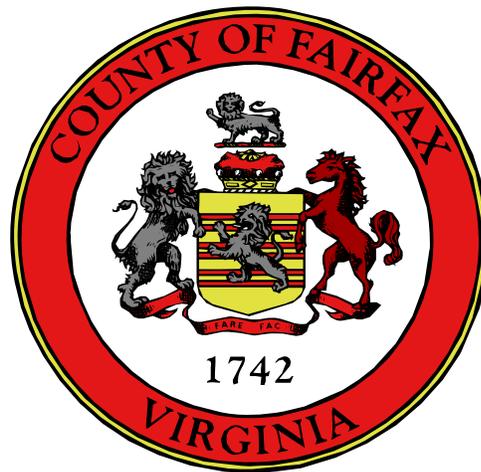


INTERNAL AUDIT REPORT

**Review of Internal Controls
Over Procurement Cards**



Fairfax County Internal Audit Office

**FAIRFAX COUNTY, VIRGINIA
INTERNAL AUDIT OFFICE
M E M O R A N D U M**

DATE: September June 24, 2003

TO: Anthony H. Griffin
County Executive

FROM: Christopher J. Pietsch, Director
Internal Audit Office

SUBJECT: Report on the *“Review of Internal Controls Over Procurement Card”*

Attached is the Internal Audit report entitled, *“Review of Internal Controls Over Procurement Card”*. It was performed as part of our FY2003 Annual Audit Plan.

The findings and recommendations of this audit were discussed with the Department of Purchasing and Supply Management (DPSM). We have reached agreement on all of the recommendations, and I will follow up periodically until implementation is complete. Its response is incorporated into the report, and the full response is attached at the end of the report. After your review and approval, we will release the report to the Board of Supervisors.

Attachment

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Introduction

The purpose of the County's Procurement Card Program is to offer County departments a procurement process for purchase and payment of low-dollar, non-inventory, non-capital items. The intent is to streamline the traditional procurement process by reducing the number of requisitions, purchase orders, invoices and checks. The procurement card system enables users to obtain goods and services faster and easier. Recently, the program has expanded to include some higher dollar payments, such as the payment of the County's bill for contract office supplies. The procurement card program generates a rebate for the County, based on total program dollars and average transaction size. The rebate for calendar year 2001 was \$ 71,437. The Department of Purchasing and Supply Management (DPSM) introduced the procurement card in November 1994. At that time a one-year pilot program was implemented consisting of five user departments. At the end of June 2002, the program has grown to forty-eight user departments, with 810 cardholders, making purchases in excess of \$12.6 million.

Unique controls have been developed for the Procurement Card Program that do not exist in a traditional credit card environment. Limits have been placed on the cards, which established certain restrictions, such as the maximum dollar amount for a single purchase, the number of transactions authorized in a day, and the maximum credit limit for each card. Also, restrictions placed on cards prevent its use for certain types of purchases (e.g., cash advances, betting) or types of vendors (e.g., bars, pawnshops, financial and related institutions). These controls help ensure that the card is used only for specific purposes and within specific dollar spending limits.

Fundamental to procurement functions is a system of principles and practices intended to protect the assets of the organization and to ensure the integrity of the financial process. That system is often referred to as the organization's "internal controls". The effective management of the procurement card process should include appropriate segregation of duties and management overview to deter errors, and prevent fraud and improprieties.

Purpose and Scope

We included a review of internal controls over procurement cards in our FY 2002 Audit Plan. We selected ten user departments that represented 53.7% of the total outstanding cards on October 31, 2001. The audit reviewed internal controls over processing by the ten user departments. The Internal Audit Office has performed a total of 29 departmental procurement card reviews since fiscal year 2000. The objectives of our testing were to determine if user departments are following County procedures and rules governing the use of the cards. These rules are outlined in Procedural Memorandum 12-02 "*Use of the County Procurement Card*". We will also determine if those rules and procedures provide reasonable assurance that the cards are used for authorized small business purchases within card restrictions, and that payments are processed, paid, and charged correctly. When card users implement effective internal control structure, the card program can serve its intended use without creating unmitigated risks, thereby increasing operating efficiency and cost savings for the County. The ten user departments selected were:

County Department	Card	% of Total \$'s
Department of Tax Administration	1	0.1%
Office for Partnerships	1	0.6%
DPW/ES-Solid Waste	7	1.6%
DPW/ES-Construction Management	4	0.3%
DPW/ES-Planning and Design	3	0.7%
Department of Finance	5	0.6%
Department of Purchasing and Supply Management	6	5.8%
Fire and Rescue	9	1.9%
Department of Vehicle Services	37	26.1%
Park Authority	106	16.0%
Totals	179	53.7%

Methodology

Audit methodology included a review and analysis of internal control procedures, procurement card expenditures and related accounting records at the ten user departments. Our review included inquiries of appropriate County employees, examination of procurement card expenditures, records and statements, interviews with users, and review of internal manuals and procedures. Our objective was to determine if adequate internal control procedures are in place and being followed by the ten user departments. We reviewed procurement card statements that were processed for July, August and September, 2001, to determine that procurement card usage was in compliance with County Procedural Memorandum 12-02 “*Use of the County Procurement Card*”. The audit was conducted in accordance with generally accepted government auditing standards.

Throughout this report we frequently used the terms User Department, Program Manager, Program Coordinator, and Bank One. These terms are defined as follows:

- **User Department** - A County department that participates in the procurement card program
- **Program Manager** - An employee who is responsible for all aspects of the procurement card program within the department
- **Program Coordinator** - An employee in the Department of Purchasing and Supply Management who administers the procurement card program for the County
- **PM 12-02** - Procedural Memorandum initiated by the Department of Purchasing and Supply Management (DPSM), dated November 30, 1999 to administrative staff, which contains County policy for use of the procurement card
- **Procurement Card** - Corporate Credit Card (MasterCard) provided through Bank One.

Executive Summary

Our review of the procurement card program disclosed that, overall, internal controls are adequate. Department of Purchasing and Supply Management (DPSM) is conscientiously administering the program. The following opportunities for enhancements to controls, limiting County liability, are discussed in detail in the report:

- The Department of Purchasing and Supply Management needs to update the Procedural Memorandum 12-02 “*Use of the County Procurement Card*” to include a definition of and the County’s position, regarding “split transactions”.
- User department’s need to adhere to internal controls as required by PM 12-02.”*Use of County Procurement Card*”. Internal control procedures at the ten user departments were well documented and included most of the elements of internal control as outlined in PM 12-02. However, the ten user departments need to address certain internal procedures to comply with PM 12-02. We presented specific recommendation to each user department in a separate memorandum.
- Adherence to internal control procedures is essential to controlling risk in the procurement card program. Increasing use of the card also increases the risks associated with the card. Periodic monitoring by DPSM and Internal Audit will be required to ensure that adequate internal controls are in place and being followed by the user departments.

Comments and Recommendations

During our limited review of the Procurement Card Program, we identified certain practices and procedures which we believe could be enhanced to strengthen internal controls, increase efficiencies and help to prevent fraudulent activities. This review was not designed or intended to be a detailed study of every procedure or activity. Accordingly, the findings and recommendations presented in this report should not be considered as all-inclusive of areas where improvements may be needed.

1. The DPSM Procedural Memorandum 12-02 needs to address and define what constitutes a “split transaction” purchase.

The DPSM Procedural Memorandum 12-02 is the base document for providing guidance to County departments for the procedures and controls as to the use, recording and administration for procurement card acquisitions. Split transactions are understood as those transactions exceeding the daily card limit amount by dividing the transaction into two or more smaller amounts for a single purchase with a vendor. This practice is suspect as a means to circumvent the required purchasing procedures for small orders or purchase orders. Even though these types of transactions are understood to be an unacceptable means of procurement, Procedural Memorandum 12-02 does not address, define or indicate the unacceptability of such a transaction.

Recommendation

Priority: Low

DPSM needs to provide a policy statement within the text of Procedural Memorandum 12-02 that defines the characteristics of a “split transaction” and the County’s position on this type of transaction. This would provide an authoritative basis for the procurement policy concerning split transactions and provide clearer guidance to departments on this issue.

Department Response

DPSM will revise PM12-02. The revised PM will include a definition of a “split transaction” and will indicate that transactions of that nature are prohibited.

2. User Department’s need to adhere to internal controls as required by Procedural Memorandum No. 12-02, “Use of County Procurement Card”.

We selected 273 transactions from ten user departments to review and test the purchasing activity for the months of July, August and September 2001. The objectives of our testing were to determine the extent that PM-12-02 “*Use of the County Procurement Card*” was being followed, and adequate internal control procedures are in place and being followed by the user departments. Some of the attributes we tested and the corresponding test results follow:

2.1 Written Departmental Internal Control Procedures

Written departmental internal control procedures were well documented and included most of the elements of internal control as outlined in PM 12-02 “*Use of County Procurement Card*”. However, the ten card user departments’ internal procedures needed updating. The following were some of the issues that users needed to address in order to comply with PM 12-02:

- Current card limitations
- Timely reporting of missing receipts
- Specify separation of responsibilities between card custodianship and reconciliation
- Retention period for receipts/sale slips
- Procedures to ensure adequate funding is available prior to card use
- Acceptable receipt if the department is unable to obtain an original receipt
- Reconciliation procedures to PVS reports, bank statements and FAMIS and the required time frames for completion
- Description of alternative reconciliation procedures if the Program Manager must use the procurement card
- Address the procedure for card cancellation and the Program Manager's responsibility in that event
- Disputed items to be reported to the bank within 60 days of receipt of the bank statement

Recommendation**Priority: Low**

The DPSM Program Coordinator should continue to advise all Program Managers to periodically review their written internal procedures. Appropriate changes should be made to correspond with current card operations and County requirements.

Department Response

DPSM will continue to review an agency's written internal procedures as part of the Procurement Assistance and Compliance (PAC) review, and advise the agency to update their procedures, as appropriate.

In the revised PM12-02, DPSM will also reiterate the need for agencies to update their internal procedures as changes occur pertinent to the card program

2.2 Physical Security Over Procurement Cards

Restricted access to only those individuals authorized to use the procurement card is a necessary preventive measure against unauthorized transactions and misuse of the cards. Two of the ten user departments under review maintained procurement cards in unsecured drawers at the Program Manager's workstation. In order to preclude possible unauthorized use and financial loss to the County, procurement cards should be physically secured with their use only possible through documented requests from those employees authorized to use the cards.

Recommendation**Priority: High**

The DPSM Procurement Card Coordinator should issue a warning to those departments who fail to physically maintain their cards in a secure manner as determined through the review process.

Department Response

DPSM will continue to spot check an agency's card security as part of the PAC review. If card security issues are discovered, they will be addressed in the PAC Review Report.

DPSM will also continue to require a written request from the appropriate agency head for replacement of a lost or stolen procurement cards to ensure he/she is aware of any potential security issues surrounding the card loss.

2.3 Split Purchase Transactions

While the approving official is in the best position to decide whether any purchase is improper, our review of the charges did not disclose any which appeared questionable, improper, or non-business related. However, we did note one instance which appeared to be a split purchase so that the user would stay within the card's single purchase limit. Card limitations provide an important safeguard against card misuse. The splitting of a single purchase transaction should be considered a direct violation of County policy.

Recommendation**Priority: Low**

We recommend that the DPSM Procurement Card Coordinator continue to issue warnings to users who are found to be engaged in split purchases to circumvent their single purchase limit.

Department Response

DPSM will continue to sample an agency's card transactions as part of the PAC review. If split transactions are discovered, the practice will be addressed in the PAC Review Report.

2.4 Vendor Receipts and Statement Approvals

The Card Program Manager reviews statements to ensure those users attach supporting receipts. If they cannot be found, the user is contacted to provide the appropriate documentation. This review process appears to be thorough. However we did find charges at eight-user departments without supporting documentation, photocopies not initialed and dated by the Program Manager, or instances where the card user could not be identified. Our conclusion was that the charges were proper and that the documentation had been misplaced.

The Program Manager is required to review the Weekly Transaction Report and indicate their approval of the charges by initialing and dating the report and/or initial and date the Bank One statement at month-end. Our review disclosed that reports at five of the ten user departments did not have the Program Manager's approval. The Weekly Transaction Report lists all transactions by user's card number that occurred from the prior week. The download reports are available online to those departments that have installed specialized vendor-provided software. Those departments that have not installed the software will receive a copy of their transactions weekly on a report sent by DPSM via the Internet.

Recommendation**Priority: Low**

The DPSM Program Coordinator should continue to advise all Program Managers to initial and date the weekly transaction report to indicate approval.

Department Response

In a DPSM memo dated November 27, 2001, we advised Program Managers of this requirement. DPSM will address this issue in greater detail in the upcoming revision to the PM12-02 and continue to monitor this activity during the PAC reviews.

2.5 Program Manager Serving As Card Custodian

Four of the ten user departments reviewed had the Program Manager responsible for the review, approval and reconciliation of procurement card transactions and was also responsible for maintaining custody of the procurement cards. In order to obtain an effective separation between card access, transaction review, and reconciliation, card custodianship should not be the responsibility of the Program Manager.

Recommendation**Priority: Medium**

The DPSM Program Coordinator should continue to advise County departments of the control risk associated with card custody and reconciliation responsibilities and require that these responsibilities be separated. If a department can show justification as to the infeasibility of such an arrangement, DPSM should require that reconciliations prepared by the Program Manager be reviewed, initialed and dated at a managerial level with-in that department.

Department Response

The DPSM Program Coordinator will continue to require that agencies maintain an adequate separation of duties for their procurement card programs. Agency procedures are evaluated as part of the PAC review process. Concerns regarding adequate separation of duties are addressed in the PAC review report to the agency director. DPSM will also readdress the issue of adequate separation of duties in the revision to PM 12-02.

2.6 Employee Acknowledgement Disclosure Form

Five of the ten user departments had a number of employees who had used the card but had not completed a Disclosure Form. PM 12-02 requires that all first-time users must sign a Disclosure Form. This form acknowledges the employee's responsibility in regards to card use and sets forth consequences for card misuse.

Recommendation**Priority: Low**

The DPSM Program Coordinator should continue to advise all Program Managers that Disclosure Forms will be reviewed during DPSM periodic program reviews. The department's Program Manager should maintain the signed form for auditing purposes.

Department Response

This advice was included in the November 27, 2001 memo to agency Program Managers. It is also included in the curriculum for Program Manager training. DPSM will continue to address the agency's requirement to maintain Disclosure forms in the PAC review.

2.7 Card Use by the Program Manager

The Program Manager at two of the ten card user departments had used the card to make departmental purchases. PM 12-02 states that the Program Manager should be an individual who does not use the card.

Recommendation

Priority: Low

The DPSM Program Coordinator should continue to advise Program Managers that when this occurs, another staff member at the same level or senior to the Program Manager must perform the reconciliation for that period. The Program Manager may use the card for travel purposes. When this occurs, the department must follow the same procedures as when the Program Manager uses the card to meet an urgent requirement.

Department Response

This advice was included in the November 27, 2001 memo to agency Program Managers. It is also included in the curriculum for Program Manager training. DPSM will address this requirement in detail in the upcoming revisions to PM 12-02.

2.8 Expenditure Log

Six of the ten card user departments were not recording all of their purchases on the Expenditure Log. There was one department from these six that did not maintain an expenditure log at all. In addition, one department recorded expenditure estimates rather than actual amounts. PM 12-02 requires, at a minimum, a system that tracks expenditures, as they occur, must be in place. Departments may use appropriate manual or computer log. Entries must be contemporaneous to give up-to-date information on funds expended.

Recommendation

Priority: Low

The DPSM Program Coordinator should continue to advise all Program Managers that Expenditure Logs will be reviewed for completeness during DPSM periodic program reviews. The department's Program Manager should periodically review the logs to determine that purchases are being entered by the cardholders.

Department Response

This requirement will be addressed in the upcoming revisions to PM 12-02.