

OFFICE OF THE CITY CONTROLLER



PARKS AND RECREATION DEPARTMENT

**PURCHASING CARD ACTIVITY
FINANCIAL RELATED AUDIT**

Judy Gray Johnson, City Controller

Steve Schoonover, City Auditor



OFFICE OF THE CITY CONTROLLER
CITY OF HOUSTON
TEXAS

JUDY GRAY JOHNSON, CPA

October 31, 2003

The Honorable Lee P. Brown, Mayor
City of Houston, Texas

SUBJECT: Parks and Recreation Department
Purchasing Card Activity – Financial Related Audit (Report No. 03-06)

Dear Mayor Brown:

The City Controller's Office Audit Division has completed a Financial Related Audit of Purchasing Card (P-Card) activity for the Parks and Recreation Department (Department). The audit objective was to assist management with the assessment of the adequacy of internal controls related to P-Card activity within the Department. In addition, the audit evaluated compliance with City administrative policy, procedures and executive orders.

The report, attached for your review, concluded that internal controls over the P-Card activities at P&R's various Divisions are adequate to provide management with reasonable assurance that P-Card activities are performed in accordance with applicable City of Houston administrative policies and procedures and executive orders, except for the findings presented in the body of the report. Draft copies of the matters contained in the report were provided to Department officials. The views of the responsible Department officials as to actions taken or being taken are appended to the report as Exhibit I.

We appreciate the cooperation extended to our auditors by Department personnel during the course of the audit.

Respectfully submitted,

Judy Gray Johnson
City Controller

xc: City Council Members
Stephen O. Tinnermon, Chief of Staff, Mayor's Office
Sara Culbreth, Acting Chief Administrative Officer
Roksan Okan-Vick, Director, Parks and Recreation Department
Philip Scheps, Ph.D., Director, Finance and Administration Department

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EXECUTIVE SUMMARY

- Our analysis of statements submitted to the department Budget Division for a six month period (July – December 2002) revealed that an average of 29% of cardholders are reporting object code corrections each month. We also observed that the majority of cardholders who are reporting corrections are the same employees each month. It is our belief that most cardholders with purchase activity should be reporting object code corrections to the Budget Division. Based on past audits performed of other City departments, as well as this examination, it is also our belief that inaccurate object codes are being reported routinely on a citywide basis.
- Sample testing of 25 monthly statements revealed that 15 statements, which included purchases from contract vendors, did not include references to BPO numbers and amounts in the spaces provided. This finding resulted from an internal control exception in accountability over spending funds approved by City Council.
- There are no established criterion or minimum requirements to qualify for a Purchasing Card (P-Card). An Internal Cardholder Agreement Form (Exhibit 1 to Executive Order 1-42) is submitted by an “authorized approver” (typically the employee’s supervisor or someone in his/her reporting chain) to the P-Card Coordinator, who establishes the single purchase and total monthly purchase limits. However, the form does not include a field to justify the employee’s need for a P-Card.
- P-Card Approving Managers (supervisors who review and approve P-Card purchases and P-Card bank statement activity) do not receive training defining their roles and responsibilities related to monitoring P-Card activity, including reviewing and approving monthly bank statement reconciliations. Failure to train Approving Managers may result in inappropriate P-Card purchases in violation of Executive Order (E.O.) 1-42.
- Sample testing of ten p-card monthly reconciliations revealed that eight of the ten (80%) statements did not include references to work order numbers on receipts.
- Sample testing of monthly p-card reconciliations and supporting receipts revealed that prohibited purchases were made. Three of the purchases totaling approximately \$640 were made at the direction of representatives from the Mayor’s Office, without obtaining written approval.
- In April 2002 there were unauthorized transactions made with a p-card assigned to a department employee. The employee discovered the transactions when reviewing his monthly statement prepared by Wells Fargo. As part of the reconciliation process, he reported the misuse of his card to his approving authority. However, the F&A Strategic Purchasing Division failed to report fraudulent purchases to Wells Fargo Bank totaling \$348.78. As a result, those charges were not reversed.

SCOPE AND PURPOSE

We have completed a financial related audit of the Parks and Recreation (P&R) Department's Purchasing Card (P-Card) activity. The audit's objectives are to evaluate the Department's compliance with applicable City of Houston administrative policies and procedures, executive orders and the Department's own standard operating procedures related to P-Cards. Also, the audit evaluated the adequacy of internal controls related to the processing of P-Cards. The audit scope period was from July 2001 through December 2002.

The scope of our work did not constitute an evaluation of the overall internal control structure of the Department. Our examination was designed to evaluate and test compliance with procedures and the adequacy of internal controls related to P-Card financial related activities. This was a financial related audit executed in accordance with Generally Accepted Government Auditing Standards.

Department management is responsible for establishing and maintaining a system of internal controls to efficiently and effectively perform financial related activities, and to adequately safeguard assets as an integral part of the Department's overall internal control structure. The objectives of a system are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or theft, and that transactions are executed in accordance with management's authorization and are recorded properly.

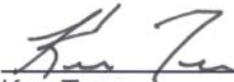
Because of inherent limitations in any system of internal accounting controls, errors or irregularities may occur and not be detected timely. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions, or that the degree of compliance with procedures may deteriorate.

CONCLUSION

Based on the results of our audit, we conclude that internal controls over the P-Card activities at P&R's various Divisions are adequate to provide management with reasonable assurance that P-Card activities are performed in accordance with applicable City of Houston administrative policies and procedures and executive orders, except for the findings presented in the body of the report.

We consider findings I. and II. of this report to be significant as they relate to the design or operation of the internal controls over p-card activities. In our judgment, those internal control weaknesses and exceptions could adversely affect management's ability to rely on reported budget activity and contract purchases, due to inaccurate or inadequate coding of p-card transactions.


Scott Haiflich
Auditor-in-charge


Ken Teer
Audit Manager


Steve Schoonover
City Auditor

INTRODUCTION

The Division Manager (DM) over Purchasing and Warehouse Operations in the Parks and Recreation Department (P&R) is the P-Card Coordinator and is responsible for overseeing P&R P-Card activity. Specifically, the DM monitors the issuance of P-Cards to the employees, distributes the monthly Wells Fargo statements to the P-Cardholders for review; monitors the purchasing activities of the P-Cardholders, and ensures that the Strategic Purchasing Division receives notification that the activity is reconciled and in compliance with Executive Order 1-42 (E.O. 1-42).

As of November 29, 2002, P&R had 54 active P-Cards. P-Card purchases for the period January 2002 through December 2002 totaled approximately \$879,000. Since the P-Card program began, four (4) cards have been cancelled. Of the four cards, two were cancelled due to non-compliance with City administrative procedures and executive orders, one was cancelled due to the cardholder making a personal purchase, and one was cancelled due to unauthorized use of the cardholder's card number to make fraudulent purchases. The unauthorized use of the card was reported to and investigated by HPD, and the cardholder was found to not be at fault.

AUDIT FINDINGS AND RECOMMENDATIONS

PURCHASING CARDS

BACKGROUND

P&R is the City's third largest user of P-Cards, in terms of the number of transactions made. Cardholders' single transaction limits range from \$250 to \$2,000. The majority of cardholders are assigned a \$5,000 monthly transaction limit, although a few have been limited to \$500, \$2,500, and \$4,000 monthly transaction limits. From October 1998 (the start of the P-Card pilot program) through November 2002, P&R completed 17,883 P-Card transactions. Monthly P-Card expenditures for the period July 2001 through December 2002 (the audit scope period) averaged approximately \$73,400. P-Card expenditures are assigned accounting object codes based on merchant category codes assigned to vendors and are recorded in the Advantage 2000 System (System).

E. O. 1-42, *Purchasing Card Policy and Procedures*, is the document which established "procedures for procuring goods and/or services using a Purchasing Card". Administrative Procedure (A.P.) 5-2 is the document which established "procedures for procuring goods and services that are consistent with E.O. 1-14, *Procurement and Payment Policies*, and procedures for changes in the procurement process that resulted from organizational and system changes".

E.O. 1-42, Section 5.2.3, requires Approving Managers (supervisors who approve monthly P-Card bank statements) to:

- Review and approve P-Card applications prior to submission to the Departmental Purchasing Card Coordinator (P-Card Coordinator).
- Review receipts and monthly bank statement reconciliations prior to submission to the P-Card Coordinator.
- Recommend suspension or cancellation of a card to the P-Card Coordinator when considered necessary.
- Notify the P-Card Coordinator when a cardholder is terminated so the card will be collected and purchasing privileges terminated.

E.O. 1-42, Section 7.0 allows P-Cards to be used to purchase any item and/or service for “immediate use” not prohibited by the executive order, another policy or procedure approved by the Mayor, or an ordinance of the City of Houston.

I. ASSIGNMENT OF TRANSACTION ACCOUNTING OBJECT CODES

BACKGROUND

Wells Fargo Bank Texas (Wells Fargo) assigns accounting object codes to p-card transactions based on the merchant category codes (MCC) assigned to each vendor. The system used to determine the commodities or services purchased is only capable of determining the type of vendor from which purchases are made. The system does not report purchases to Wells Fargo on the commodity or service level. Therefore, Wells Fargo frequently uses a miscellaneous object code, since the MCC often doesn't allow assignment of object codes with any degree of accuracy. Object codes appear on monthly statements issued by Wells Fargo. P&R Department cardholders have been instructed to review the object codes reflected on statements to assure that the codes are accurately assigned, and to forward copies of statements with corrected codes to the P&R Budget Division.

FINDING

Our analysis of statements submitted to the P&R Budget Division for a six month period (July – December 2002) revealed that an average of 29% of cardholders are reporting object code corrections each month. We also observed that the majority of cardholders who are reporting corrections are the same employees each month. It is our belief that most cardholders with purchase activity should be reporting object code corrections to the Budget Division. Based on past audits performed of other City departments, as well as this examination, it is also our belief that inaccurate object codes are being reported routinely on a citywide basis.

Citywide p-card expenditures for the period January through November 2002 totaled \$8.6 million. It is the conclusion of the auditors that the impact of the increased use of p-cards combined with the inability of Wells Fargo to accurately report accounting object codes could have a significant negative impact on the ability to determine actual budget activity.

RECOMMENDATION

We recommend that the department P-card Coordinator initiate a combined effort with the Finance and Administration Strategic Purchasing Division to analyze the control weakness with respect to the reporting of accounting object codes, and determine effective control procedures to resolve the problem. Possible solutions could include:

- Implementing p-card program procedures that require all cardholders to submit their monthly reconciliations with corrected object codes, and to justify the use of the miscellaneous object codes that are not corrected.
- Developing a training program for cardholders, approving authorities and coordinators to educate them concerning the correct assignment of object codes. Since cardholders now have purchasing profiles and routinely purchase the same type commodities and/or services, it would appear that cardholders should be able to easily become familiar the object codes that apply to their individual profiles.

II. REPORTING CONTRACT PURCHASES

BACKGROUND

E.O. 1-42, Section 12.0, *Using the Card* states, "The Cardholder determines if the item is a contract purchase and reports the purchase to the Purchasing Card Administrator", by recording the BPO number and applicable amount in the spaces provided on monthly statement.

FINDING

Purchases from contract vendors are not necessarily contract transactions. Price lists are typically produced to identify the commodities and services that are applicable to contracts. However, due to the differences in descriptions of commodities and services listed on price lists and the descriptions provided on receipts, it is often very difficult to determine if a purchase should be charged to a particular contract. In many cases, even the contract vendor employee is unable to determine if commodities or services purchased are contract related transactions. This situation makes it extremely difficult for Approving Authorities and

the P-card Coordinator to determine if purchases reflected on monthly statements are contract related. This is an internal control exception in accountability over spending the funds approved by City Council.

Sample testing of 25 monthly statements revealed that 15 statements, which included purchases from contract vendors, did not include references to BPO numbers and amounts in the spaces provided.

RECOMMENDATION

We recommend that the Strategic Purchasing Division's P-card Administrator and department P-card Coordinators review the process of reporting contract p-card purchases, including the method of identifying contract related transactions, and develop procedures to adequately control the process.

III. P-CARD JUSTIFICATION

FINDING

There are no established criterion or minimum requirements to qualify for a P-Card. An Internal Cardholder Agreement Form (Exhibit 1 to E.O. 1-42) is submitted by an "authorized approver" (typically the employee's supervisor or someone in his/her reporting chain) to the P-Card Coordinator, who establishes the single purchase and total monthly purchase limits. However, the form does not include a field to justify the employee's need for a P-Card.

RECOMMENDATION

We recommend that P&R's P-Card Coordinator, along with the Finance and Administration Department's P-Card Administrator, develop minimum requirements to qualify for a P-Card. Perhaps a committee minimally made up of the P-Card Administrator and all the P-Card Coordinators from the departments participating in the program should form to assist in the development of the P-Card qualification minimum requirements.

IV. P-CARD APPROVING MANAGER TRAINING

FINDING

P-Card Approving Managers (supervisors who review and approve P-Card purchases and P-Card bank statement activity)

do not receive training defining their roles and responsibilities related to monitoring P-Card activity, including reviewing and approving monthly bank statement reconciliations. Some Approving Managers had not even attended the basic P-Card training. Failure to train Approving Managers may result in inappropriate P-Card purchases in violation of E. O. 1-42.

RECOMMENDATION

We recommend that P&R management discuss with the P-Card Administrator the need for training Approving Managers to define their roles and responsibilities for monitoring P-Card activity.

V. WORKORDER REFERENCES RECORDED ON RECONCILIATIONS

BACKGROUND

Maintenance and construction activities typically include work order systems which enable management to prioritize, plan and monitor projects. One of the critical features of a well-controlled work order system is the ability to account for parts and materials used during projects.

FINDING

During fieldwork we were informed that the Fleet and Facilities Development & Maintenance Divisions use workorder systems to manage projects. Our sample testing of ten p-card monthly reconciliations revealed that eight of the ten (80%) statements did not include references to work order numbers on receipts. The Department does not have a system in place that allows for the reconciliation of parts and materials purchased to work orders. The audit team was not able to trace parts and materials purchased with P-Cards to specific work orders. The inability to reconcile parts and materials purchased to work orders is a significant control weakness. Typically, work order related items are parts and materials that can be easily sold to salvage yards and parts vendors. Failure to control work order related purchases invites the theft of items that can be easily sold.

RECOMMENDATION

We recommend that P&R management implement procedures requiring cardholders to record work orders on applicable receipts as part of the monthly reconciliation process.

VI. RESTRICTED PURCHASES

BACKGROUND

Section 8.0 of E.O. 1-42 identifies personal purchases, cash advances, sales tax and restocking inventory as prohibited purchases. By extension from the stated prohibited purchases,

the F&A Strategic Purchasing Division prepared a list of restricted Merchant Category Codes. P-card commodities or services are not to be purchased from those merchants.

FINDING

Sample audit testing of monthly p-card reconciliations and supporting receipts revealed the following prohibited transactions:

- A limousine was rented totaling \$130 to take an entertainer to IAH who appeared at the Olympic Torch Relay event at the George R Brown Convention Center. The purchase was made at the direction of a representative from the Mayor's Office, without obtaining written approval.
- Office supplies totaling \$112.79 were purchased to restock inventory.
- Floral centerpieces totaling \$400 were purchased from a florist for the Mayor's official holiday celebration. The purchase was made at the direction of a representative from the Mayor's Office, without obtaining written approval.

RECOMMENDATION

We recommend that the P-card Coordinator reemphasize the importance of being aware of prohibited purchases. We also recommend that cardholders obtain written approval from the Mayor's Office when instructed to purchase prohibited commodities or services.

VII. FRAUDULENT P-CARD PURCHASES

BACKGROUND

Section IV, I of the agreement between the City and Wells Fargo Bank Texas requires the City to inform the bank in writing of any disputed transactions reported on monthly statements within 60 days of the date of the statement.

FINDING

In April 2002, there were unauthorized transactions made with a p-card assigned to a P&R employee. The employee discovered the transactions when reviewing his monthly statement prepared by Wells Fargo. As part of the reconciliation process, he reported the misuse of his card. However, the F&A Strategic Purchasing Division failed to report fraudulent purchases totaling \$348.78. As a result, those charges were not reversed.

The unauthorized use of the p-card was investigated by the Police Department, and the cardholder was found to be not at fault since he was in possession of the card when the purchases were made,

and other evidence indicated that he was not the person who made the purchases.

RECOMMENDATION

We recommend that the P-card Coordinator initiate discussion with the F&A Strategic Purchasing Division to address the timeline for cardholders reporting disputed transactions, and for ensuring that Wells Fargo Bank is subsequently informed in writing within the 60 day period required by the contract. We also recommend that future unauthorized or fraudulent use of p-cards be reported to the Office of the Inspector General, since those type investigations involve City employees.

EXHIBIT I



CITY OF HOUSTON

Parks and Recreation
Department

Interoffice

RECEIVED
OCT 1 2003
Correspondence
CONTROLLERS
OFFICE

To: Judy Gray Johnson, Controller

From: Roksan Okan-Vick, AIA
Director

Date: September 26, 2003

Subject: **P-Card Audit – Department Response**

In your memo dated September 9, 2003, your office conveyed to the Parks and Recreation Department (PAR) the Controller's Office's audit report regarding a financial related audit of purchasing card activity. A total of seven findings were identified in the audit.

PAR understands that audits provide organizations with useful tool information that can be used to improve operations and safeguard City of Houston resources. PAR's response to these findings follows.

FINDING #1: ASSIGNMENT OF TRANSACTION ACCOUNTING OBJECT CODES

PAR agrees with the Controller's finding and has already taken action to correct the deficiency. All divisions are required to submit expenditure corrections to PAR's Budget Office monthly.

FINDING #2: REPORTING CONTRACT PURCHASES

PAR agrees with the finding. At the present time it is difficult in some instances to identify contract purchases with the limited information that is contained on the transaction receipts. As suggested in your audit letter, implementing the needed corrective action is dependent on the Strategic Purchasing Division. PAR will advise SPD's P-card Administrator of this problem and recommend corrective action. We will include the Controller's Office on the distribution of this memo.

FINDING #3: P-CARD JUSTIFICATION

PAR disagrees with this finding and the recommended corrective action. We believe that the minimum qualifications already exists because in PAR, the holder of a P-card:

- Must be a City of Houston employee and have a need to make immediate small dollar purchases in the performance of his/her job duties; and
- Must be recommended by his/her supervisor, approved by an executive level employee in the same division as the employee, and must be approved by PAR's P-card Coordinator.

This method of justifying the issuance of a P-card has worked for PAR as evidenced by the fact that PAR's P-card Coordinator has discontinued the use of very few P-cards because the P-card holder did not follow the established rules and regulations associated with P-card usage.

FINDING #4: P-CARD APPROVING MANAGER TRAINING

We agree in principal with the Controller's recommendation, however, we believe that the training that is provided to the P-card holder is also adequate for the manager who approves the employee's purchases. Therefore, henceforth, whenever a P-card is issued, the manager who approves purchases will be required to attend the same P-card training as the employee who holds the card.

*Views of Responsible
Officials*

EXHIBIT I

Page 2

FINDING #5: WORK ORDER REFERENCES RECORDED ON RECONCILIATIONS

PARD agrees with the Controller's finding and has already taken action to correct the deficiency. All divisions have been notified that when a work order number exists, it must be noted on the purchase receipt or on the monthly P-card statement.

FINDING #6: RESTRICTED PURCHASES

PARD agrees with the Controller's finding and as explained to the Auditor-in-Charge during the audit, corrective action has already been taken to prevent these types of purchases from occurring in the future through the following actions:

- The P-card Coordinator continues to scrutinize purchases during the monthly review of all P-card statements.
- If restricted purchases are made, the division that made the restricted purchase will be required to identify a Non-City of Houston source of funding for the purchase and the employee who made the purchase will be disciplined.
- The P-card will be discontinued immediately if such purchases are made.

FINDING #6: FRAUDULENT P-CARD PURCHASES

PARD agrees with the finding, however, as suggested in the recommendation for corrective action that is included in the Controller's audit letter, implementing the needed corrective action is dependent on the Strategic Purchasing Division (SPD). PARD reported the fraudulent purchases immediately upon discovery to the P-card Administrator via telephone and also in writing using the City of Houston Purchasing Card (PCard) Dispute Resolution Form. SPD recently sent PARD a draft policy that addresses this deficiency, therefore, we anticipate that a final, approved, policy will be forthcoming from SPD very soon.

Please contact Maggie Mottesheard (5-1304) if you have any questions about the Department's response.

Sincerely,



Roxsan Okan-Vick, AIA
Director
Parks and Recreation Department

Cy: Steve Schoonover, City Auditor
Ken Teer, Audit Manager
Scott Haiflich, Auditor-in-Charge
Susan Bandy, Assistant Director, Finance and Administration Department
Maggie Mottesheard
Diane Deaton

**Views of Responsible
Officials**