source: Parks and Recreation Department Operations Manager

The Parks and Recreation Department provided the above breakeven analysis completed in 2013, which concluded that renting a truck for 12 months at a time is cost effective through year two. Their analysis estimates the monthly cost of renting a utility truck to be \$1,500 per month (or \$18,000 per year). As shown above, the cost of renting a vehicle for two years (\$36,000) would then break even with the purchase and maintenance price of the vehicle (\$35,087) in year two. However, it appears the calculation only compared the City’s cash outlay for purchasing or renting the vehicles and did not take into account a key feature of purchasing assets--their residual (resale) value.

We performed an analysis of the cost to own a utility vehicle versus the cost to rent, including the vehicle’s resale value, and determined that renting a utility vehicle over a two year period would not be cost effective. Our analysis is presented in Figure 5, below.

Figure 5: Purchase vs. Rental Analysis Developed by the Auditor’s Office

| Cost of Truck - Purchase vs Rental (12 months) | | | | | | | | | |
|--|-------------|-------------------------------|--------------------------------------|--------------------------------------|----------------------------|----------|-------------------|------------|----------------------|
| | | Purchase | | | Rental for 12 months | | | Difference | |
| | Annual Cost | Cumulative Cost | Resale Value of Vehicle ⁴ | Net Cost (Cumulative - Resale Value) | Annual Cost (@ \$1,200/mo) | | Cumulative Cost | | |
| Year 1 | \$34,273 | Purchase and O&M ¹ | \$34,273 | \$23,906 | \$10,367 | \$14,400 | Rent ³ | \$14,400 | |
| Year 2 | \$785 | O&M ² | \$35,058 | \$22,306 | \$12,752 | \$14,400 | Rent | \$28,800 | \$16,048 Per Vehicle |
| Year 3 | \$652 | O&M | \$35,710 | \$20,906 | \$14,804 | \$14,400 | Rent | \$43,200 | |

¹ Purchase price of \$33,873 provided by the vendor we used to rent the trucks.
² O&M includes maintenance and repair estimates from Edmunds.com "Total Cost of Ownership" tool for a similar vehicle type.
³ Monthly rental rate of \$1,200 is an average of the actual tax and rental price based on invoices for the last two years.
⁴ Vehicle depreciation is based on car industry averages for similar vehicles.

Source: Auditor generated

Based on our analysis, the cost of renting one vehicle for two years is approximately \$28,800 (or \$1,200 x 24 months). We projected the cost to purchase a new utility truck plus two years of repair and maintenance expenses at \$35,058. A conservative estimate of the residual value of a two-year-old utility truck is approximately \$22,306. If we account for the residual value, the net cost of purchasing the vehicle over a two year period is \$12,752. In this case, the City could have saved \$16,048 per vehicle (or \$64,192 for the four vehicles) by purchasing instead of renting.

As shown above, the initial cash outlay to purchase a utility vehicle is higher than renting a vehicle. However, when we take into account the residual value of the vehicle, the overall net cost of purchasing a vehicle is significantly lower than renting. As a result of miscalculating the breakeven analysis, the Parks and Recreation department erroneously concluded that renting would be more cost effective than purchasing over a two year period. The Parks and Recreation department is currently working on purchasing trucks to replace some of their rentals. In our opinion, the residual value of the vehicles should be included in the Department’s future evaluations on whether to rent or buy vehicles that they intend to use for an extended period.

RECOMMENDATION

We recommend the Parks and Recreation Department:

2. Consider the residual value of assets when determining whether it is more cost effective to rent or purchase vehicles and equipment.

Fleet failed to identify nearly \$1,300 in overpriced smog fees related to servicing City vehicles

The current process for paying invoices relies on City employees to verify invoiced amounts against contracted pricing before forwarding them to AP for payment. During our review of the City's Master Vendor File we noticed that payments to one of the City's vendors for vehicle smog services were more than the contracted amount. The invoices show that the City was regularly charged \$38.95 for smog services, but the most recent contract with this vendor listed the price at \$34.95. Occasionally, the City was also charged an additional \$8.25 for smog certificates, which should have been included as part of the \$34.95 contracted fee for smog services.

Based on a review of the invoices, we calculated that the City overpaid for smog services by nearly \$1,000 in fiscal year 2014/2015. To gain an understanding of the significance of the overage, we also calculated the total amount of smog-related fees during this timeframe and determined they were approximately \$12,000. We contacted the City's Fleet Division, the department responsible for managing the smog contract, to learn more about why the City was overcharged. The Fleet Department attributed the overbilling to the vendor's failure to adjust the price in their system after a new contract was negotiated. Fleet has since contacted the vendor to dispute the overbilling and to resolve the issue going forward. As a result of these efforts, the City was refunded nearly \$1,300 in smog fees.

The above example represents an approximate 10 percent overpayment on a relatively small contracted service. Potentially, a similar 10 percent overpayment on a larger contracted good or service could result in a much larger overpayment. In our opinion, invoices should be reviewed and verified against contracted amounts to ensure the City is paying the agreed-upon amount for goods and services. Employees failing to properly compare invoices to City contracts provide opportunities for vendors to either intentionally or unintentionally overcharge the City.

RECOMMENDATION

We recommend the Finance Department and all City Departments that process invoices for goods and services:

3. Develop policies that direct employees on their responsibilities for reviewing and approving invoices and provide training that reinforces the significant of these responsibilities.

Departments should train employees to review invoices against contracted amounts to ensure the City is being appropriately billed for goods and services.

Finding 2: City employees with incompatible duties had access to the Master Vendor File

The Finance Department’s informal process of entering and approving changes to the Master Vendor File is designed so that separate individuals perform these two functions. One employee is responsible for entering the information in the system and another employee is responsible for reviewing and approving the addition. The separation of these tasks creates a segregation of duties designed to aid in the reduction of errors and prevent fraudulent vendors from being added to the Master Vendor File. Segregation of duties is a vital element of many internal control systems and should be designed in a way that limits an employee’s ability to perform incompatible or unnecessary tasks. When we reviewed system access to the Master Vendor File, we found:

- Three employees had access to both enter and approve vendors in the Master Vendor File;
- Five individuals had unnecessary access to the Master Vendor File;
- Lack of an ongoing process to monitor for changes to the system’s access levels; and
- Lack of a formal process or policy to define who should have access to the Master Vendor File.

System access should be limited to only those employees that require it to complete their job duties. Responsibilities should be continuously reviewed on a regular basis to prevent users with incompatible duties from being added in the future. While we did not find evidence of fraud or abuse during our review of system access, the lack of documentation that would facilitate this type of a review made fraud or abuse difficult to detect. Incompatible duties and an excessive number of users with the ability to make changes could increase the risk of a fraudulent vendor being added to the Master Vendor File.

Three employees had access to both enter and approve vendors in the Master Vendor File

We reviewed system access to the Master Vendor File and identified 15 individuals with some level of access. We consolidated the system access information and used it to develop Figure 6 below. When we reviewed the permissions of these 15 employees, we found that three of these users had the ability to both enter *and* approve changes in the system; they are highlighted below in red. Having access to both enter and approve changes to the vendor file defeats the segregation of duties model.

Segregation of duties over the Master Vendor File was not being appropriately enforced.

Figure 6: Master Vendor File User Access

| Job Title | Department | Enter | Approve |
|-------------------------------|-------------------------------|-------|---------|
| Accountant Auditor | Engineering Services Admin | N | Y |
| Senior Accounting Technician | Accounting Administration | N | Y |
| Senior Accountant Auditor | Accounting Administration | N | Y |
| Supervising Financial Analyst | Off-Street Parking Admin | N | Y |
| Accounting Technician | Accounting Administration | N | Y |
| Account Clerk II | Accounting Administration | N | Y |
| Account Clerk II | Accounting Administration | N | Y |
| Accountant | JPA- SACVB (Visitor's Bureau) | Y | N |
| Accounting Technician | Building | Y | N |
| Program Specialist | IT Business Management | Y | Y |
| Account Clerk II | Accounting Administration | Y | N |
| Account Clerk II | Accounting Administration | Y | Y |
| Claims Collector | Enforcement and Collection | Y | N |
| Principal Accountant | Accounting Administration | Y | Y |
| Account Clerk II | Accounting Administration | Y | N |

Source: Auditor generated based on eCAPS user reports

In an effort to determine if any employees used their access to both enter and approve a vendor in the Master Vendor File, we attempted to run reports showing which employees added and approved additions or changes to the vendor file. However, according to the City’s Information Technology (IT) Department, eCAPS does not maintain a log of all changes made to the Master Vendor File. Instead, it overwrites the previous record and simply records who made the most recent change and the date the change was made. Without a system log to record who approved a particular change, we were unable to determine if any employees had both entered and approved a change to the Master Vendor File. This matter is discussed in more detail in Finding 3.

Although the Finance Department’s process of entering and approving additions to the Master Vendor File was intended to require a segregation of duties, our testing of the process found this was not the case. Three individuals had the ability to perform both functions, thereby defeating the segregation of duties model. Segregation of duties should be enforced in an effort to reduce errors and prevent opportunities for fraud. A secondary person reviewing additions to the Master Vendor File would have an opportunity to catch data entry errors made by the person entering the information, thereby reducing errors. An employee with the ability to both enter and approve a new vendor could potentially add a fraudulent vendor to Master Vendor File without detection and then ultimately use that vendor record to issue City checks. The opportunity to commit fraud is one of the key elements required to perpetrate

fraud within an organization and should be minimized. In our opinion, strengthening segregation of duties over the Master Vendor File will help to prevent errors and reduce opportunities to commit fraud.

RECOMMENDATION

We recommend the Finance department:

4. Enforce segregation of duties by restricting access to allow only the ability to either enter *or* approve changes to the Master Vendor File.

Five individuals had unnecessary access to the Master Vendor File

According to the Information Systems and Control Association (ISACA), an organization that provides industry-leading knowledge and practices for information systems, logical system access to computerized information should be granted on a “need-to-know” basis where there is a legitimate business requirement to have access to data. When we reviewed the job titles and assignments of the employees in Figure 6, we identified five employees that did not appear to have job duties that would necessitate access to the Master Vendor File. These employees’ titles are highlighted in yellow. We consulted with the AP Department regarding the responsibilities of these individuals and found that in most cases these employees had previously worked in the Accounting Department. When these employees transitioned from Accounting to a different City department, the Finance Department neglected to revoke their access to the Master Vendor File. In our opinion, employees that no longer require vendor information to perform their job duties should be restricted from accessing it.

Employees with unnecessary access to the Master Vendor File could provide opportunities for fraud or abuse. City departments should have processes in place to ensure access to sensitive systems is revoked when employees no longer require it to perform their job duties. The Institute of Internal Auditor’s (IIA) Global Technology Audit Guide on *Identity and Access Management* (GTAG 9) states that “As part of its Identity and Access Management (IAM) monitoring process, the organization should establish a methodology to periodically review the access rights granted to all identities residing in its IT environment.” In our opinion, user accounts should be reviewed on a regular basis to ensure the number of users and their level of permission is commensurate with their responsibilities and limits the potential for theft or abuse of City assets.

Some employees’ access to the Master Vendor File had not been removed when their role changed or when they switched to a different City department.

RECOMMENDATIONS

We recommend the Finance Department:

5. Revoke system access from employees that do not require access to the Master Vendor File to perform their job duties.
6. Develop a process to review user accounts on a regular basis to ensure the number of users and their level of permission is commensurate with their responsibilities.

AP lacks a formal process for adding users to the Master Vendor File

According to the IIA's guide on *Information Technology Controls* (GTAG 1), all organizations should define their aims and objectives through strategic plans and policy statements. Without clear statements of policy and standards for direction, organizations can become disoriented and perform ineffectively. The IIA's guide on *Identity and Access Management* (GTAG 9) states that "when a user is granted an identity through the provisioning process, an evaluation of the access rights being granted or changed should be part of the business owner's approval and the IT department's review of the access request."

When we reviewed access to the Master Vendor File we noted that there is not a formal policy in place for documenting approval and removal of users. It is important to memorialize these practices in a policy so that departments clearly understand who should have access to the Master Vendor File and who should not. A lack of clear direction on who has the responsibility for approving or removing system access to the Master Vendor File could create ambiguity and allow for unauthorized users to be granted access.

RECOMMENDATION

We recommend the Finance Department:

7. Establish a formal process for review and approval of new user access and memorialize the process in a policy.

Access control policies help to provide guidance and eliminate ambiguity over who should have access to critical IT resources.

Finding 3: The City should improve controls over the Master Vendor File to increase data integrity and prevent fraud

The Accounts Payable Network, an organization that provides training and certification programs specifically for professionals in AP, states that having a clean and accurate Master Vendor File cuts down on the effort involved in processing payments and helps to prevent a business from becoming a victim of fraud. One of the ways to help prevent fraud is to verify the legitimacy of vendors before they are added to the Master Vendor File. In keeping with this idea, the Accounts Payable Network recommends the first two goals of a vendor master file management plan should be: 1) catching and reducing fraud; and 2) knowing your vendors. When we reviewed the processes used to maintain the City's Master Vendor File we found the Finance Department:

- Does not regularly verify vendors before they are added to the Master Vendor File;
- Lacks adequate documentation to support Master Vendor File changes;
- Does not have a process in place to monitor changes to the Master Vendor File;
- Does not validate the tax identification numbers of all vendors on a regular basis; and
- Lacks formal guidance on how to maintain the Master Vendor File.

Assessing the legitimacy of vendors is a first step in preventing fictitious vendors from being added to the Master Vendor File. Recording and monitoring transactions made to the Master Vendor File is another layer of protection that helps to detect and deter fraud. Developing and maintaining a robust system of internal controls over the Master Vendor File helps to reduce opportunities for fraud and increases data integrity.

Vendors are not regularly verified by AP staff before they are added to the Master Vendor File

AP relies heavily on the department requesting a new vendor be added to the Master Vendor File for information about that vendor, such as mailing address and tax identification number. However, at the department level, the same people who request the addition of vendors also prepare requisitions and AP vouchers. These individuals could potentially request the addition of a fictitious vendor and then prepare false invoices, process AP vouchers, and have those vouchers approved for payment. In order to combat this type of fraud, the Accounts Payable Network recommends performing due diligence to verify the legitimacy of new vendors. The Finance Department can use several methods

Developing a robust system of internal controls over the Master Vendor File helps to reduce opportunities for fraud and increases data integrity.

to obtain reasonable assurance that the vendors being added to the Master Vendor File are genuine. Some of these options include looking at the vendor's website, contacting the vendor by phone, and verifying that the entity is registered with a state agency, such as the Secretary of State's office. In our opinion, AP should verify vendor information as part of their regular onboarding process in order to prevent fictitious or fraudulent vendors from being added to the Master Vendor File.

RECOMMENDATION

We recommend the Finance Department:

8. Verify the legitimacy of new vendors before adding them to the Master Vendor File.

AP lacks adequate documentation for Master Vendor File changes

There is not a formal process in place for documenting requests for additions or changes to the Master Vendor File. Requests to update vendor files are made via email from one employee to another and the change request itself is not logged or tracked. Currently AP only retains a record of the new information, such as a printout of the vendor's new address, but does not retain the actual request to update the address. This lack of support makes it difficult to determine who requested the change or why the change was needed. To document vendor information change requests Crystallus Inc., a business consulting company, recommends in their *Accounts Payable Consultant Handbook* that a form should be created and used for vendor file updates and should not only be completed by the person requesting the addition/change but also approved by someone at a higher level. The forms should then be kept in a readily accessible central location, which would allow for them to be retrieved in the future, should a question arise as to who requested a change or why a change was made.

Insufficient documentation makes it challenging to detect fraud, determine who requested a vendor be added to the Master Vendor File, or to determine the purpose for the change after the fact. Lack of a mechanism to adequately document requests for changes to the Master Vendor File could lead to a lack of accountability or the addition of a fraudulent vendor.

Finance should perform due diligence to verify the legitimacy of new vendors before they are added to the Master Vendor File.

RECOMMENDATION

We recommend the Finance Department:

9. Establish a process that records requests for additions or changes to the Master Vendor File and maintains them in an accessible format.

AP does not have a process in place to monitor changes to the Master Vendor File

The Accounts Payable Network article titled *Management Reporting Keeps AP Honest* recommends running monthly vendor setup/change audit reports. These reports are used to review for consistency in the setup process and to ensure vendor data guidelines are followed. Reviewing vendor data change reports is also a way to monitor for fraud. When we reviewed the City's ability to monitor changes to the Master Vendor File, we found the software used to manage the vendor file (eCAPS) is currently set up to overwrite the vendor record when a user makes a change to the vendor file and does not record the details of the change. The lack of an audit log makes it difficult to identify errors and detect fraudulent activity.

Crystallus Inc. suggests in their *Accounts Payable Consultant Handbook* that management should review a report of all changes made to the Master Vendor File as a frontline defense against employee fraud through manipulation of the Master Vendor File. The review process also acts as a fraud deterrent; if employees know the entries will be closely reviewed and scrutinized, that may be enough to prevent inappropriate changes to the Master Vendor File. In our opinion, AP should work with IT to develop reports that facilitate management's ability to monitor additions or changes to the Master Vendor File so that fraud and errors can be more readily detected.

RECOMMENDATION

We recommend the Finance Department:

10. Develop an eCAPS report that records changes to the Master Vendor File, including when the change was made and by whom.
11. Review the change reports on a regular basis to detect errors.

AP does not validate the tax identification numbers of all vendors on a regular basis

A Taxpayer Identification Number (TIN) is a number used by the Internal Revenue Service (IRS) in the administration of tax laws. It is issued either by the Social Security Administration (SSA) or by the IRS. AP currently relies on the TIN supplied by the vendor and does not regularly verify its accuracy.

Changes to the Master Vendor File should be documented and monitored as part of an ongoing process.

In an effort to identify errors or fraudulent vendors, we used the IRS's TIN Matching System to verify the tax identification numbers listed for each vendor in the Master Vendor File. The IRS TIN Matching system is a tool that allows payers to match TIN's against IRS records in order to verify the legitimacy of the TIN. Use of the matching system identified 27 vendor records that contained incorrect TINs. This included tax identification numbers that, according to the IRS, had never been issued and those that were more or less than the IRS's standard 9 digits. Inaccurate tax reporting could increase City staff time needed to correct the errors and, while unlikely, could potentially lead to fines of up to \$100 per instance¹.

While 27 inaccurate TIN's out of approximately 5,000 active vendors does not appear to be a widespread problem, erroneous TIN's should be detected and addressed in a timely fashion in order to maintain the integrity of the Master Vendor File and to help ensure accurate tax reporting. In order to prevent incorrect TIN's from being added to the Master Vendor File, AP should verify TIN's during the onboarding process and occasionally scrub the entire dataset to identify errors. When errors are identified, AP should contact the vendor and obtain the correct tax identification number.

The Accounts Payable Network article titled *Vendor Naming Convention* states that a standard naming convention is a "critical component of good vendor file management." The article suggest several naming guidelines that can be used to assist companies in setting up new vendors, enhancing the likelihood of finding the right vendor in the file, and facilitating 1099 reporting. A standard naming convention instructs employees on how to enter vendor names in the Master Vendor File. For example, if a company is called "The Widget Company" it could be entered into the system several different ways, such as "Widget Co." or "The Widget Co". A standard naming convention provides direction on how to enter the name, thereby increasing consistency in the data and reducing the likelihood of vendor duplication.

One example of a disadvantage of not having a standard naming convention occurred when we attempted to use the IRS's TIN Matching System described above. Initially, we were hindered from using the matching system because the City's Master Vendor File contains vendor records with special characters (i.e. @, *, ?, and /) and the IRS's TIN Matching system does not allow special characters to be contained in the data set. While there were less than 100 vendors that contained these special characters, it took time to discover and remove them from the data set. We found no business need to have special

¹ Per Internal Revenue Service (IRS) 2015 General Instructions for Certain Information Returns

characters in the Master Vendor File and it appears the characters could be eliminated by updating the vendor names that contain these characters. Restricting special characters from being added to the Master Vendor File when naming new vendors would help to standardize the information in the system and would facilitate future uploads to the IRS TIN Matching website.

In our opinion, AP should perform TIN matching on a regular basis and work to develop a standard naming convention that could support other potential uses of the Master Vendor File.

RECOMMENDATIONS

We recommend the Finance Department:

12. Require all TIN's in the eCAPS system be limited to 9 digits.
13. Perform a TIN matching review on a regular basis to identify and correct errors.
14. Restrict the use of special characters in vendor names.
15. Develop guidelines for a Master Vendor File standard naming convention.

AP lacks formal guidance on how to maintain the Master Vendor File

According to Pacific Crest Group, a business consulting firm with experience in accounting and billing administration, policies are desirable when there is a need for consistency in an organization's day-to-day operational activities. Pacific Crest Group also asserts that policies provide clarity to employees when dealing with accountability issues or activities that are of critical importance an organization, such as legal liabilities, regulatory requirements or issues that have serious consequences. As the Master Vendor File is a critical aspect of the City's AP process, we would expect to find policies and procedures in place that guide employees and provide direction on all aspects of maintaining and protecting the Master Vendor File. Such guidance should include who can request a new vendor, standards for naming vendors, instructions for making changes to the master vendor file, identification of incompatible duties, and how frequently to purge inactive vendors.

When we reviewed AP's documentation pertaining to the Master Vendor File, we found a general lack of department and/or citywide policies. In our opinion, AP's lack of policies and procedures to guide employees on how to make changes to the Master Vendor File or instruct employees on who can request changes to the Master Vendor File could result in less accountability.

The Master Vendor File is a critical City resource. As such, Finance should have policies in place that provide guidance on all aspects of maintaining and securing the Master Vendor File.

RECOMMENDATION

We recommend the Finance Department:

16. Develop policies and procedures that guide employees and provide direction on all major aspects of maintaining and protecting the Master Vendor File.

Finding 4: Prohibited vendors with potential conflicts of interest conducted business with the City

A conflict of interest can occur when an employee of an organization has a personal economic interest in a transaction that may adversely affect the organization. City employees have intimate knowledge of City operations that could provide an unfair advantage over other vendors when competing for contracts. Through the course of their duties, City employees also develop associations with other City employees that could potentially impair their judgment when negotiating contracts or billing for services. In an effort to prevent these types of conflicts of interest, City employees are prohibited from having a financial interest in City contracts and are not eligible to provide goods or services as vendors. This exclusion is explicitly defined in *City Code 2.16.010 Prohibition on City Employee Interest in City Contract* which states:

"No city employee shall engage in any employment, activity, or enterprise from which the employee receives compensation or in which the employee has a financial interest and which is funded, all or in part, by the city or any city department through or by a city contract unless the employment, activity, or enterprise is required as a condition of the employee's regular city employment. No city employee shall contract on his or her own individual behalf as an independent contractor with the city or any city department to provide services or goods."

In an effort to prevent conflicts of interest, City Code 2.16.010 expressly prohibits employees from contracting with the City.

As a result of the prohibition outlined in City Code 2.16.010, we would expect AP to have controls in place aimed at preventing City employees from being added to the Master Vendor File as separate and distinct vendors for the purposes of providing contracted services to the City that are in addition to their regular job duties.² Finance conducted an analysis in 2014 comparing the vendor file against employee records to determine if any employees were also serving as vendors. However, the department's analysis was flawed and did not identify all potential matches.

When we compared the City's Master Vendor File against employee records, we identified three current City employees that were also paid as vendors between

² It is important to note that while City employees are prohibited from being vendors with the City, employees are frequently reimbursed through the previously mentioned Single Payment Vendor codes in the Master Vendor File which are specifically designated to facilitate processing reimbursements for employee travel and business expenses.

2011-2014. Based on our review, the total amount of payments to these three vendors associated with City employees was \$37,770. Failing to prevent City employees from contracting with the City as vendors could create opportunities for fraud, waste, and abuse.

A City employee billed the City for services while also receiving their regular pay

Based on our identification of three City employees that had also acted as vendors, we expanded our scope to include a detailed investigation of each of these businesses' activity with the City. Two of the vendors appeared to be providing services to the City during their own personal time and, based on the information we reviewed, did not appear to have violated any additional employment rules. However, one of the City employee vendors appears to have "double-dipped" and billed the City for services while also receiving their regular pay. When we reviewed the employee's timecard, we noted that the employee had also been paid their regular City wage during the same week they billed a City Department for work under their business' name. This individual's business invoiced a City Department \$3,230 for 38 hours of consulting work during the week of July 15, 2013 through July 19, 2013. Below is a copy of the employee's City of Sacramento timecard showing this individual reported a full week's worth of regular hours as a City employee during the same period this individual was paid by the City as a consultant.

Three current City employees were also contracting with the City as vendors. Failing to prevent employees from contracting with the City as vendors could provide opportunities for fraud, waste, and abuse.

Figure 7: Employee Timesheet

The screenshot shows a timesheet summary for an employee. The 'Reported Hours' and 'Scheduled Hours' are both 80.00. The date is 07/13/2013. The table below shows the daily breakdown of hours reported.

| Sat 7/13 | Sun 7/14 | Mon 7/15 | Tue 7/16 | Wed 7/17 | Thu 7/18 | Fri 7/19 | Sat 7/20 | Sun 7/21 | Mon 7/22 | Tue 7/23 | Wed 7/24 | Thu 7/25 | Fri 7/26 | Total Hours | Time Reporting Code |
|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|----------|-------------|---------------------|
| | | 8.00 | 8.00 | 8.00 | 8.00 | 8.00 | | | 8.00 | 8.00 | 8.00 | 8.00 | 8.00 | 80.00 | REG - Regular |

Source: eCAPS Timesheet Summary Screen

It is important to note that this individual is not an hourly employee and is an exempt or "salary" employee. While the nature of exempt employment may allow for some flexibility in the number of hours an employee works in a day, in our opinion, it is unlikely that an employee could provide the City with a full week's worth of effort as an employee and provide an additional 38 hours as a contractor. Between 2013 and 2014 we found three more work weeks in which this employee appears to have "double-dipped" by providing contracted services to a City Department under their business name while also being paid as a City employee during the same week. Using the employee's hourly pay rate of approximately \$33 per hour, we estimated the dollar amount of potential timecard fraud to the City for those four weeks to be approximately \$5,270.

As this example demonstrates, allowing City employees to contract with the City for their services as a vendor provides opportunities for fraud and should be prevented.

An employee also appears to have engaged in supplementary employment while at work

In addition to being paid twice by the City, it appears that this individual was also paid by non-City entities to provide consulting services, potentially resulting in additional timecard fraud. The labor agreement covering this employee prohibits engaging in supplemental or “off-duty” employment unless expressly approved in writing. Approval to engage in supplementary employment must be requested, in advance, from their department head or designated representative. When we requested a copy of this employee’s current application for supplemental employment from the employee and the Department, neither was able to furnish a copy.

Full time employees are prohibited from engaging in supplementary employment unless expressly approved in writing.

In addition to the incidents above, this employee also appears to be regularly engaging in outside employment by contracting to provide consulting services on an ongoing basis with other entities. Based on our investigation, it appears this employee may have been paid a regular wage at the City of Sacramento while also being paid to provide services for non-City entities during the same time period. For example, this individual’s business invoiced another entity for 38 hours of work during the period of March 9, 2015 through March 13, 2015. The employee’s City timecard in the figure below shows that this individual also reported working a full week during the same time period they were paid by another entity to provide services.

Figure 8: Employee Timesheet

The screenshot shows a timesheet for an employee with ID [REDACTED]. The job title is [REDACTED]. The report is for the period ending 03/07/2015. The reported hours are 80.00, and the scheduled hours are also 80.00. The timesheet table shows 8.00 hours reported for each day from Monday to Friday.

| Sat | Sun | Mon | Tue | Wed | Thu | Fri | Sat | Sun | Mon | Tue | Wed | Thu | Fri | Total Hours | Reporting Code |
|-----|-----|------|------|------|------|------|------|------|------|------|------|------|------|-------------|----------------|
| 3/7 | 3/8 | 3/9 | 3/10 | 3/11 | 3/12 | 3/13 | 3/14 | 3/15 | 3/16 | 3/17 | 3/18 | 3/19 | 3/20 | | |
| | | 8.00 | 8.00 | 8.00 | 8.00 | 8.00 | | | 8.00 | 8.00 | 8.00 | 8.00 | 8.00 | 80.00 | REG - Regular |

Source: eCAPS Timesheet Summary Screen

Using a \$33 per hour rate for the employee’s wage at the City, we estimate the potential fraud to the City in this instance was approximately \$1,250.

When we reviewed the employee’s City email history we also found numerous instances where this employee used City resources to conduct business with, or on behalf of, other clients. Some of the contracts and invoices related to other entities state that this individual’s business offers “24 hour support (via phone, email, one on one)”. Providing 24-hour support for other entities may be in

conflict with the requirements of full-time employment with the City of Sacramento and appears to be in violation of the City's off-duty employment rules. We calculated approximately 30 percent of this individual's emails in one recent month were related to non-City business. In our opinion, it is doubtful that a full-time employee could engage in this level of supplementary employment while also providing the City of Sacramento with a reasonable work effort.

If we estimate that this employee spent 25 percent of their time working on a consulting business while at the City, then the estimated amount of fraud would be approximately \$17,000 per year (\$33 per hour x 2080 hours x 25 percent). Based on the timeframe and volume of emails, this individual has engaged in outside employment for some time, which would bring the potential loss to the City closer to \$35,000 over the last two years.

Furthermore, by using City resources to conduct a business, this employee is likely violating the City's Information Technology Resources (ITR) Policy. This policy states that "City ITRs shall be used to conduct City business. City ITRs may be used for incidental personal needs as long as such use does not result in or subject the City to additional cost of liability" or "involve the expenditure of a significant amount of time by the User away from their job duties." In our opinion, a substantial number of emails to and from this employee's City email account appear to be unrelated to City business.

We have referred the information cited above to the City's Labor Relations Division for further review so they can determine if disciplinary action is warranted.

Failing to prevent City employees from contracting with the City as vendors provides opportunities for both real and perceived conflicts of interest. In addition, not restricting City employees from acting as vendors could also provide opportunities for fraud, waste, and abuse. In our opinion, the Finance Department should strengthen controls over the Master Vendor File to enforce City Code 2.16.010 and prevent employees from inappropriately contracting with the City.

City employees and supervisors should be aware of the City Code that provides restrictions on employees performing services as a vendor. We recommend additional training be provided to City employees and supervisors on City Code 2.16.010 to increase awareness of the prohibition on City employee interest in City contracts and help to discourage this from happening in the future.

A current City employee appears to be engaging in supplemental employment without approval and may also be violating the City's IT policy by using City resources to run a business.

RECOMMENDATIONS

We recommend the Finance Department:

17. Deactivate vendors that are in violation of City Code 2.16.010 *Prohibition on City Employee Interest in City Contract*.
18. Develop and document more robust and frequent methods of searching the Master Vendor File for vendors that could potentially represent conflicts of interest.

We recommend the City Manager:

19. Provide training on City Code 2.16.010 *Prohibition on City Employee Interest in City Contract* to City employees responsible for selecting vendors.

MEMORANDUM

DATE: November 20, 2015
TO: Jorge Oseguera, City Auditor
FROM: Leyne Milstein, Finance Director
CC: Howard Chan, Assistant City Manager
SUBJECT: **Master Vendor File Audit**

1. This letter is in response to the City Auditor's Audit of the Master Vendor File.
2. The Department of Finance acknowledges receipt and concurs with the recommendations from the City Auditor's draft report.
3. Corrective actions have begun and some items have been completed. Policies and procedures are being developed and staff training is being scheduled to address the remaining audit recommendations.
4. I would like to take this opportunity to thank the City Auditor and staff for their efforts in identifying process improvements in this audit. Please feel free to contact me directly should you have any questions.
5. Below is the department response to the 19 audit recommendations identified in the audit report:

AUDIT RECOMMENDATIONS AND DEPARTMENTAL RESPONSE:

1. **Develop an ongoing monitoring process to ensure the City realizes discounts for which they are eligible.**

Response: Finance will develop a formal monitoring process to ensure the City realizes negotiated prompt payment discounts and identify training opportunities for departments that are not meeting the requirements of the discount terms. The City's Accounts Payable (AP) Automation project, expected to be deployed in late spring 2016, will incorporate new procedures to identify invoices with prompt payment discounts as soon as the invoice is received from the vendor. Finance will provide training to City employees to identify negotiated prompt payment discounts on purchase requisitions to establish the payment terms on purchase orders. Finance will emphasize the significance of timely processing and approval of vendor invoices to take advantage of prompt payment discounts. The AP Automation project will enhance transparency and accountability by recording vendor invoices in eCAPS when they are received.

2. **Consider the residual value of assets when determining whether it is more cost effective to rent or purchase vehicles and equipment.**

Response: The Parks and Recreation Department concurs with the findings and recommendation of the audit. As such, Park Maintenance and Safety Divisions have already reduced the number of rental vehicles by 21% during the first quarter of fiscal year 2015/16 and anticipate an additional 29% reduction will be realized by the end of the second quarter or upon Fleet's delivery of several new vehicles that were approved during budget adoption.

After a 50% reduction, the remaining rental vehicles (approximately 7) for the Park Operations group will remain under contract for additional seasonal help/enhanced service levels within special district areas/trust funds. Unfortunately due to the specifications of these industrial type vehicles (utility beds, towing hitch, lift gate, etc.), they are not easily obtained by commercial rental car companies. Average lead time to secure these types of vehicles may extend over six months and are quickly reserved. Therefore, the Parks Department retains a minimum number of year round leases to ensure availability. It is the Department's plan to continue to request permanent replacements for the remaining rental vehicles in the upcoming mid-year budget cycle and/or buy-out the current rental vehicles on-hand; whichever is most cost-effective.

3. **Provide additional training to employees who review and approve invoices on the significance of comparing invoices to contracted amounts before submitting invoices for payment.**

Response: Fleet and Finance will provide training to City employees on the significance of comparing amounts charged by vendors on invoices to contracted amounts.

4. **Enforce segregation of duties by restricting access to allow only the ability to either enter or approve changes to the Master Vendor File.**

Response: Finance will work with the Information Technology (IT) Department (responsible for setting security roles) to restrict access to allow only the ability to either enter or approve changes to the Master Vendor File.

5. **Revoke system access from employees that do not require access to the Master Vendor File to perform their job duties.**

Response: Finance, in coordination with IT, has revoked system access from employees that do not require access to the Master Vendor File.

6. **Develop a process to review user accounts on a regular basis to ensure the number of users and their level of permission is commensurate with their responsibilities.**

Response: Finance will improve and document the process to review user accounts on a regular basis to ensure the number of users and their level of permission is commensurate with their

responsibilities. This process will be incorporated into the policies and procedures currently under development.

7. Establish a formal process for review and approval of new user access and memorialize the process in a policy.

Response: Finance will establish a formal process for review and approval of new user access and incorporate that process in the policies and procedures currently under development.

8. Verify the legitimacy of new vendors before adding them to the Master Vendor File.

Response: Finance will work with all City departments to develop procedures to verify the legitimacy of new vendors before adding them to the Master Vendor File. These procedures will be incorporated into the policies and procedures currently under development.

9. Establish a documented process that records requests for additions or changes to the Master Vendor File that is maintained in a documented format.

Response: Finance will improve the current process for documenting Master Vendor File change requests and incorporate that process in the policies and procedures currently under development.

10. Develop an eCAPS report that records changes to the Master Vendor File, including when the change was made and by whom.

Response: Finance will use reports available in the upgraded PeopleSoft Version 9.2 financial system (eCAPS), expected to go live in late spring 2016, or will develop custom reports to implement the recommendation.

11. Review the change reports on a regular basis to detect errors.

Response: Finance will review the vendor record change reports regularly to detect errors and identify training opportunities.

12. Require all TIN's in the eCAPS system be limited to 9 digits.

Response: Finance will require all TIN's to be limited to 9 digits.

13. Perform a TIN matching review on a regular basis to identify and correct errors.

Response: Finance will step up its performance of IRS TIN matching to regular basis.

14. Restrict the use of special characters in vendor names.

Response: Finance will restrict the use of special characters in vendor names to order to implement regular IRS TIN Matching.

15. Develop guidelines for a Master Vendor File standard naming convention.

Response: Finance will incorporate its undocumented Master Vendor File standard naming conventions in the policies and procedures currently under development.

16. Develop policies and procedures that guide employees and provide direction on all major aspects of maintaining and protecting the Master Vendor File.

Response: Finance is in the process of developing policies and procedures to address maintenance of the Master Vendor File and expects to publish the guidance in spring 2016.

17. Deactivate vendors that are in violation of City Code 2.16.010 Prohibition on City Employee Interest in City Contract.

Response: The three vendors identified in the audit have been deactivated. Finance will immediately deactivate vendors found to be in violation of the City Code.

18. Develop more robust and frequent methods of searching the Master Vendor File for vendors that could potentially represent conflicts of interest.

Response: Finance will improve procedures for searching the Master Vendor File for vendors with potential conflicts of interest and perform the procedures more frequently.

19. Provide training on City Code 2.16.010 Prohibition on City Employee Interest in City Contract to City employees responsible for selecting vendors.

Response: Finance will coordinate with the City Manager's Office to provide the recommended training to the Executive Team and other City employees responsible for selecting vendors.