



**Mecklenburg County
Department of Internal Audit**

Department of Finance
Accounts Payable
Audit Report 1162

July 18, 2011

Internal Audit Mission

Through open communication, professionalism, expertise and trust, Internal Audit assists executive management and the Audit Review Committee in accomplishing the Board's objectives by bringing a systematic and disciplined approach to evaluate the effectiveness of the County's risk management, control and governance processes in the delivery of services.

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MECKLENBURG COUNTY
Department of Internal Audit

To: Dena Diorio, Director, Department of Finance
From: Joanne Whitmore, Director, Department of Internal Audit
Date: July 18, 2011
Subject: Accounts Payable Report 1162

The Department of Internal Audit has completed its FY2011 audit of the Department of Finance (the “Department”) to evaluate whether internal controls currently in place effectively manage key business risks inherent to accounts payable. Internal Audit interviewed key personnel, observed operations, reviewed and evaluated policies, procedures and other documents and tested specific transaction activity from July 1, 2007 through September 30, 2010.

Internal Audit conducted this audit under the guidance of the International Standards for the Professional Practice of Internal Auditing. These standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

OVERALL EVALUATION

Countywide policies and procedures, as well as the Department’s internal policies and procedures, were generally acceptable to manage key risks associated with accounts payable. The accounts payable policies and procedures do not, however, reflect some current activities or best practices. In addition, the Department does not validate or periodically review and update information in the County’s master vendor file. Further, it does not have sufficient separation of duties over some invoice and disbursement activities and the check register review is not documented once conducted. Last, key performance indicators for some accounts payable activities to measure the success of the process have not been established.

These issues, as well as recommendations and management’s response, are discussed in detail in the following pages. Internal Audit will conduct a follow-up review at a later date to verify that recommendations are implemented and working as expected.

ISSUES

1. The Department's accounts payable policies and procedures do not document some current activities and best practices.
2. The Department does not validate or periodically review and update the master vendor file.
3. The Department does not have sufficient separation of duties over some invoice and disbursement activities.
4. Key performance indicators for some accounts payable activities have not been established.
5. Department staff does not document their review of the check register.

We appreciate the cooperation you and your staff provided during this audit. Please feel free to contact me at 704-336-2575 if you have any questions or concerns.

cc: Harry Jones, County Manager
Michelle Lancaster, General Manager
John McGillicuddy, General Manager
Bobbie Shields, General Manager
Audit Review Committee Members

BACKGROUND

The Department of Finance is responsible for the administration of County finances in accordance with State laws and budget ordinances established by the Mecklenburg Board of County Commissioners. The Department's mission is to ensure quality financial services and information is provided to management, departments, the financial community and others for the benefit of the County and its residents. Accounting duties include, but are not limited to, the administration of Advantage, the County's financial system; investments of County money; financial reporting; cash flow and banking; debt management; budgetary compliance and payroll and accounts payable.

Policies and Procedures

As part of its oversight duties, the Department establishes and documents countywide financial policies and procedures with which all departments must comply. County departments may adopt more stringent control practices for their operations but all exemptions to countywide policies and procedures must be first approved by the Department. In addition, the Department writes internal policies and procedures for its staff activities. As a result of a prior audit, the Department is developing a formal, documented process to ensure countywide and internal policies and procedures are routinely reviewed and updated as necessary.

Policies and procedures are important control activities to help ensure management's directives are carried out while mitigating risks that may prevent the organization from achieving its objectives. Policies and procedures include a range of activities, such as approvals, authorizations, verifications, reconciliations, operational reviews, asset security and separation of duties. Thus, it is critical that the Department's formal, documented policies and procedures provide adequate guidance to help ensure staff performs their activities in accordance with management's expectations and that adequate controls are in place to effectively mitigate risks inherent to those activities.

Invoice and Disbursement Processing

Mecklenburg County procures goods and services through a decentralized accounts payable process. The Department uses Advantage to process accounts payable and disbursement transactions. Invoices for goods and services are addressed to and received by the various County departments, who are responsible for ensuring items invoiced have been received in accordance with County policies and procedures. Invoices processed and approved within the various County departments are then submitted to the Department of Finance for final approval and payment.

Current County policy requires payment of "vendor invoices within 30 days of the vendor's invoice date and as soon as the supporting documentation has been received from the departments". The Department of Finance enters travel-related payment requests into Advantage upon receipt of an approved travel form submitted by the various departments.

Several Department of Finance staff process payments for his or her assigned County departments. There are manual reviews, such as validating payment requests and supporting documentation and reviewing the check register for unusual disbursements. System access rights are assigned within Advantage based on role and position.

Once a payment request is properly created and approved within Advantage, the payment is disbursed in the form of a check, an Electronic Funds Transfer (EFT) or a wire transfer. Checks and EFTs are processed daily and the County encourages all vendors to receive their payments via EFT. Wire transfers are rarely used and must be approved by Department of Finance management prior to being processed.

Invoice and Disbursement Processing Data		
Activity Description	FY2010	FY2011 as of 9/30/10
Invoices Processed	121,438	25,501
Percentage of Invoices Processed as EFTs	13%	17%

Source: Department of Finance, unaudited

Vendor Set-up and Maintenance

The Advantage system maintains the County's master vendor file, which is the main source for vendor information, such as vendor name, vendor number, contact information and tax identification number (TIN). The master vendor file is the critical reference the County uses to process vendor payments and employee reimbursements and to file Internal Revenue Service (IRS) Form 1099 information returns related to vendor payments.

All companies or individuals wanting to do business with the County must complete and submit a signed IRS Form W-9. County departments may request an address change or an additional remittance address for a vendor by submitting documents, such as a vendor's invoice, that reflects the change. Miscellaneous vendor codes are used for miscellaneous refunds and other approved expenses.

Number of Vendors and New Vendor Registrations		
Activity Description	FY2010	FY2011 as of 9/30/10
Total number of vendors	23,082	23,422
New vendor registrations processed (included in total number of vendors)	1,661	340

Source: Department of Finance, unaudited

ISSUES, RECOMMENDATIONS AND RESPONSES

Issue 1: The Department's accounts payable policies and procedures do not document some current activities and best practices.

Risk Observations

- A. There are no documented procedures outlining the process for staff to verify the approval signature for travel-related expenditures.
- B. Existing policies and procedures do not provide staff guidance for validation of vendor information prior to setting up new vendors in the master vendor file. Nor do the policies and procedures require a periodic review of the master vendor file to remove or deactivate duplicate or inactive vendors and other maintenance efforts.
- C. Existing policies and procedures do not address separation of duties requirements for some invoice and disbursement functions.
- D. The Department does not have a documented policy and procedure in place to identify and recover duplicate payments disbursed to vendors.

Recommendations

Internal Audit recommends that the Department of Finance:

- A. Establish an internal and countywide policy and procedure that requires each County department to submit to the Department of Finance a list of authorized approvers and their respective signatures for travel-related expenditures. The information should be updated when any changes occur.
- B. Develop and implement more comprehensive documented policies and procedures for master vendor file management to improve its accuracy and reliability. Staff should be trained on the policies and procedures. The written policies and procedures should have a framework that establishes, at a minimum:
 - a. requirements and process to validate vendor names, addresses, TINs and telephone numbers prior to setting vendors up in the Advantage master vendor file
 - b. requirements to compare new vendors against debarment lists
 - c. timeframe to periodically review and clean up the master vendor file
 - d. procedures to identify and remove or deactivate duplicate or inactivate duplicate vendors
 - e. an independent review of changes to the master vendor file
 - f. data entry requirements, such as vendor naming conventions and critical field entries
 - g. master vendor file change management for all changes
 - h. management oversight requirements
- C. Develop and implement a more comprehensive documented policy and procedure for separation of duties requirements within the invoice and disbursement process that establishes, at a minimum:
 - a. definition of adequate separation of duties for authorization, recording, verification, custody and system administration
 - b. identification of incompatible functions based on authorized roles and responsibilities
 - c. mitigating controls used to manage areas of inadequate separation of duties
 - d. periodic assessments to identify changes that may impact controls

- D. Develop and implement policies and procedures to identify and recover duplicate payments disbursed to vendors. In addition, management should follow up on the 113 potential duplicate payment events auditors identified in the audit period FY2008 through the first quarter of FY2011 to determine those that are actual duplicate payments and seek recovery where feasible.

Management Response

Agree. The Finance Department will revise its accounts payable policies and procedures to reflect current activities and best practices as recommended by Internal Audit. The anticipated completion date is September 30, 2011. The Finance Department will seek input from the Internal Audit Department on the draft revisions to policies and procedures prior to final approval of the revisions.

County Manager’s Response

The Finance Department’s plan to revise its accounts payable policies and procedures is appropriate to address the Internal Audit findings and recommendations.

Issue 2: The Department does not validate or periodically review and update the master vendor file.

Risk Observations

- A. Although the Department requires all vendors to provide a completed and signed Form W-9 before they are set up in the master vendor file, it does not validate the information. Nor does staff ensure the vendors are not on a debarment list. Failure to have a validation process increases the risk of inaccurate master vendor file data and provides an opportunity for errors and fraud.
- B. The master vendor file contains duplicate vendors and missing information, such as TINs and telephone numbers. Moreover, the master vendor file contains vendors who have been inactive for an extended period of time. Failure to update the master vendor file and remove or deactivate duplicate and inactive vendors increases the opportunity for duplicate payments and fraud.
- C. The Department does not review and approve all changes to the master vendor file.

Master Vendor File—Active Vendor Records			
Data Issue			Number of Records
Vendors with duplicate TINs			665
Vendors with same name and TIN, different vendor number			267
Vendors with missing TINs			7,547
Vendors with missing telephone numbers			18,671
Payment Activity— Active Vendors			
Period of Inactivity	Vendors with Activity	Vendors without Activity	% Inactive Vendors
Last 15 months (07/01/2009 – 09/30/2010)	7,148	15,900	69%
Last 18 months (04/01/2009 – 09/30/2010)	7,842	15,206	66%
Last 24 months (10/01/2008 – 09/30/2010)	9,955	13,093	57%

Source: Internal Audit analysis of Advantage data as of October 5, 2010

Recommendations

Internal Audit recommends that the Department of Finance:

- A. Validate information provided by the vendor on the IRS Form W-9 and check against debarment lists before entering vendor data into the master vendor file.
- B. Remove or deactivate duplicate and inactive vendors from the master vendor file. Because of the risk exposure of duplicate payments and fraud, management should make corrective action a high priority.
- C. Design a report detailing all additions, deletions and other changes made to the master vendor file, including the identity of the staff making the change. A senior level manager should periodically review and approve the report.

Management Response

Agree. Prior to the audit, the Finance Department has taken several steps to better manage the vendor file. The Department no longer accepts W-9 forms directly from departments and requires that the information be submitted directly by the vendor. In addition, several years ago the Finance Department no longer allowed departments to modify the vendor file to insure that vendors are entered using a consistent naming scheme and validates to insure duplicate vendors are not entered.

The Department is unable to remove inactive or duplicate vendors from the vendor file as the payment history associated with those vendors will no longer be accessible. However, the Finance Department has begun developing and implementing processes to deactivate inactive/duplicate vendors from the master vendor file. This will prohibit any errant payments to those vendors but will maintain the relevant history. The anticipated completion date for inactivating these vendors is July 31, 2011.

In addition, the Finance department will implement procedures to validate vendor information prior to vendor setup and conduct reviews of master vendor file additions and changes as recommended by Internal Audit. The anticipated completion date to implement these procedures is September 30, 2011.

The Finance Department will seek input from the Internal Audit Department on the proposed procedures prior to implementation.

County Manager's Response

The steps already being implemented by Finance Department to validate vendor files, along with its plan to deactivate inactive/duplicate vendor files and validate/review vendor information are appropriate to address the Internal Audit findings and recommendations.

Issue 3: The Department does not have sufficient separation of duties over some invoice and disbursement activities.

Risk Observations

- A. Three department staff members are assigned specific County departments for which they approve all payment requests. They are also assigned on a rotational basis the responsibility to review the printed checks for accuracy. While management has separated the review and printing processes, staff still

has the responsibility for multiple aspects of the invoice and disbursement process. Insufficient separation of duties, however, could increase the opportunity for errors and fraud.

- B. Internal Audit reviewed disbursement activity between FY2008 and the first quarter of FY2011 and identified 93 PRC and GAX payment requests¹ initiated by the Department's two system administrators. While system administrators require full system access to carry out system support duties, which may include creating or approving payment requests, insufficient separation of duties could increase the opportunity for errors and fraud.

Recommendations

Internal Audit recommends that the Department of Finance:

- A. Separate the authorization and review processes to ensure no one person has the responsibility to conduct two or more phases of the invoice and disbursement process. If adequate segregation of duties cannot be achieved, management should put appropriate mitigating controls in place.
- B. If adequate segregation of duties cannot be achieved, management should put appropriate mitigating controls in place. Periodically reemphasize the roles, responsibilities and restrictions of system administrator staff.

Management Response

- A. Partially agree. The Finance Department separates the duties related to the authorization and review of disbursements by rotating responsibility for the check run and review process daily. The process of running the checks involves putting the check stock in the printer and initiating a process that moves transactions from a vouchers payable file to a disbursement file. The check run cannot be modified or altered by a single individual and presents very little risk for fraud or abuse. These duties are currently separated because these same staff also has responsibility for approving payments. This separation ensures that no one person conducts all three parts of the process on any given day.

Additionally, staff responsible for approving payments in the Finance Department does not have the ability to generate payment requests. Payment requests are generated at the department level and two levels of sign-off are required before the payment is forwarded to the Finance Department for final approval and disbursement. The separation between creating a payment request, and approving a payment and generating a disbursement is a significant control that reduces the risk of fraud. Collusion between at least two employees would need to exist for fraud to occur.

However, to be responsive to the issue raised by the Internal Audit Department, the Finance Department will assign one individual responsibility for printing and reviewing the checks on a daily basis. Since processing the check run is a low risk activity, combining these activities does not pose a significant threat to internal controls. However, when the assigned individual is away, other staff members who do approve payments will need to process the check run and review the checks. This requires that mitigating controls be implemented. Therefore, the Financial Reporting Manager will review the check run on a monthly basis and document that review.

- B. Agree. With regard to the 93 payments created over a three year period by the IT Business Analysts, 27 were related to paying vendors as a course of business, and the others were entered to assist users

¹ PRC: Commodity-based Payment Request – Payment of a Purchase Order; GAX: General Accounting Expenditure – Payment that either references a general accounting encumbrance or has no reference to an encumbrance

with processing their documents. IT Business Analysts provide support to departments on application issues and problems. This requires that they have full system access. The 27 payments included invoices from CGI for the financial system upgrade and maintenance and to department managers for petty cash. It should be noted that even though an IT Business Analysts created the payment documents in the system, they were approved by someone else representing proper separation of duties each time.

Going forward, another person in the Finance Department will be assigned responsibility for processing those vendor invoices and maintaining petty cash funds for departments. For those documents that are created to assist other departments, the IT Business Analysts will maintain a log of those transactions that will be submitted to the Finance Director on a monthly basis for review. All of these process changes will be documented in the Finance Department's internal policies and procedures.

County Manager's Response

The Finance Department's plan to provide additional management oversight and review as mitigating controls is appropriate and consistent with the Internal Audit recommendations.

Issue 4: Key performance indicators for some accounts payable activities have not been established.

Risk Observations

While the Department has service level performance measures, as published each year by the County, it has not established key performance indicators (KPIs) for some of its accounts payable activities, such as the percentage of invoices processed timely or the number of duplicate payments made. Such KPIs would articulate expectations, monitor performance and react to shortfalls.

Recommendations

Internal Audit recommends that the Department of Finance develop formal KPIs for the major components of its accounts payable process, such as accuracy, timeliness, training or other key process objectives.

Management Response

Agree. The Finance Department currently tracks data for over thirty performance measures across all functions in the Department consistent with the requirements of the County's balanced scorecard. However, the Finance Department will develop key performance indicators for the major components of the accounts payable process as recommended by the Internal Audit Department. The Finance Department will work with its SOI Analyst to create measures consistent with their guidelines. The anticipated completion date is September 30, 2011.

County Manager's Response

The Finance Department's plan to collaborate with SOI and develop key performance indicators for the accounts payable process is appropriate to implement the Internal Audit recommendations.

Issue 5: Department staff does not document their review of the check register.

Risk Observations

While a staff person reviews the check register for any unusual disbursements, it is not evidenced on the check register or otherwise documented. As a result, there is no way to validate that the review of the check register has been completed.

Recommendations

Internal Audit recommends that the Department of Finance have the check register reviewer initial and the date the check register or otherwise document that a review has been conducted.

Management Response

Agree. The Finance department has implemented a process as of June 2011 to document the review of the check register. On a daily basis, the staff person reviewing the check register will electronically initial the check register and document any errors identified.

County Manager's Response

The Finance Department's implementation of electronically initialing the check register upon document review is appropriate and consistent with the Internal Audit recommendations.