

CITY OF VAUGHAN

EXTRACT FROM COUNCIL MEETING MINUTES OF FEBRUARY 19, 2013

Item 1, Report No. 3, of the Finance and Administration Committee, which was adopted without amendment by the Council of the City of Vaughan on February 19, 2013.

1 INTERNAL AUDIT REPORT – ACCOUNTS PAYABLE

The Finance and Administration Committee recommends approval of the recommendation contained in the following report of the Director of Internal Audit, dated February 11, 2013:

Recommendation

The Director of Internal Audit recommends that the Internal Audit Report on Accounts Payable be received and approved.

Contribution to Sustainability

Internal Audit activities and subsequent reports contribute to the sustainability of the City by providing advice and assurance that controls supporting the effective delivery of services and programs are effective. Longer term sustainability needs the support of good, efficient risk mitigation strategies. Internal Audit can provide support for that sustainability by providing independent advice and assurance.

Economic Impact

There are no direct economic impacts associated with this report.

Communications Plan

Not applicable.

Purpose

To present to the Finance and Administration Committee the Internal Audit Report on Accounts Payable and to provide an evaluation of operational controls, as well as opportunities for improvement to help mitigate potential risks.

Background - Analysis and Options

This audit was done to evaluate the effectiveness of controls, processes and procedures in place to mitigate risks that could affect Accounts Payable in meeting departmental and the City's business objectives.

The audit was part of the 2012 to 2014 Risk Based Internal Audit Plan previously approved by the Finance and Administration Committee.

Relationship to Vaughan Vision 2020/Strategic Plan

This report is consistent with the priorities previously set by Council and the necessary resources have been allocated and approved.

Regional Implications

Not applicable.

Conclusion

The report concluded that some improvement in controls was needed to effectively manage the potential risk of unauthorized or improper payments. Although testing did not find any evidence

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EXTRACT FROM COUNCIL MEETING MINUTES OF FEBRUARY 19, 2013

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of inappropriate, duplicate or unauthorized expenses, the improvements suggested would be proactive in reducing risk. These opportunities for improvement were discussed with departmental management and they have agreed to make changes.

Attachment

Internal Audit Report – Accounts Payable

Report prepared by:

Michael Tupchong CA, CIA, CPA, CFE
Operational and Compliance Auditor

(A copy of the attachments referred to in the foregoing have been forwarded to each Member of Council and a copy thereof is also on file in the office of the City Clerk.)

FINANCE AND ADMINISTRATION COMMITTEE - FEBRUARY 11, 2013

INTERNAL AUDIT REPORT – ACCOUNTS PAYABLE

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Internal Audit Report – Accounts Payable

Report prepared by:

Michael Tupchong CA, CIA, CPA, CFE
Operational and Compliance Auditor

Respectfully submitted,

Paul Wallis CMA, CIA, CISA
Director, Internal Audit



INTERNAL AUDIT REPORT

Accounts Payable

December 2012

INTERNAL AUDIT REPORT

AUDIT OF ACCOUNTS PAYABLE

CONCLUSION AND SUMMARY

We conclude that some improvement in control is needed to effectively manage the potential risk of unauthorized or improper payments. Although we did not find any evidence of inappropriate, duplicate or unauthorized expenses, improving control would help reduce the overall risk.

The most significant issues are highlighted below:

- Various staff has the ability to set up a vendor, process a supplier invoice, access blank cheques and use the cheque signing software.
- Changes to the vendor master file are not monitored.
- The vendor master file is not reviewed for inactive vendors.
- All Accounts Payable staff have access to signed cheques before the cheques are mailed out.

Limited staff and managing a large number of vendors has resulted in staff having to perform incompatible functions. There are approximately 20,000 vendors in the system; a majority of them (approximately 80%) are for small purchases under \$3000 using the Field Purchase Orders.

Reducing the number of staff to have full access to the payment cycle in combination with more effective monitoring would reduce the risk of unauthorized or improper payments. The right combination needs to balance the potential risk with the increase in cost of control.

With the impending introduction of Purchase Cards, the number of cheques and vendors is expected to significantly decrease. This will provide opportunities to streamline the payment processing system and improve controls.

However in the meantime, an interim solution is needed to manage existing risk.

Management has agreed to make changes where it is practical within the staffing constraints of a small section so that separation of duties is improved. The recommended changes proposed by management will be discussed with internal audit so that the optimum solution is reached prior to implementation. In terms of the vendor list both the monitoring and the deletion of inactive vendors will or has been initiated. The signed cheques are now being delivered by accounting staff directly to the mail room.

INTERNAL AUDIT REPORT

AUDIT OF ACCOUNTS PAYABLE

BACKGROUND

The Accounts Payable department processes thousands of invoices totalling approximately \$140 million in a calendar year.

The vendor master file consists of approximately 20,000 vendors of which approximately 80% are as a result of purchases through the Field Purchase Order process.

OBJECTIVES AND SCOPE

The objective of the audit was to evaluate the effectiveness of controls, processes and procedures in place, to mitigate risks that could hinder the Accounts Payable department from making accurate, timely and relevant payments to the City's vendors.

The Scope included the activities and processes within the Accounts Payable department and covered the period from January 1, 2011 to December 31, 2011

Auditor and Author: Michael Tupchong CA, CIA, CPA, CFE

Director: Paul Wallis CMA, CIA, CISA

Signature: _____

Date: _____

INTERNAL AUDIT REPORT

AUDIT OF ACCOUNTS PAYABLE

DETAILED REPORT

1. *Payment Cycle Access and Vendor Master File Management*

Four staff in the Finance department, the Accounts Payable (AP) Supervisor, Accounting Supervisor, one AP Clerk, and Accounting Manager, have access and the ability to perform all of the following functions:

- Access to set up new Vendors or the ability to make changes to vendors already in the system
- Access to the Accounts Payable system to input an invoice for payment
- Access to blank cheques
- Access to the cheque signing software
- Access to signed cheques before they are mailed out

In conjunction with the above, staff listed below have the following capabilities in the payment processing cycle:

- All AP Clerks have access to the system to input invoices for payment and have access to signed cheques
- The Treasury Clerk has access to set up a vendor or make changes to an existing vendor and has access to signed cheques
- Three people in the Purchasing department have access to set up Vendors in order to issue Purchase Orders

In addition to the staff access issues above:

- Changes to the vendor master file are not actively monitored. In addition, the master file is not regularly reviewed for inactive vendors
- There are no documented procedures that outline the processes or provide guidelines supporting the payment process cycle

The risk of having multiple staff having access to the complete payment cycle, combined with the absence of vendor master file monitoring, is that there is a greater risk that unauthorized or improper payments can be made.

INTERNAL AUDIT REPORT

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Recommendations

Optimal control to minimize this risk is a combination of increased monitoring of vendor master file activities and reducing or separating the duties of those staff having access to complete payment cycle. The right approach will be one that balances existing resources with one that minimizes the critical risks.

The introduction of P-cards has the ability to address a number of the issues identified as well as improve overall payment controls. It is expected the number of vendors will be significantly reduced, thus streamlining vendor file maintenance issues, and that staff duties can be allocated in a way that reduces complete access to the payment process.

In the meantime, given existing resources, we recommend the following:

- Examine opportunities to reduce the number of staff having multiple accesses to all components of the payment cycle.
- Determine the number of vendors that have been inactive for more than two years and, if necessary, deactivate or remove them from the master file.
- Develop a report that will identify additions or changes to the vendor master file. Once developed, it is further recommended that an independent supervisor or manager review the report to determine if changes or additions are reasonable.
- Develop written procedures that support vendor management and the accounts payable process cycle.

Management Action Plan

In terms of the additions to the vendor master file staff will develop a log book to maintain a listing of new vendors. This listing will be reviewed and signed off by an independent senior staff member outside of the accounts payable area. In addition a review of the existing vendor master file will be conducted and the inactive vendors will be deleted.

In terms of staff having multiple access to the various components of the payment cycle, changes will be made where practical so that the separation of duties is improved. These changes to the payment cycle will be presented to internal audit.

Written procedures will be developed for vendor management, the accounts payable process and the cheque production cycle.

INTERNAL AUDIT REPORT

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2. Access to Signed Cheques

Cheques are printed and signed every Wednesday afternoon. Once signed, the cheque back-up is matched to the actual cheque for correct payee and amount, by a clerk independent of the Accounts Payable function.

Once verified, the envelopes with enclosed signed cheques (approximately 350-400 envelopes in quantity), are locked in a cabinet in the accounting department. Only the clerk verifying the cheques has the key. Every Monday morning the envelopes with signed cheques are placed in a tray in an open area which is accessible to all Finance staff (including Accounts Payable staff) until they are picked up by the mailroom clerk in the afternoon approximately five hours later. The signed cheques are placed on the mailroom clerk's cart without being secured. Cheques remain in the open until they reach their final destination, the mailroom.

In addition, the mailroom has allowed staff to pick up some signed cheques without signing for them. City staff from many departments has occasionally picked up envelopes (scheduled to be mailed out) from the mail room without signing for them.

The risk of not properly securing cheques is that they are openly accessible to Accounts Payable staff who prepared them as well as other Finance staff. Further, open access to cheques on the mailroom cart increase the risk of loss or compromise.

A compensating control is in place to identify cheques that may have been modified or compromised. The bank provides a "positive pay" process that matches cheque amounts and payee to an electronic file. If there is no match, payment is withheld.

Recommendations

The risk of cheques being altered and cashed after they have been printed is low. However, control would be improved if cheques were delivered directly to the mailroom after printing.

We recommend that once cheques have been verified by the control clerk, they be taken directly to the mailroom for safekeeping prior to being mailed out. In addition, if cheques or any mail are to be picked up by city staff from the mailroom, they should be signed for and a log of receipt should be properly maintained.

Management Action Plan

The accounts payable section is now delivering cheques directly to the mailroom. In addition, a log book will be created so that when cheques are picked up in the mailroom location, a signature is required.

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AUDIT OF ACCOUNTS PAYABLE

3. *Final Documentation and Cheque Review*

Before cheques are issued to the vendor, another verification control is applied prior to cheques being mailed:

- For cheques between \$0 and \$4,999, every fifth cheque with supporting documents is reviewed by the Accounts Payable supervisor.
- For cheques between \$5,000 and \$14,999, cheques with documentation are reviewed by either one or two staff as follows: one administrative clerk and the Accounting Manager, **or** the Accounts Payable supervisor alone or Accounting Manager alone.
- For cheques between \$15,000 and \$49,999, cheques with documentation are reviewed by one person, either the Accounting Manager or the Accounts Payable supervisor.
- For cheques greater than \$50,000, the cheques with documentation within this range are reviewed and the cheques are signed by two people; the Director of Finance and the Mayor.

Even though this process provides additional control and assurance, we believe it is an inefficient level of control. As the City continues to grow and the number of larger payments increases, this additional process will add administrative burden. With improved segregation of duties and monitoring combined with independent verification of the cheque amounts done by an Accounting Clerk, we believe the additional verification as indicated above adds additional time to the payment process with marginal benefit.

Staff has the authority to change the process for cheques up to \$50,000. For cheques over \$50,000, Council approval is required to change the existing process.

Recommendation

We recommend that this additional documentation and cheque review process be reexamined and possibly eliminated.

If the organization feels the risk is too great to eliminate this process, a phased approach could be considered where more random reviews are done with gradual elimination of the existing process.

Management Action Plan

Staff supports the above recommendation; however it is believed that continuing the review to a lesser extent is valid. Staff has changed the review process to a random verification for cheques up to \$50,000.

INTERNAL AUDIT REPORT

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4. Vendor Reporting (Field Purchase Orders) - Cumulative Reporting

Purchasing policy requires that a competitive process is required from vendors if purchases exceed a pre-prescribed amount. That amount depends on the goods or services provided and if certain technical conditions are required. The purpose of the competitive process is to obtain the best quality and price in the market for the City in order to achieve good value on large dollar purchases.

Currently there is no report showing current month and accumulative year-to-date purchases from vendors. Therefore a number of purchases from vendors may accumulate beyond the thresholds outlined in the purchasing policy. This is especially true for multiple Field Purchase Order purchases to the same vendors.

Currently, the Accounts Payable system has not been set up to generate a report of accumulated purchases per vendor that would provide an early warning on when thresholds are being approached.

The risk of not knowing when thresholds are being reached is that opportunities to take advantage of lower prices through a competitive process may not be realized.

Recommendations

The reporting capabilities within the proposed P-Card process should provide more opportunity to analyze spending trends for frequent and small purchases. Threshold reporting on P-Card purchases will provide early warning on potential savings opportunities.

Given that full implementation of the P-Card process may be one year or more away, we recommend that a report be designed that will give preliminary information where competitive bidding and savings opportunities can be further explored.

Management Action Plan

Previously there was an informal method when monitoring FPO's however as recommended above a FPO report has been developed by accounting that accumulates the purchases by vendor. This report is issued monthly to the purchasing department. The report will provide a more formal approach and will aid in monitoring the use of FPO's by supplier.