

CONSENT CALENDAR
February 9, 2010

To: Honorable Mayor and Members of the City Council
From: Ann-Marie Hogan, City Auditor
Subject: Audit: Over \$38,000 in Duplicate and Over Payments Recovered

RECOMMENDATION

Request the City Manager to report back on or before September 21, 2010 on the implementation status of each of the City Auditor's recommendations in the attached report. Report back no later than every six months, thereafter, until all recommendations have been fully implemented.

SUMMARY

Using Audit Command Language software, we tested disbursements made between July 1, 2008 and December 31, 2008 to identify duplicate payments. As a sub-objective, we documented accounts payable internal control weaknesses that came to our attention.

Over \$23,000 in duplicate and over payments were identified in the six-month disbursement period tested. Audit work prompted one vendor to examine charges to the City of Berkeley. This resulted in an additional \$15,163 in City credits for a total of \$38,165 in City refunds and credits. Other concerns include:

- Invoice and credit memo routing timeliness.
- Duplicate vendor and stale vendor records.
- Lack of clearly identified vendor discounts.
- Unclear written procedures.

Recent Sungard/HTE improvements may help Finance address a 1997 audit recommendation. Sungard/HTE added a multiple remittance address feature to the purchasing module, which allows a user to merge multiple vendor records into one. Finance is working to combine multiple vendor records to further reduce the risk of duplicate payments.

Finance's internal control practices and procedures have helped reduce the City's exposure to duplicate payments. Some studies estimate that .1% to 2% of an organization's disbursements are duplicate payments¹. By contrast, the City's duplicate payments represent only .03% of the City's Fiscal Year 2009 accounts payable expenditures.

FISCAL IMPACTS OF RECOMMENDATION

Audit work resulted in over \$38,000 in City refunds and credits.

RATIONALE FOR RECOMMENDATION

Implementing our recommendations will reduce the likelihood of duplicate payments, reduce the risk of fraud, and increase opportunities to save money.

CONTACT PERSON

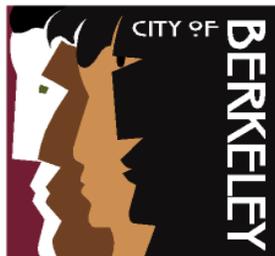
Ann-Marie Hogan, City Auditor (510) 981-6750

Attachments:

1: Audit: Over \$38,000 in Duplicate and Over Payments Recovered

¹ This would be \$149,000 to \$2,900,000 based on the City of Berkeley's Fiscal Year 2009 accounts payable expenditures.

City of Berkeley



Audit: Over \$38,000 in Duplicate and Over Payments Recovered

Prepared by:

Ann-Marie Hogan, City Auditor, CIA, CGAP
Teresa Berkeley-Simmons, Audit Manager, CIA, CGAP
Claudette Biemeret, Auditor II

Presented to Council February 9, 2010

**Audit: Over \$38,000 in
Duplicate and Over Payments Recovered**

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I. Audit Objectives and Results

Objectives

We used Audit Command Language to test disbursements made between July 1, 2008 and December 31, 2008 and identify duplicate payments. We also documented accounts payable internal control weaknesses that came to our attention.

Results and Prior Audit Recommendations

Audit results in over \$38,000 in refunds and credits.

Over \$23,000¹ in duplicate and over payments were identified in the six-month disbursement period tested (Finding 1). Audit work prompted one vendor to examine their charges to the City of Berkeley. This resulted in an additional \$15,163 in City credits for a total of \$38,165 in City refunds and credits. Other concerns include:

- Invoice and credit memo routing timeliness. (Finding 2)
- Duplicate vendor and stale vendor records. (Finding 3)
- Lack of clearly identified vendor discounts. (Finding 4)
- Unclear written procedures. (Finding 5)

Finance must enforce, and operating departments must adhere to, payment policies to reduce risk of accidental overpayment, vendor fraud, and employee fraud.

FUND\$ software improvements may help.

Finance has not cleared two prior audit² recommendations to eliminate duplicate vendor records. Finance previously stated it lacked the resources to do so ([Accounts Payable Audit](#)). Not implementing the recommendations increases the risk that an invoice will be paid twice. Recent Sungard/HTE software improvements may make it possible to finally resolve the issue.

Finance has also not cleared a prior audit³ recommendation to use the automated discount feature in the City's financial system⁴. Finance previously stated it could not implement this recommendation without additional resources. Using the automated discount feature would eliminate the need for Accounts Payable to manually calculate discounts.

¹ As compared to \$12,474 in duplicate payments identified in the [Accounts Payable Audit \(December 2003\)](#), which tested a one-year disbursement period.

² [Accounts Payable Audit \(December 16, 2003\)](#) – Recommendation 5 and [Review of Manual Check Process \(October 7, 1997\)](#) – Recommendation 5.1

³ [Accounts Payable Audit \(December 16, 2003\)](#) – Recommendation 9: “Implement use of the FUND\$ feature that provides for the automatic payment of invoices within the discount period. Formally request HTE Inc. to address any problems that prohibit the implementation of this recommendation.”

⁴ Sungard/HTE (FUND\$)

II. Auditee Accomplishments

To reduce the risk of duplicate payments and errors, Accounts Payable developed standard invoice numbering systems for:

- Payments made without invoices (for example, event registrations and monthly lease payments).
- Department created invoices (for example, construction progress payments and grant advances).
- Vendors that recycle their invoices numbers.

To address vendor-naming standards and a vendor file merger, Purchasing recently updated vendor maintenance policies and procedures.

Finance's internal control practices and procedures have helped reduce the City's exposure to duplicate payments. Some studies estimate that .1% to 2% of an organization's disbursements are duplicate payments⁵. By contrast, the City's duplicate payments represent only .03% of the City's Fiscal Year 2009 accounts payable expenditures.

III. Background

Duplicate payments can be costly: Medicare made an estimated \$89 million in duplicate payments in 1998.

Duplicate payments represent a vulnerability to any organization. In most cases, these payments are not fraud related. Duplicate vendor records and transposed invoice numbers are common reasons for duplicate payments. Another cause is using copied or faxed invoices to make payments.

The City's financial system includes a duplicate-invoice safety feature. The feature alerts a user if an invoice number already exists for the specified vendor. A user can override the safety feature by adding an extension or otherwise altering the invoice number. Any change to the invoice number prevents the system from identifying a duplicate.

Accounts Payable, a division of Finance, controls most disbursements made with City funds⁶. This includes ensuring that all payments are timely, accurate, and made in compliance with City policies and procedures. Accounts Payable staff is comprised of one Accounting Office Specialist Supervisor, one Accounting Office Specialist III, and two Office Specialists II.

⁵ This would be \$149,000 to \$2,900,000 based on the City of Berkeley's Fiscal Year 2009 expenditures.

⁶ Excludes investment, payroll and payroll liability, and workers' comp administrator payments.

Departments are responsible for ensuring funds are available and obtaining department manager or supervisor approval before purchasing goods and services. Departments must review and approve their invoices, as well as ensure the invoices have not already been paid, before forwarding to Accounts Payable. All departments must verify receipt of goods or services, and confirm prices and charges.

After verifying that an invoice is accurate and complete, the department forwards it to Accounts Payable. Accounts Payable reviews the invoice to ensure it includes information such as supervisor approval and purchase order number. If the information is correct and it does not appear the invoice has already been paid, the invoice is processed for payment.

Accounts Payable processed over 40,000 disbursements totaling over \$149,500,000 in fiscal year 2009. This included vendor invoices, refunds, and employee reimbursement vouchers.

IV. Findings and Recommendations

Finding 1: Enforce and Adhere To Finance Policies

Over \$38,000
in refunds and
credits
recovered.

Over \$23,000 in duplicate and over payments was made because Finance did not enforce, and staff in other departments did not adhere to, Finance policies. Audit work prompted one vendor to perform their own examination of invoices submitted to the City of Berkeley. Result: An additional \$15,163 in City credits.

Faxed Invoice Used to Pay Vendor

Public Works and Finance Used a Faxed Invoice to Pay Western States Oil

The City overpaid Western States Oil \$20,939 because Public Works submitted both the original and faxed copy of an invoice to Finance for payment. The duplicate safety feature in the City's financial system did not identify the duplicate invoice because the faxed copy was difficult to read, resulting in a data entry error⁷. Finance and Public Works could have prevented the duplicate payment by adhering to the Finance policy that "only original invoices should be submitted" to Accounts Payable (see also Finding 5).

Finance contacted Western States Oil when audit work revealed the duplicate payment. The City received a refund of \$20,939 on April 8, 2009.

⁷ The correct invoice number was 749379, but it was entered as 749375.

Parks, Recreation, & Waterfront and Finance Used a Faxed Invoice to Pay Western Exterminator

Following and enforcing Finance policies reduces the risk of duplicate payments.

The City overpaid Western Exterminator \$500 because Parks, Recreation, and Waterfront (Parks) submitted both the original and faxed copy of an invoice to Finance for payment. The duplicate safety feature in the City's financial system did not recognize the duplicate payment because Western Exterminator modified⁸ the invoice number on the faxed copy. Parks did not know why Western Exterminator made the modification. Finance and Parks could have prevented the duplicate payment by adhering to the Finance's policy to submit "only original invoices" to Accounts Payable (see also Finding 5).

The vendor identified the overpayment and refunded the City \$500 on February 1, 2009.

Inadequate Invoice Review

The Police Department Did Not Verify Receipt of Services

The City paid for goods and services it did not receive.

The Police Department approved a \$1,500 invoice from Forensic Analytical Services for services provided to another jurisdiction, not the City of Berkeley. Finance requires that receiving departments "verify receipt of goods" and services. A change in staff may have contributed to the error.

The vendor identified the error and credited the City \$1,500 on November 2, 2007.

Public Works Did Not Verify Receipt of Goods and the Fire Department and Finance Used a Shipping Slip to Pay Albany Steel

Public Works approved a \$196 invoice from Albany Steel for products received by the Fire Department. Therefore, it appears that Public Works did not confirm receipt of goods before approving the invoice. The Fire Department approved the corresponding shipping slip and submitted it to Finance as an invoice.

Finance policy stipulates, "payment is made from original *invoice*." Additionally, Accounts Payable procedures state that the Office Specialist II "always checks to ensure invoices are actual invoices not packaging slips." Careful review would have shown that a shipping slip, not an invoice, was used for payment.

⁸ The vendor added "-1" to original invoice number. Sometimes vendors change an invoice number when printing a second copy. This could be due to system limitations or in-house tracking procedures and might not necessarily be an indication of fraud.

Internal control steps are only effective if consistently performed.

Verifying the receipt of goods, properly reviewing invoices, and complying with Finance's original invoice policy could have prevented this duplication. The duplicate safety feature in the City's financial system did not identify the duplicate because the order number on the shipping slip was used in place of an invoice number.

The Auditor's Office contacted Albany Steel when audit work revealed the duplicate. The City received a refund of \$196 on April 1, 2009.

City Manager's Response to Finding

Agree.

Recommendations and City Manager's Response

- 1.1 **Finance** should enforce its original invoice policy. If an exception is necessary, **Finance** should closely monitor the vendor invoices to ensure a duplicate payment is not made, and document which department and staff submitted a copied invoice to identify a pattern or an employee training need. **Finance** should remind departments to submit only invoices to Accounts Payable.

Finance will continue to accept faxed and photocopied invoices, as a last option. Faxed or copied invoices over 30-days old will be stamped past due. AP procedures provided to receiving departments by Finance will be updated to clarify the use of copied invoices. When Accounts Payable receives a faxed or photocopied past-due invoice, staff will either attach the vendor statement to the invoice (this will clearly show the invoice number), or contact the vendor to verify the invoice number (if the number is unclear).

Accounts Payable will call the vendor if an invoice number is not clear on any faxed or photocopied invoice where a vendor statement is not available. Accounts Payable staff will note the date, time, and name of the person contacted on the invoice. Staff will log faxed or copied invoices to identify if there is a pattern, except for situations where it is the norm to receive a copy: original invoices were left at an off-site location, e.g., deliveries to campsites. Finance's Accounts Payable procedures will be updated to include these changes.

Accounts Payable staff will reconcile vendor statements on a monthly basis and contact the vendor for copies of outstanding invoices. The Accounts Payable Unit will sign up with vendors that offer the option to manage the City's account online.

Finance agrees to implement an alternative process by January 31, 2010.

- 1.2 **Public Works** and the **Police Department** should verify receipt of goods and services before approving an invoice for payment.

Public Works and the Police Department agree and implemented the recommendation in April 2009.

- 1.3 **Parks, Recreation, and Waterfront** should closely monitor Western Exterminator invoices and consider contacting the vendor when an invoice number is modified to determination the reason for the modification.

Parks agrees and implemented the recommendation in January 2010.

Finding 2: Timely Route Invoices and Credit Memos to Accounts Payable

Public Works Delayed Payments

Delayed payments put the delivery of fuel to the City at risk.

Public Works owed \$105,696 in past due invoices to Western States Oil⁹. Finance requires the “timely processing of invoices” by the responsible department. The vendor intended to place the City’s account on credit hold until the outstanding invoices were paid.

According to Public Works, the department could not increase the active purchase order for Western States Oil due to budget constraints¹⁰. The department had to wait for the fiscal year 2009 purchase order to be issued. The new purchase order was issued on July 2, 2008, but an additional six business days passed before Public Works forwarded the invoices to Accounts Payable. The Senior Equipment Supervisor did not respond to inquiries about the delay. Therefore, it is unknown why Public Works did not prioritize payment of the overdue invoices. This delay increased the risk that the City of Berkeley’s account would be placed on hold.

Public Works does not have a written policy requiring timely review, approval, and routing of invoices. A written Public Works policy would help reduce the risk of credit holds and ensure timely payments.

⁹ Western States Oil provides fuel for City vehicles, including Fire and refuse trucks.

¹⁰ Although the Council Authorized spending limit had not been reached, the fund used for fuel, oil, and lubricant purchases was in a deficit.

The Police Department Delayed Credit Memo

As noted in Finding 1, the City received a \$1,500 credit memo from Forensic Analytical Services. Although the Police Department received the credit in November 2007, the department did not submit the credit memo to Finance until July 21, 2008.

It is Finance's policy that receiving departments apply credit memos against payable invoices. It appears the Police Department could have applied the credit to an invoice¹¹ received less than one month after the vendor issued the credit memo.

City Manager's Response to Finding

Agree.

Recommendations and City Manager's Response

- 2.1 **Public Works** should prepare and distribute written policies and procedures for the timely review, approval, and routing of invoices. **Public Works** should consider identifying a specific number of invoice routing days and should clarify how to prioritize time-sensitive payments.

Public Works agrees and will implement the recommendation by March 2010.

- 2.2 The **Police Department** should submit credit memos to Accounts Payable as soon as the department receives an invoice to which the credit can be applied.

The Police Department agrees and implemented the recommendation in April 2009.

¹¹ Invoice was for \$1,750 and dated 11/23/07.

Finding 3: Deactivate Duplicate Vendor and Stale Vendor Records

Duplicate vendor records are the number one cause of duplicate payments.

Multiple Vendor Records Increase Risk of Duplicate Payments

Almost 400 vendors have more than one record in City's financial system. The City's system has 26 records for the Alameda County Treasurer alone. There appear to be at least three reasons for the duplicates:

1. Sungard/HTE¹² lacked a multiple remittance address feature. This limitation required General Services to create a duplicate record for vendors with more than one remittance address. The most recent version of Sungard/HTE includes a multiple address feature. The City put this version into production in October 2009. Finance is currently testing the multiple remittance address feature and expects to start using it by December 2010.
2. Finance merged two vendor files. Finance performed work to eliminate most duplicate vendors before the merger. However, Finance may not have captured all the duplicates at that time.
3. Staff created vendor records using different naming formats.¹³ Finance reduced this problem by limiting the creation of new vendor records to Purchasing staff. Previously, staff from the Library and Accounts Payable could add new vendors. Although General Services has some written vendor maintenance procedures, naming standards are not addressed. Additionally, the procedures appear to pre-date the vendor file merger.

Multiple vendor records increase the likelihood of duplicate payments, accidentally or intentionally, and make it difficult to compile vendor payment history. It is important to be able to identify vendor payments should a supplier claim non-payment, and to properly prepare budgets and negotiate contracts. Accurate, complete, and clutter free records will assist Finance in reducing risks and preserving City assets.

In May 2009, Finance began working to deactivate the duplicate vendor records. Finance stated a maintenance plan to deactivate duplicate vendor records is in development. Finance will document the plan when it is finalized.

¹² The City's core financial and work management system, FUND\$.

¹³ For example, the Alameda County Treasurer is recorded as both Alameda County Treasurer and County of Alameda-Treasurer.

Fraud Risk: Stale Vendor Records Can Be Used to Commit Fraud

Fraudsters could use a stale vendor record to commit fraud.

The City's financial system includes 14,558 stale vendor records. A stale vendor record is an approved vendor record that has not had payment activity for an extended period of time¹⁴. Stale vendor records present a fraud opportunity because they could be used in a shell-vendor¹⁵ scam.

Finance expects to inactivate vendor records with no payment activity for five or more years by December 31, 2009. Finance stated a maintenance plan to inactivate records that become stale after December 2009 is in development. Finance will document the plan when it is finalized.

City Manager's Response to Finding

Agree.

Recommendations

- 3.1 **Finance** should finalize and document the duplicate vendor records maintenance plan and schedule.

Finance agrees and will implement the recommendation by July 2010.

- 3.2 **Finance** should continue with its plan to use the new multiple remittance address feature in the City's financial system. **Finance** should work with Information Technology to combine duplicate records and merge payment information. If the feature is not adequate, **Finance** should submit a formal written request to Sungard/HTE asking for a software enhancement that addresses the limitation(s). **Finance** should consider having the request come from the City Manager's Office.

Finance agrees with the recommendation and is currently testing the new feature. If the feature meets the City's needs, it will be put into use by December 2010. Finance will combine duplicate vendor records and work with IT to merge payment information. The time it will take to combine all duplicate records is unknown, but the task will be incorporated into the duplicate vendor maintenance plan. If the feature is not adequate, Finance will request that the City Manager submit a formal request to address the limitation(s) as soon as the limitation(s) is noted.

¹⁴ For example, the last payment was made to the vendor over 3 years ago.

¹⁵ A shell vendor is a fictitious company used to generate false payments from the victim organization.

- 3.3 **Finance** should update its vendor maintenance policies and procedures to reflect changes since the vendor file merger, and to address vendor-naming standards.

Finance agrees and implemented the recommendation in January 2010.

- 3.4 **Finance** should document the stale vendor records maintenance plan and schedule once finalized. **Finance** should consider reducing the stale payment period from five to three years.

Finance agrees and will finalize and document the plan by July 2010. Finance will consider reducing the stale payment period. The benefits of doing so will be assessed and Finance will make a decision by July 2010.

Finding 4: Identify Vendor Discounts

The City could be missing opportunities to save money.

There is no system in place to ensure Accounts Payable is aware of all vendor discounts. Project managers in operating departments negotiate vendor discounts during the bidding process. The project managers do not always communicate them to the clerical staff that process invoices. Accounts Payable knows about these discounts only when stated on the vendor's invoices. It appears that not all vendors clearly identify discounts on their invoices. Result: It is possible that the City is missing opportunities to save money.

The City's financial system includes an automated discount feature for percentage-based discounts¹⁶. Finance has not cleared a prior audit recommendation¹⁷ to use this feature. Result: Accounts Payable staff manually calculate discounts. Using the discount feature would be more efficient. It would also help ensure Accounts Payable is aware of percentage-based discounts. However, operating departments still need to inform Accounts Payable of all other negotiated discounts.

City Manager's Response to Finding

Agree.

¹⁶ For example, 10% off total invoice for early payments.

¹⁷ [Accounts Payable Audit \(December 16, 2003\)](#) – Recommendation 9: “Implement use of the FUND\$ feature that provides for the automatic payment of invoices within the discount period. Formally request HTE Inc. to address any problems that prohibit the implementation of this recommendation.”

Recommendations

- 4.1 **Finance** should send a memo to department heads stating that each department is responsible for ensuring vendor discounts are communicated with the appropriate staff and clearly identified on all applicable invoices prior to transmitting invoices to Finance for payment. **Finance** should consider having the memo come from the City Manager.

Finance agrees with the recommendation. Finance will request that the City Manager submit a memo to departments regarding vendor discounts. AP will also update the "AP Procedures & Online Training Resources" guide in groupware with this requirement. Recommendation will be implemented by January 31, 2010.

- 4.2 **Finance** should use the automated discount feature.

Finance agrees and will begin testing the feature in June 2010. If it works correctly, Finance will put it into use by December 31, 2010.

Finding 5: Clarify Written Procedures

The citywide accounts payable procedures contain conflicting information. Instructions for invoice review state, "only original invoices should be submitted to AP." However, the instructions for receiving online¹⁸ state, "payment is made from original invoice or copy of the invoice." This could result in confusion as to whether invoice copies may be used to pay vendors. Instructions should be clear and consistent to reduce the risk of errors.

City Manager's Response to Finding

Agree.

Recommendation

- 5.1 Finance should update its citywide accounts payable procedures so that they are clear and consistent.

Finance agrees and will implement the recommendation by January 31, 2010.

¹⁸ Receiving online is the method of recording the invoice amount to the City's financial system.

V. Fiscal Impact

Fraudulent disbursements are a common cash scheme.

Audit work resulted in over \$38,000 in City refunds and credits. Implementing our recommendations will reduce the likelihood of duplicate payments, reduce the risk of fraud, and increase opportunities to save money.

The Association of Certified Fraud Examiners (ACFE) reported that fraudulent disbursements are “the most common form of cash scheme.”¹⁹ The ACFE also reported that 23.9% of all cases examined reported losses from billing schemes. The median loss was \$100,000.

Expenditures resulting from duplicate payments range from 0.1% to 2%. At the lower rate (0.1%), Berkeley could lose \$747,000 over a five-year period.

VI. Conclusion

Bypassed policies resulted in duplicate and over payments. There are also control weaknesses that could result in duplicate payments and that increase the risk of fraud. The auditors found:

Bypassed policies, not fraud, resulted in duplicate and over payments.

- Finance should enforce and departments should adhere to Finance policies. (Finding 1)
- Public Works and the Police Department should verify receipt of goods and services before approving an invoice for payment. (Finding 1)
- Public Works should ensure that invoices are timely routed for payment. (Finding 2)
- The Police Department should ensure that credit memos are submitted to Accounts Payable as soon as possible. (Finding 2)
- Finance should deactivate duplicate vendor and stale vendor records. (Finding 3)
- Departments should clearly identify vendor discounts on applicable invoices. (Finding 4)

We would like to thank Finance for their cooperation and assistance during this audit.

¹⁹ [2008 Report to the Nation on Occupational Fraud & Abuse](#), Association of Fraud Examiners

Appendix A

Scope and Methodology

We used Audit Command Language (ACL) software to perform analysis of City of Berkeley disbursements made between July 1, 2008 and December 31, 2008. We performed preliminary survey and fieldwork between January 2009 and August 2009. We reviewed duplicate payment and vendor maintenance articles, prior audit reports, procurement procedures, Sungard/HTE (Sungard) purchasing overviews, and vendor invoices. We also held interviews and discussions with staff and vendors, and performed Sungard inquiries. The results of our ACL analyses, reviews, interviews, Sungard inquiries, and discussions are the basis for the findings in this report.

Report findings and recommendations do not heavily rely on data obtained from information systems. Discussions with staff and review of invoices were sufficient to support the conclusions in this report.

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

This performance audit was initiated by the Auditor's Office and scheduled as part of the fiscal year 2009 Amended Audit Plan. The 2009 Amended Audit Plan was presented to Council on March 24, 2009.

