

AUDIT TEAM

Jim Williamson, CPA, CIA, City Auditor
Matt Weller, CPA, Assistant City Auditor
Lori Rice, MBA, Audit Manager

**CITYWIDE SERVICE CONTRACT
PAYMENT CONTROLS**

JANUARY 28, 2014

MAYOR AND CITY COUNCIL

<i>Mick Cornett</i>	<i>Audit Committee, Mayor</i>
<i>James Greiner</i>	<i>Ward 1</i>
<i>Ed Shadid</i>	<i>Ward 2</i>
<i>Larry McAtee</i>	<i>Audit Committee, Ward 3</i>
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<i>John A. Pettis Jr.</i>	<i>Ward 7</i>
<i>Patrick J. Ryan</i>	<i>Ward 8</i>



January 28, 2014

The Mayor and City Council:

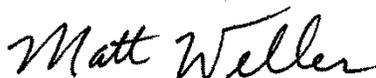
The Office of the City Auditor has completed an audit evaluating the adequacy of citywide controls ensuring segregation of responsibilities over service contract payments.

Based upon the results of our audit, we believe that, as of August 31, 2013, citywide controls ensuring segregation of responsibilities over service contract payments should be improved to prevent or detect erroneous or fraudulent payments.

The City's purchasing policies should be revised to clearly require that two employees with reasonable knowledge of the purchase transaction either be involved in approving the purchase or verifying receipt of the purchase. Additionally, purchasing policies should be revised to specifically address principles for service contract progress payment approvals.

All comments, recommendations, suggestions and observations arising from our audit have been discussed in detail with appropriate representatives from management. These discussions were held to assure a complete understanding of the content and emphasis of items in this report. A response to this report from management is attached.


Jim Williamson
City Auditor


Matt Weller
Assistant City Auditor


Lori Rice
Audit Manager

CITYWIDE SERVICE CONTRACT PAYMENT CONTROLS

AUDIT OBJECTIVE, BACKGROUND, SCOPE AND METHODOLOGY

The objective of this audit was to evaluate the adequacy of citywide controls ensuring segregation of responsibilities over service contract payments as of August 31, 2013.

The City Council approved a resolution on October 2, 2012 authorizing the Mayor to request an audit by the Oklahoma State Auditor & Inspector (SA&I) of certain City contracts for implementation of various public safety systems. As a result, the SA&I issued a special audit report on April 30, 2013, which included an observation that the Public Safety Capital Projects (PSCP) Program Manager was the only City staff person verifying the existence of deliverables prior to authorizing payments to the public safety systems consultant. An additional invoice review prior to payment authorization by qualified, knowledgeable staff was recommended by the SA&I to prevent or detect erroneous public safety systems vendor payments.

Management's response to the SA&I's recommendation stated that City purchasing policies and procedures would be evaluated to determine whether a formal policy for such additional review is warranted citywide. Our audit was designed to complete this evaluation. Procedures performed during our audit included interviewing management personnel; reviewing City purchasing policies; assessing the City's purchasing process including both PeopleSoft financial system (PeopleSoft) and centralized payment approval processes; evaluating department-level payment approval procedures; and examining service contract terms.

We conducted our audit in accordance with generally accepted government auditing standards. Those 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.

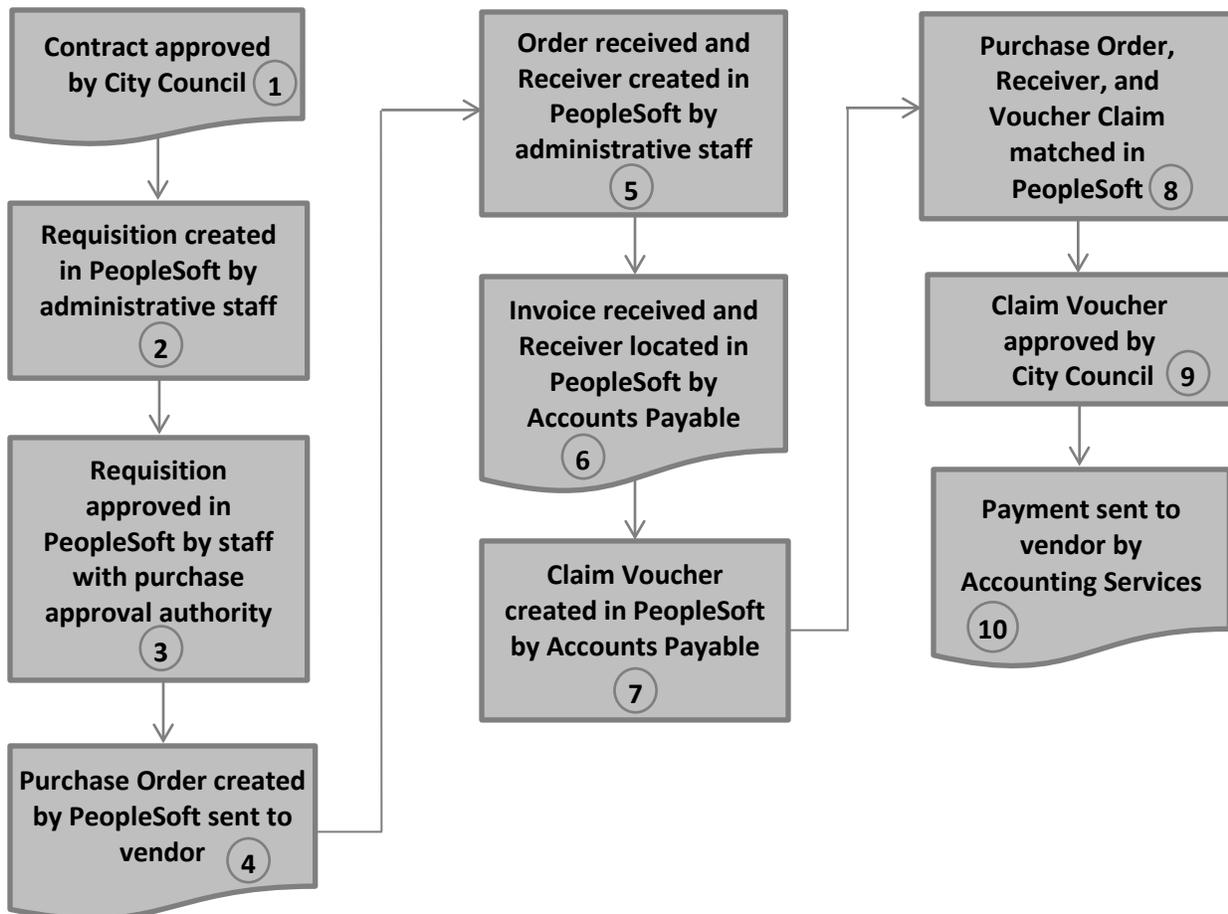
The following section of this report includes a recommendation intended to provide constructive suggestions for improving segregation of responsibilities over service contract payments. The recommendation included in this report is immediately followed by *management's response*. *Management's response* is attached to this report in its entirety.

RESULTS OF WORK PERFORMED

Results of our audit indicate that, as of August 31, 2013, citywide controls ensuring segregation of responsibilities over service contract payments should be improved to prevent or detect erroneous or fraudulent payments.

City purchasing policies require departments to assign purchasing duties in such a fashion that no one individual controls all phases of the transaction. PeopleSoft purchase processing steps generally involve two separate employees approving or initiating certain actions involving a purchasing transaction. With respect to service contracts, however, both employees responsible for these PeopleSoft steps are not always reasonably knowledgeable of the actions occurring, making these PeopleSoft steps a clerical function rather than a safeguard against a single employee controlling the entire transaction. While City purchasing policies require departments to establish internal controls ensuring proper segregation of purchase order and receiver creation duties, involvement by knowledgeable employees in performing these duties or recommended controls to compensate for inadequate segregation are not addressed.

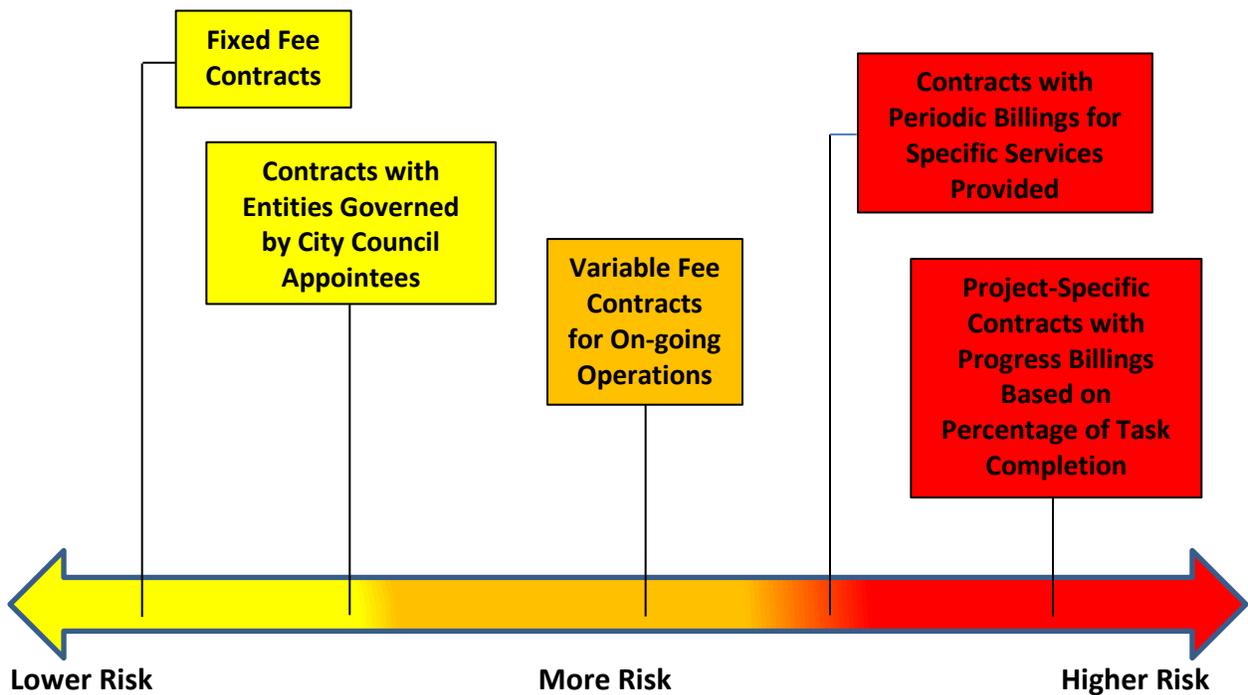
Exhibit 1. City's Purchasing Process Steps



While PeopleSoft requires separate employees to approve or initiate certain purchasing actions, in most cases the same City staff person is effectively responsible for authorizing service contract purchases, verifying receipt of services and initiating service provider payments. For service contracts, the contract administrator usually directs administrative staff to enter a requisition ② that is then approved by the contract administrator ③. The contract administrator subsequently reviews invoices from service providers to verify contract deliverables have been received and, if so, instructs administrative staff to create a receiver in PeopleSoft to initiate the payment process ⑤. Administrative personnel generally rely on the contract administrator’s representation that service deliverables have been received and have no ability to independently confirm receipt.

A single City staff person effectively controlling all phases of the purchase transaction creates the risk for erroneous or fraudulent service contract payments to go undetected. Risks resulting from inadequate segregation of duties vary depending on service contract characteristics such as type of service, provider, fee structure, and billing frequency.

Exhibit 2. Service Contract Risk Spectrum



Involvement in service contract purchase approvals or verification of service contract receipts by a second City staff person with sufficient knowledge of the services would mitigate the above risks with respect to most service contract payments. However, service contracts involving progress payments over the life of the contract generally only involve a single purchase approval when the contract is executed. For these contracts, involving a second City staff person with sufficient knowledge in verifying receipt of invoiced services would be required to mitigate the above risks.

Recommendation

The City's purchasing policies should be revised to clearly require that two employees with reasonable knowledge of the purchase transaction either be involved in approving the purchase or verifying receipt of the purchase to ensure reasonably adequate controls over payment approvals. Additionally, purchasing policies should be revised to specifically address principles for service contract progress payment approvals which generally occur without individual purchase approvals including:

- Requiring invoice review by a second City staff person with sufficient knowledge to corroborate whether an invoiced service was received.
- When and how invoice review responsibilities will be assigned (specified in request for proposal, determined at contract award, etc.).
- Appropriate level of contractual and/or operational knowledge required to perform the corroborating invoice review.
- Suggested contract terms to establish billing consistency enabling an efficient, plausible invoice review by a second City staff person (aligning deliverables with payment schedule, performance data, etc.).
- How invoice review by a second City staff person will be evidenced (electronic sign-off in PeopleSoft or manual sign-off in contract files).
- Acceptable compensating controls when invoice review by a second City staff person is not practical (contract audit requirements, Council representation on governing body, etc.).

- Required approvals for exceptions to the policy and how such exceptions will be documented when it is determined that invoice review by a second City staff person is not warranted or practical.

Finance Department Response

We concur with the recommendations of the City Auditor regarding service contract payment controls. The City's purchasing policies, including the guidelines for professional consultant selection, will be reviewed and updated to incorporate these recommendations. The purchasing policies and procedures will be updated by May 1, 2014 and the training will be completed by September 1, 2014.



MEMORANDUM

The City of
OKLAHOMA CITY



TO: Jim Williamson, City Auditor

THROUGH: James D. Couch, City Manager *JDC*

FROM: Craig Freeman, Finance Director *CF*

DATE: January 17, 2014

SUBJECT: Audit No. 13-05 - Finance Department – Citywide Service Contract
Payment Controls

Recommendation

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