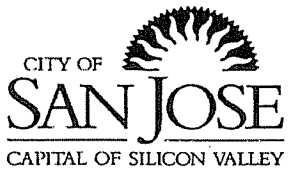
PSFSS Committee: 01/17/08
ITEM: #11



Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Steve Hendrickson, Interim City Auditor

SUBJECT: *Review Of The Procurement Card Program – Ongoing Audit*

DATE: January 9, 2008

The City Auditor's Office issued its first Procurement Card Program (Program) Audit in September 2006 and recommended that the Office conduct on-going audits for the Program. The audit found that the Program had weak internal controls which exposed the City to the risk of improper, abusive, and fraudulent uses of procurement cards. At the time, the audit did not measure or project the extent of inappropriate use. The goal of this audit is to establish a baseline against which to track Program improvement over time. The baseline period is between June 2006 and August 2006, which was prior to the Administration's issuance of a revised Procurement Card Policy and Program improvements. The revised policy was published on December 7, 2006.

We reviewed the City's Procurement Card Program (Program) and found that 164 of the 368 selected transactions (45 percent) appeared to be non-compliant with the City's Procurement Card Policy (City Policy). Specifically, we found significant non-compliance with approving official reviews. Additionally, we found personal transactions, splitting transactions, and insufficient supporting documentation. Based upon our sample, we are 95 percent confident plus or minus 5 percent that 3,932 of the 8,822 transactions between June 2006 and August 2006 were non-compliant with City Policy and that the City's exposure was about $1.1 million. We will conduct a follow-up audit to gauge Program improvements in reducing non-compliant transactions.

Scope And Methodology

We randomly selected 368 transactions from a population of 8,822 transactions during June 2006 through August 2006 to ascertain the extent of improper, abusive, or potentially fraudulent activity. We reviewed Finance Department documentation for the 368 transactions we sampled. Based upon our sample size, we are 95 percent confident plus or minus 5 percent that our findings are reflective of the entire population. We also conducted interviews with several cardholders.

We used the Government Accountability Office's definitions of improper, abusive, and fraudulent transactions when classifying questionable purchases:

- **Improper Transactions** are generally purchases intended for City use but not permitted by law, regulation, or organizational policy.
- **Abusive transactions** are purchases or authorized goods or services, at terms that are excessive, are for a questionable government need, or both.
- **Fraudulent transactions** are defined as using the procurement card to acquire goods or services that are unauthorized and intended for personal use or gain.

We want to thank the Finance Department for their assistance. We conducted this audit in accordance with Generally Accepted Government Audit Standards.

About 45 Percent Of The City's 8,822 Procurement Card Transactions Between June 2006 And August 2006 Were Non-Compliant With City Policy

We found that between June 2006 and August 2006 the Program had significant non-compliance with City Policy. Specifically, about 164 of the 368 transactions (45 percent) we selected for testing appear to be improper, abusive, or potentially fraudulent. The non-compliant transactions represent $43,962 exposure to possible abuse. Specifically, we found:

- 121 transactions with inappropriate approving official review,
- 3 personal transactions,
- 5 split transactions to circumvent purchase limits or violations of Citywide Open Purchase Orders,
- 24 transactions with documentation issues, and
- 11 transactions with an inappropriate cardholder signature or missing the correct cardholder's signature.

The Finance Department conducted training sessions for approving officials and cardholders, reauthorized procurement cards, and identified single points of contacts in departments. The results of this follow-up audit should be viewed as a baseline for the Program prior to the City's recent implementation of Program improvements.

Designated Approving Officials Do Not Consistently Review Transactions

We identified 121 transactions (33 percent) which violated the City Policy requirement for approving official review. City Policy requires a designated approving official sign every assigned cardholder statement showing that they reviewed the transactions. According to best practices, the approving official reviews of cardholders' statements is one of the most important controls to ensure the proper use of procurement cards.

Specifically, we found that the approving signatures were either not the appropriate approving officials or their signatures were illegible. For example in one department, 36 of 63 transactions (57 percent) were in violation of the City's Policy regarding appropriate approving officials' signatures.

According to Finance Department staff, changes to approving officials may not be reflected on procurement card statements for almost two months. Consequently, some of the non-compliance in our sample may be during a time of changes in approving officials. We recommend the Finance Department consider providing an exception process where department directors can certify changes to approving officials immediately and include the certification with cardholder statements. This should result in a consistent chain of responsibility when approving officials change and a reduction of non-compliance with City Policy.

We recommend the Finance Department:

Recommendation #1

Consider an approving official exception process for designating approving officials to ensure a consistent chain of responsibility when approving officials change. (Priority 2)

City Employees Use City Procurement Cards For Personal Use

We identified three non-City business transactions. City Policy states the City Procurement Card is for official City business and may not be used for personal purchases under any circumstances.

Specifically, one employee used his City Procurement Card for a personal transaction valued at $62.01 at a Union 76 gas station. The same employee used his City Procurement card three days earlier in another potentially personal transaction at Albertsons for $74.45. The fact that this employee subsequently reimbursed the City does not alter the potentially fraudulent nature of the transactions. We will forward our documentation for these potentially fraudulent transactions to the Office of Employee Relations for review and follow-up.

City Employees Violate City Policy By Splitting Transactions Or Violating Open Purchase Orders

We identified several employees splitting purchases to circumvent purchase limits or making purchases in violation of Open Purchase Order restrictions. Procurement cards retain single purchase limit restrictions as a control on spending. The purchase limits include the full cost of the purchase including tax. The maximum single purchase limit is $2,500 unless the Finance Department approves a higher limit. The City Policy restricts the purchase of items from vendors where the City maintains a Citywide Open Purchase Order.

We identified an employee splitting expenses exceeding $4,600 between the employee's City procurement card and personal credit card for a hospitality function. The evening hospitality function was for approximately fifty guests that included the board of directors of an international organization whose conferees the City was hosting in San Jose. City records show the City reimbursed the employee for the full "personal" credit card expenditure of about $2,270. According to the employee, he provided his City procurement card to staff to coordinate and pay in advance for the dinner event during a five-day conference. Advance payment arrangements were not communicated to the restaurant wait staff because the employee was presented with the bill at the end of the dinner. Therefore, the employee asserts he was unaware the bill was to be paid the night of the event. As a result, he used his personal credit card to cover the remaining balance after he reached the City's procurement card limit of $2,500. Our review revealed the purchase amount was known in advance and the employee had other payment options to avoid the use of a personal credit card. While the employee agreed in retrospect that there were other options such as not paying the bill as presented, he said he felt obligated to settle the bill. Additionally, the employee provided an additional gratuity of $100 where the contract amount already included a gratuity and service charge of $700 (20 percent of the food and beverage cost). In our opinion, the additional gratuity paid by City funds was inappropriate. According to department staff, the department has since established a power user procurement card with a higher card limit. This would allow the staff member to make purchases for protocol type activities where the cost exceeds a normal credit card limit.

We identified another violation of City Policy when two employees made purchases at office supply vendors Office Depot and Staples even though the City maintains an Open Purchase Order with Office Max. The purchases totaled about $200 and included items such as inkjet cartridges, labels, scissors, pens, and batteries.

Cardholder Statements Do Not Include Adequate Supporting Documentation

We identified several purchase card transactions for which supporting documentation did not adequately describe what was purchased. City Policy holds the cardholder responsible for obtaining an itemized receipt which includes a description of the goods and/or services purchased. We found 20 transactions for which an itemized receipt either failed to describe what was purchased or for which no receipt of any kind was provided supporting the purchase. The total represented about $2,700. Additionally, in four cases, Finance was not able to locate documentation. The total represented about $290. Lack of documentation hinders Finance's ability to verify the appropriate use of City Procurement Cards.

Conclusion

Based upon our sample of 368 transactions, we estimate 3,932 of the 8,822 transactions (45 percent) between June 2006 and August 2006 were at risk of non-compliance with City Policy and the City's maximum exposure is about $1.1 million. We found significant non-compliance with approving official reviews, personal transactions, splitting transactions, and insufficient supporting documentation. We will conduct another review to gauge the City's progress in reducing non-compliance in the Program.

Steven M Hendrickson
Steve Hendrickson
Interim City Auditor

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SH:lg

cc: Debra Figone
Scott Johnson
Deanna Santana
Walter Rossmann

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: **Steven Hendrickson**

FROM: Scott P. Johnson

SUBJECT: **RESPONSE TO THE AUDIT OF CITY'S PROCUREMENT CARD PROGRAM**

DATE: January 7, 2008

Approved Deanna Santana **Date** 1/8/08

The Administration has reviewed the Audit of the City's Procurement Card Program and is in general agreement with the recommendation and issues identified in the report. This memorandum responds to the audit recommendation and summarizes recent measures the Administration has taken to improve the City's Procurement Card Program.

As stated in the Auditor's report, the goal of this audit is to establish a baseline against which to track program improvement over time. The baseline period is between June and August 2006, which was prior to the issuance of a revised Procurement Card Policy and program enhancements. The revised policy was published on December 7, 2006. After publication of the revised policy, which includes detailed responsibilities for departmental and Finance staff, outlines purchase prohibitions, restrictions, and regulations, and describes various procedures, Finance conducted over ten trainings citywide and published a website dedicated to the Procurement Card program to ensure understanding about and compliance with the policy.

Recommendation #1: The Auditor's Office recommends that the Administration consider an approving official exception process for designating approving officials to ensure a consistent chain of responsibility when approving officials change. (Priority 2)

As outlined in the report, the Auditor's Office identified 121 transactions which appeared to violate the Procurement Card Policy requirement for approving official review. The updated policy requires that a designated approving official sign the monthly Procurement Card statement of every assigned cardholder. With the approval of the statement, the approving official attests that the procurement card transactions were handled in compliance with the policy.

The P-Card policy issued on December 7, 2006 addresses the audit recommendation. Specifically, on page 6 of the policy it states that, "on a temporary basis, another department's Approving Official can approve Monthly Statement of Accounts for Department's Cardholders." Additionally, as outlined on page 7 of the policy, Department Procurement Card Coordinators are required to ensure that the appropriate Cardholder and Approving Official sign off on the monthly statements.

The following section of the Administration's response restates the issues identified in the Audit and offers a response.

Issue #1: About 45 Percent of the City's 8,822 Procurement Card Transactions between June 2006 and August 2006 are non-compliant with City Policy
The Administration anticipates that the number of violations outlined in the Audit report will be reduced through the implementation of the revised policy and the continuous outreach to departments. For the review period, the exposure as identified in the Audit report in the amount of $43,962 represents 1.9 % of the total spent between June 2006 and August 2006. The total spent through the City's P-Cards for this period was $2,336,682.

Issue #2: City employees use City Procurement Cards for Personal Use
The Administration has followed-up on specific inappropriate purchases identified through the Audit. This follow-up is handled as personnel matters by the Office of Employee Relations in collaboration with the applicable department and appropriate action will be taken.

Issue #3: City Employees violate City Policy by splitting Transactions or violating Open Purchase Orders
The Administration has discussed these issues with the affected employees and implemented procedures to avoid the reoccurrence of these issues should a similar operational need arise. Through Finance's outreach to departments and departmental review of Procurement Card statements, employees have been educated regarding appropriate processes.

Issue #4: Cardholder Statements do not include adequate supporting Documentation
In general, Finance has stressed the importance of documentation supporting procurement card transactions through the revised policy published in December 2006 and its educational outreach to departments and expects increased compliance.

In conclusion, the Administration recognizes the findings in the audit report and addressed these issues through the publication of the revised policy in December 2006 and outreach to affected employees and departments. Finance appreciates the close working relationship with your staff throughout this audit.

For questions regarding this memorandum, please contact Walter C. Rossmann, Chief Purchasing Officer, at (408) 535-7051.

for David McPherson

SCOTT P. JOHNSON
Director, Finance

APPENDIX A

DEFINITIONS OF PRIORITY 1, 2, AND 3 AUDIT RECOMMENDATIONS

The City of San Jose's City Administration Manual (CAM) defines the classification scheme applicable to audit recommendations and the appropriate corrective actions as follows:

Priority Class[1]	Description	Implementation Category	Implementation Action[3]
1	Fraud or serious violations are being committed, significant fiscal or equivalent non-fiscal losses are occurring.[2]	Priority	Immediate
2	A potential for incurring significant fiscal or equivalent fiscal or equivalent non-fiscal losses exists.[2]	Priority	Within 60 days
3	Operation or administrative process will be improved.	General	60 days to one year

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1 The City Auditor is responsible for assigning audit recommendation priority class numbers. A recommendation which clearly fits the description for more than one priority class shall be assigned the higher number. **(CAM 196.4)**

2 For an audit recommendation to be considered related to a significant fiscal loss, it will usually be necessary for an actual loss of $25,000 or more to be involved or for a potential loss (including unrealized revenue increases) of $50,000 to be involved. Equivalent non-fiscal losses would include, but not be limited to, omission or commission of acts by or on behalf of the City which would be likely to expose the City to adverse criticism in the eyes of its citizens.
(CAM 196.4)

3 The implementation time frame indicated for each priority class is intended as a guideline for establishing implementation target dates. While prioritizing recommendations is the responsibility of the City Auditor, determining implementation dates is the responsibility of the City Administration.
(CAM 196.4)