



GARLAND

INTERNAL AUDIT

A/P Vendor Master File Audit Follow-up

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Authorization

Internal Audit (IA) conducted a follow-up audit of Accounts Payable (A/P) Vendor Master File Audit, issued December 12, 2012. This audit was conducted under the authority of Article VII, Section 5 of the Garland City Charter and in accordance with the Annual Audit Plan approved by the Garland City Council.

Objective

This is a follow-up of the "Accounts Payable - Vendor Master File Audit" report issued on December 12, 2012. The objective was to determine if previous audit recommendations were implemented.

The original objective was to determine if adequate controls exist and are operating effectively over the Vendor Master File.

Scope and Methodology

IA 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 and 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 scope of this follow-up was to review vendors created and A/P payments since December 12, 2012.

In order to determine if previous recommendations were implemented, IA:

- Obtained and reviewed directives and policies and procedures to determine if they were updated.
- Sampled and examined vendor applications, as well as associated W-9s, to ensure appropriateness of 1099 reporting (See Exhibit A).
- Discussed and reviewed process changes with Finance regarding segregation of duties.
- Reviewed the Vendor Master File to ensure that previously identified exceptions regarding One-time vendors and duplicate vendors were corrected and determine if additional duplicate vendors exist.
- Performed analysis of the Vendor Master File to determine if duplicate payments were made across different vendors.

For data reliability purposes, IA determined that the system, processes and individuals involved did not change significantly from the previous audit. Therefore, IA believes that the data still is sufficiently reliable for the purposes of this report.

Overall Conclusion

IA's review of previous audit Findings and Recommendations revealed that of the 10 recommendations, 7 were fully implemented and 3 were partially implemented.

Background

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

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

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

Sources: Vendor Master File and A/P Supervisor

Audit Follow-up

This follow-up audit was not intended to be a detailed study of every relevant system, procedure and transaction. Accordingly, the Follow-up section presented in this report may not be all-inclusive of areas where improvement might be needed.

The following results for each finding are as follows:

Finding # 1
Condition (The way it is)
<p>One-Time vendors are created for refunds and other purposes through entry into the Finance system. The Finance system is programmed to automatically deactivate these vendors once a check has been printed.</p> <p>Our review of the deactivation status of processed One-Time Vendors revealed the following:</p> <ul style="list-style-type: none">A. 106 unauthorized One-Time vendors were created and found to be active in the system as a result of IT's testing in the production environment of the Finance system versus the testing environment.B. Another One-Time vendor number created as a result of a claim was found to be active in the System after a check that was issued was voided.
Recommendation
<p>Management should ensure:</p> <ul style="list-style-type: none">A. The 106 unauthorized One-Time Vendors are immediately deactivated in the system.B. Review and monitor One-Time Vendors monthly to ensure that vendors are deactivated.
Management Response
Concur
Action Plan
<p>The 106 one-time vendors that were created by IT testing on 07/27/12 and 08/07/12 have been deactivated in the Cayenta system as of 11/12/12. The A/P Supervisor will run a monthly query on new one-time vendors that are created. The one-time vendor list will be reviewed to ensure that one-time vendors are correctly deactivated.</p>
Implementation Date
December 15, 2012

Follow-up

- A. IA reviewed the 106 unauthorized One-Time Vendors previously identified and found that they had been deactivated in the system. In addition, IA inquired with IT and found that no other testing in the Finance production system had been performed since the exception was identified.

- B. IA's inquiry regarding process changes, since the previous audit, revealed that the A/P Supervisor queries the Vendor Master File and deactivates any One-Time Vendors left active for 45 days. IA performed a query and found that there were four (4) One-Time vendors that remained active in the system. IA's inquiry revealed that one vendor was a contract employee who was hired recently, one vendor was setup by mistake and not deactivated, and two vendors were set up for wire transfers. The system does not automatically deactivate one-time vendors when wire transfers are issued. Upon IA's notification, the A/P Supervisor deactivated these vendors.

Implementation

- A. Fully Implemented.

- B. Fully Implemented.

Finding # 2

Condition (The way it is)

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

Recommendation

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

Management Response

Concur

Action Plan

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

Implementation Date

Immediately

Follow-up

IA's inquiry revealed that responsibility for vendor setup was transferred to another individual (primary employee). However, the original employee acts as a backup (secondary employee) and continues to enter/edit vendors and approve batches in the system. IA's additional inquiry revealed that no reconciliation process was in place to monitor the activity of the secondary employee.

IA's review of vendor setup confirmed that the majority of vendors setup in the system, since the previous audit, had been setup by the primary employee. In addition, IA compared vendors that were setup and edited in the Finance system to batches approved by the secondary employee. IA then compared employee data listed in the City's payroll system to the Vendor Master File, to determine if any inappropriate activity had occurred. IA found no inappropriate activity by the secondary employee. Management indicated that going forward they will try to limit the secondary employee's activities regarding vendor maintenance.

Implementation

Partially Implemented.

Finding # 3

Condition (The way it is)

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

During our review, we found the following issues:

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

Finance immediately corrected these errors upon notification.

Recommendation

Management should ensure:

- A. Vendors are setup correctly according to the organizational structure.
- B. A mechanism is developed to notify Finance when contract employees are hired to a permanent position with the City.
- C. Employee 1099 status should be evaluated and updated at the beginning of the next tax year.

Management Response

Concur

Action Plan

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

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

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

Implementation Date

Immediately

Follow-up

- A. IA performed a sample (see Exhibit A) and compared recent vendor applications and W-9 forms to the Finance system data. IA found that all vendors reviewed were appropriately setup in the system.

- B. IA's inquiry with the A/P Supervisor revealed that a mechanism is currently not in place to notify Finance when a contract employee is hired to a permanent position. Further inquiry with the HR department revealed that HR is coordinating discussions with Finance, Purchasing, and IT to develop a solution.

- C. IA's inquiry with the A/P Supervisor revealed that the department prepares over 1,300 1099s each year and conducts a thorough review. IA's review of vendors setup to receive a 1099 in the Finance system did not reveal any vendors inappropriately setup to receive a 1099.

Implementation

- A. Fully Implemented.

- B. Partially Implemented.

- C. Fully Implemented.

Finding # 4

Condition (The way it is)

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

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

Recommendation

Management should ensure:

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

Management Response

Concur

Action Plan

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

Implementation Date

Immediately

Follow-up

- IA's review of previously identified duplicated vendors revealed that they had been appropriately deactivated.
- IA's inquiry with the A/P Supervisor revealed that a process was not in place to detect duplicate vendors. After discussions, the A/P Supervisor developed a mechanism to detect duplicate vendors in the queries performed quarterly.

IA's review of the Vendor Master File revealed 46 additional duplicate vendors since the previous audit. Upon IA's notification, 26 of these additional duplicated vendors were deactivated and 20 were pending deactivation due to activity in the current fiscal year. IA's further review of payments made to these vendors did not reveal any duplicate payments. However, while conducting this test, IA identified two payments that were duplicated between multiple vendors. One of these transactions was immediately detected and reversed in the Finance system. A refund request has been processed to the vendor by Finance to resolve the second

duplicate payment.

Implementation

- Fully Implemented.
- Partially Implemented.

Finding # 5

Condition (The way it is)

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

Recommendation

Management should:

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

Management Response

Concur

Action Plan

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

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

Implementation Date

February 15, 2013

Follow-up

IA's review of SOPs obtained from Finance revealed changes requested from the previous audit were made and they are up to date.

Implementation

- Fully Implemented.
- Fully Implemented.

Additional Consideration

IA's review of the AP process revealed that the system allows departments to create a One-Time vendor when initiating a payment in the Finance system. An individual can enter the payment information into the system, select the option for a One-Time vendor and the payment is then approved by the individual's supervisor. The system will then create a One-Time vendor number for the payment and process the check payment. Discussions with the Accounts Payable Supervisor revealed that there are no restrictions at the department level to prevent the creation of a One-Time vendor, which could potentially cause inappropriate activities.

Management should:

- Evaluate whether the One-Time vendor option can be restricted to Finance Personnel.
- Continue monitoring One-Time vendor payments created by departments to identify possible inappropriate activities.

Exhibit A – Sampling Methodology

The Vendor Master File contains approximately 163,000 records. To reduce the size of the sample IA needed to determine if vendors were correctly setup in the system, IA used the Stop-and-Go sampling methodology. Using this sampling methodology allowed IA to further expand the sample size if exceptions were found.

IA randomly selected 35 vendor applications and associated W-9s from the files maintained in the Finance Department. IA then reviewed each application and compared it to both the associated W-9 form and the Finance system to ensure accuracy. IA found no exceptions in our review and the results can be projected to the intended population.