CITY OF KILLEEN

PURCHASING CARD PROGRAM AUDIT

CITY MANAGER TAKES CONCRETE STEPS TO REPAIR STRUCTURALLY FLAWED PROGRAM

Audit Report #18-01

A Report to the City of Killeen Audit Committee

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AUDIT REPORT

HIGHLIGHTS

Why Was This Audit Conducted?

The City Auditor conducted this audit because: (1) the program has never been audited;
(2) p-card programs are an inherently high-risk area; (3) the program experienced a prior incident of abuse; and (4) the City Manager had requested a review of the program.

What Was Recommended?

The City Auditor recommended thorough policy revisions to align program policy with best practices, as well as the development of reporting systems to help management monitor and evaluate the program.

Purchasing Card Program Audit

Mayor and Council,

I am pleased to present this audit of the City of Killeen's Purchasing Card Program.

BACKGROUND

The City's Purchasing Card (P-Card) program was created in FY 2008 to help streamline the procurement process for low-dollar, routine purchases. From FY 2012 through FY 2016, p-card purchases doubled from $2.5 million to $5 million. At the time of the audit, there were a total of 243 p-cards in circulation, or about 1 p-card for every 5 employees.

OBJECTIVES AND SCOPE

The objectives of the audit were to (1) determine if program policies are in line with GFOA best practices, and (2) assess both the design and implementation of the program's internal controls. The scope of the audit focused primarily on, but was not limited to P-Card program activity from FY 2012 through FY 2016.

AUDIT RESULTS

The P-Card program's internal control system is deeply flawed, resulting from a legacy of permissiveness and weak internal controls established early in the program's history. The City revised its policy in October 2016, in the wake of the former City Auditor's investigation into habitual, long-term abuse of p-card privileges, but the systemic problems went unaddressed. The City Manager agreed with the findings and recommendations, and has already taken significant steps to address the program's weaknesses, including sharply reducing the number of p-cards in circulation, establishing a formal p-card training program, developing a process for documenting p-card violations, and strengthening policy guidance on p-card operations.

The City Auditor greatly appreciates the cooperation of the City Manager, Finance Director, Purchasing Division and departmental staff in the completion of this audit.

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INTRODUCTION

The City Auditor conducted this performance audit of the City of Killeen's Purchasing Card (P-Card) program pursuant to Article III, Chapter 40 of the City Charter, as Amended May 11, 2013, and in accordance with the City Auditor's Annual Audit Plan, approved by the Audit Committee, April 17, 2017.

We included this audit in the Annual Audit Plan based on the following criteria: (1) the program has never been audited; (2) purchasing card programs are an inherently high-risk area; (3) the program has experienced at least one prior incident of abuse; and (4) the City Manager had requested a review of the program.

The objectives of the audit were to (1) determine if the City's P-Card program policies are in line with Government Finance Officers Association (GFOA) and other best practices; and (2) assess both the design and implementation of the program's internal controls with regard to their ability to deter and detect the occurrence of fraud and abuse.[1] The scope of the review focused primarily on, but was not limited to P-Card activity from FY 2012 through FY 2016.

Background

Local governments' use of p-cards dates back to the early 1990's, and has gained in popularity since as a more efficient and cost effective alternative to the traditional purchase-order-driven procurement process for low-dollar, high-volume purchases. The benefits most often attributed to p-cards include (1) the reduction in operational costs, with net savings estimated at about $82 per transaction; (2) more timely payments to vendors; (3) quicker delivery of goods and services; and (4) rebates on P-Card usage.[2]

City-wide use of p-cards dates back about 10 years to the creation of the City's original P-Card program in FY 2008. Between FY 2012 and

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[1] The GFOA represents public finance officials throughout the United States and Canada. Founded in 1906, the GFOA's mission is to enhance and promote the professional management of governmental resources.

[2] The National Institute of Governmental Purchasing in its 2009 Purchasing Card Benchmark Survey of American cities and counties estimated the average net savings from P-Card usage at about $82 per transaction.

FY 2016, the number of p-cards in circulation averaged about 285. At the time of audit, there were 243 p-cards in circulation.

In FY 2012, the City established a P-Card Administrator position in its Purchasing Division, and hired a full-time P-Card Administrator to monitor the program. Prior to that, day-to-day monitoring of p-card activity fell largely to various Finance staff. It was at this time that the City moved from JP Morgan, its initial p-card vendor, to its current provider, Citibank. From FY 2012 through FY 2016, P-Card program activity grew both in the total dollars expended, which doubled from approximately $2.5 million in FY 2012 to more than $5 million in FY 2016, and in the number of p-card transactions, which grew from about 14,000 in FY 2012, to 16,000 in FY 2016.

P-Card Use: Dollars Spent

Source: AS400

P-Card Use: Number of Transactions
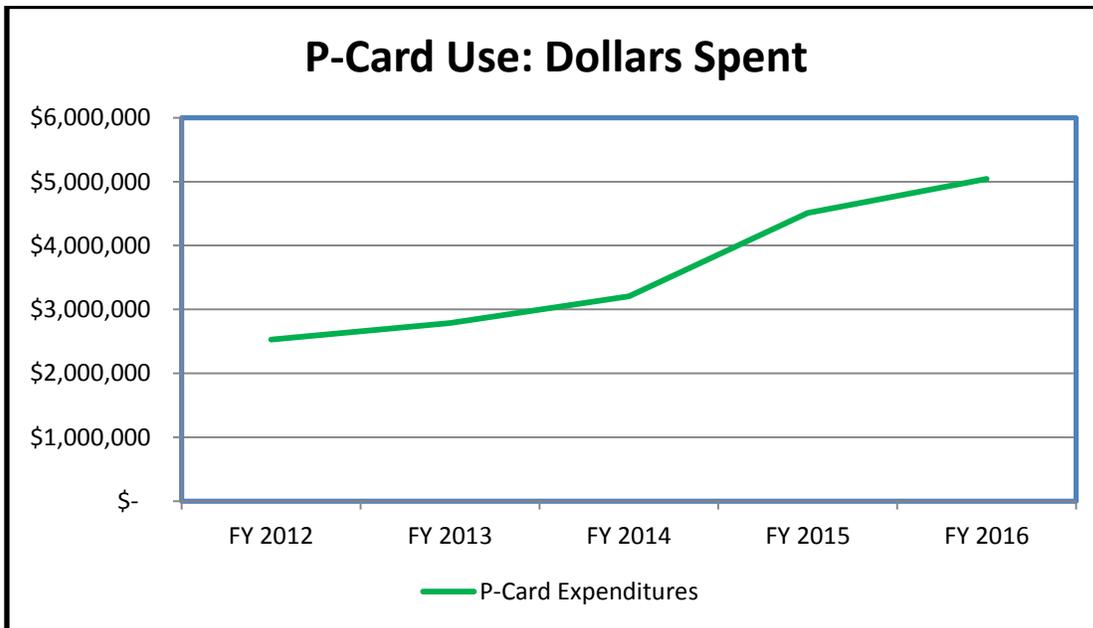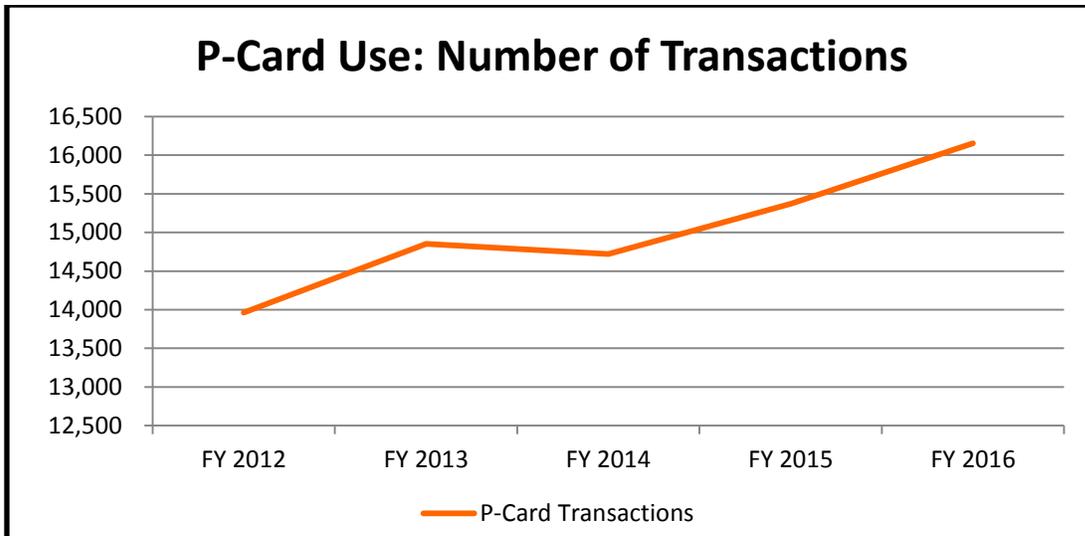
Source: AS400

P-Card Program: Players and Processes

The P-Card program revolves around three main players: The P-Card Administrator, who serves as the central hub for p-card activity; the P-Card Processors, who serve in a liaison capacity between the departments and the P-Card Administrator, and the P-Cardholders. Duties performed by each include, but are not limited to the following:

P-Card Administrator
- ▶ Issues new cards requested by the departments, and cancels cards no longer in use.
- ▶ Sets monthly and per-transaction limits for cards issued, as well as the appropriate Merchant Commercial Codes (MCC).[3]
- ▶ Downloads transactions weekly from Citibank and disseminates to P Card Processors via AS400.[4]
- ▶ Reviews receipts received weekly from P-Card Processors for completeness and accuracy.
- ▶ Prepares weekly batches of p-card transactions and forwards to Accounts Payable for payment to Citibank.
- ▶ Provides training and guidance to processors and cardholders.

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[3] Four-digit number used to categorize businesses by the type of goods or services it provides. MCC codes can be used along with spending limits to tailor authorized p-card use to each cardholder account.

[4] AS400 refers to the Superion enterprise resource planning (ERP) software currently used by the City.

<u>P-Cardholders</u>
- ▶ Makes authorized purchases of goods and/or services, when necessary, in accordance with P-Card policy guidance.
- ▶ Obtains receipts for all purchases and submits to P-Card Processors on a timely basis.
- ▶ Ensures that taxes are not included in the purchase.
- ▶ Maintains p-cards in a secure location.

<u>P-Card Processors</u>
- ▶ Obtains and reviews receipts for pending transactions from P-Cardholders on a timely basis.
- ▶ Assigns pending transactions to the proper budget account.
- ▶ Provides weekly transactions with back-up to the Department Director for review and approval.

Statement of Compliance with Audit Standards

We conducted this performance 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.

FINDINGS AND RECOMMENDATIONS

City Manager Has Taken Concrete Steps to Repair Structurally Flawed Program

The City's P-Card program can be likened to a sturdy house frame resting upon a fundamentally flawed foundation. The P-Card Administrator, P-Card Processors, and the overwhelming majority of P-Cardholders are dedicated, conscientious professionals, but they are working within the confines of a fundamentally flawed system of internal controls. These systemic flaws include the lack of pre-authorization for many purchases, no provisions for reconciliation of p-card statements, and the lack of a formal training program for cardholders and their supervisors. In addition, the program has no mechanism for reviewing p-card utilization. As a result the number of p-cards in circulation has been allowed to proliferate beyond the needs of the program. Finally, the lack of clarity and consistency in both the design and implementation of policy guidance on prohibited practices has allowed the program to become vulnerable to abuse. Taken as a whole, these weaknesses have compromised the internal control system's capacity to deter and detect incidents of fraud and abuse. The City Manager has already taken significant corrective action to address some of these program weaknesses, including sharply reducing the number of cards in circulation, implementing a p-card training program, and strengthening the City's program policy, which will be required to fully address the structural deficiencies in the internal control system.

Wake-up Call

On November 18, 2015, the former City Auditor was notified by the Chief of Police of an allegation of inappropriate p-card use by an employee in the Fire Department. The City Auditor's investigation revealed a pattern of abuse going back as far as 2008, which included payments for personal phone bills, unauthorized car rentals, and meals at local restaurants, resulting in approximately $2,700 in fraudulent charges. According to colleagues, the employee had encouraged at least one other employee to use their card for personal purchases, indicating he was not only p-card abuser, but a corrupting influence, as well. By the time the former City Auditor was notified, the former Executive Director for Support Services had already directed the

P-Card Administrator to reduce the employee's p-card limit to $0.00, effectively suspending the card, albeit only after the 15th incident in a six-year string of "accidental" personal purchases. Surprisingly, the Executive Director chose not to fully revoke the employee's p-card privileges, suggesting that at some point the individual's p-card privileges might be reinstated. It would be January 2016, nearly eight years after the initial "accidental" personal purchase that the P-Card Administrator, in the absence of further direction from above, acted on her own initiative and cancelled the employee's p-card. The department took no disciplinary action against the employee during the six-year period of abuse. It was only after the former City Auditor's investigation that the department finally acted, in the form a letter of counseling. While the costs for the fraudulent charges were ultimately recovered from the employee, the incident exposed fundamental weaknesses in the program's internal control system, in its design, and implementation.

The Fraud Triangle
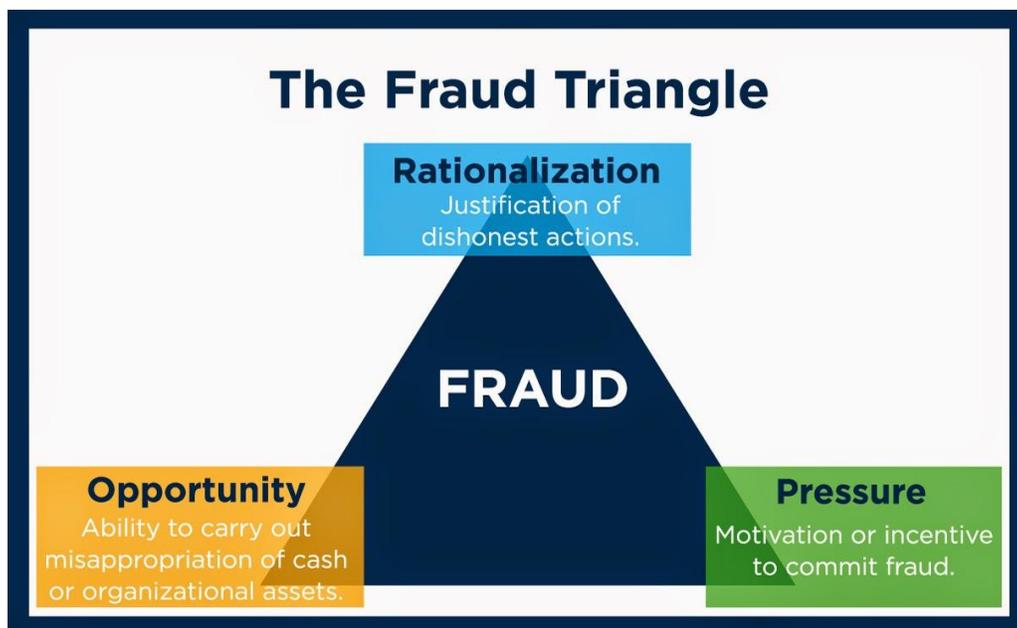
In the early 1950's American criminologist Donald Cressey developed a theory defining the three elements necessary for fraud to occur. That theory, now widely accepted, is referred to as the "Fraud Triangle." The element termed "Pressure" refers to external forces pushing down on an employee, usually financial in nature. "Rationalization" refers to an employee's ability to justify in their own mind the dishonest act. "Opportunity" refers to the ability to get away with the dishonest act.

There is arguably little an employer can do about external pressures affecting their employees; perhaps employee assistance programs, to a certain extent. There is even less an employer can do to affect an employee's psychological make-up. The one area, in which employers can exercise control is in closing the window of opportunity to commit fraud. This is where the internal control system comes into play.

The Internal Control System

The term "internal control" typically conjures up images of policies and procedures involving checklists, logs, reconciliations and other procedures. However, policies and procedures are but one component among several that comprise an effective internal control system. To understand how and why the system failed in the case reported to the former City Auditor, it is helpful to know what these components are, and how they relate to the system as a whole.

In 1992, the Committee of Sponsoring Organizations (COSO) developed a conceptual framework defining the components necessary to create an effective system of internal controls.[5] That model is now widely recognized as the definitive standard against which organizations measure the effectiveness of their internal control systems. COSO recently expanded its conceptual framework by drilling down into the components to further define their guiding principles, but the five core components remain the same, as follows:

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[5] COSO was organized in 1985 to provide thought leadership dealing with three interrelated subjects: enterprise risk management (ERM), internal control, and fraud deterrence. The sponsoring organizations were the American Accounting Association (AAA), the American Institute of Certified Public Accountants (AICPA), Financial Executives International (FEI), the Institute of Internal Auditors (IIA), and the Institute of Management Accountants (IMA).

- **Control Environment**: Sometimes referred to as "the tone at the top," Control Environment refers to the example set by executive management in its attitude toward the organization's internal controls. In short, Control Environment refers to the extent to which management "walks the walk" in its approach to internal controls.

- **Risk Assessment**: What can possibly go wrong? Risk Assessment seeks to identify risk factors, both external and internal, that could prevent the organization from achieving its objectives.

- **Control Activities**: Control Activities refers to the policies and procedures put in place to meet the organization's objectives, while minimizing the risk factors identified in the risk assessment.

- **Information and Communication**: The internal control system cannot exist in a vacuum. Information and Communication refers to the need to foster the flow of relevant information both to and from management regarding the effectiveness of the internal control system at meeting the organization's objectives.

- **Monitoring**: Management needs to continually evaluate the performance of its system of internal controls to identify and correct any flaws in the system.

In the following pages, we will evaluate the P-Card program's internal control system through the lens of the COSO conceptual framework. It is important to reiterate that the current Administration has taken significant steps since the completion of audit fieldwork to strengthen the program, and those actions are **highlighted** throughout this report.

Control Environment – Walking the Walk

Whether intentional or unintentional, executive management's collective attitudes and practices in the workplace result in a "tone at the top" that invariably filters down through the ranks of an organization. An internal control system cannot function effectively without the support of executive management, who must not only enforce an organization's internal controls, but live by them, as well.

With regard to the P-Card program, executive management set a "tone at the top" early in the program's history, first by not properly staffing the program with a full-time program administrator, and second by engaging in frequent, inappropriate use of p-cards for breakfast and

lunch meetings with staff or other managers, for holiday parties and other special occasions, for coffee and kitchen supplies, and for flowers and treats for Administrative Assistants' Day. While such expenditures are not uncommon in the private sector, they are generally frowned upon, and usually prohibited in the public sector. The City of McAllen, for example, specifically prohibits the use of p-cards for food and/or drinks for staff meetings, as well as for business meals. Federal grant programs would disallow such expenditures if charged against a federal grant. These were not extravagant expenditures, amounting to less than $10,000 over several years, but they were nonetheless inappropriate uses of public dollars, and were symptomatic of an attitude of permissiveness on the part of senior management toward the use of government p-cards.

Throughout its 10-year history there is no evidence of any employee's p-card privileges ever being permanently revoked. Some were suspended, but only temporarily, and then reinstated. One possible explanation is that none of the employees issued p-cards over the past 10 years ever committed any p-card violations warranting revocation of privileges. However, the City Auditor noted at least one additional instance of multiple "accidental" personal purchases, involving eight instances of abuse over a six-year period that resulted neither in disciplinary action, nor the loss of p-card privileges. Another involved an employee sharing their p-card with other employees.

A more likely explanation for the lack of policy enforcement is that prior managements' own permissive practices and attitudes toward p-card use contributed to a lax control environment, in which abusive practices were permitted to persist. When supervisors, department heads and senior executives repeatedly give a cardholder a pass on p-card violations, as happened in the above-mentioned case, it sets a tone, and it conveys a message that internal controls are not important. Not surprisingly, the City continues to struggle with the legacy of the control environment established early in program's history, in particular in the area of food purchases, which will be discussed later in the report.

The current administration it should be noted, has endeavored to set its own "tone at the top," one that appears grounded in accountability, transparency, and fiscal discipline, as evidenced by the City's FY 2018 balanced budget, and ongoing efforts to strengthen the City's internal control policy framework. This represents a positive step in the right direction.

Risk Assessment – What Can Go Wrong?

Risk assessment is not a static, one-time event, but rather an ongoing process for identifying risk factors both internal and external to a program or activity that could prevent or deter management from achieving its objectives. The risk assessment process helps bring into focus the policies and procedures necessary to effectively minimize those risks. The City's use of customized Merchant Category Codes (MCC), for example, is a control designed to minimize the risk of cards being used for inappropriate purchases, such as alcohol or adult entertainment. As will be discussed in the following sections, the policies and practices put in place for the P-Card program suggest that there were basic risk factors overlooked in developing the program's internal controls.

Control Activities – How Do We Prevent It From Going Wrong?

Control activities are what we typically visualize when talking about the internal control system. These are the policies and procedures put in place to ensure that a program achieves its objectives. The City's current P-Card program policy manual, dated October 2016, contains several GFOA best practices, including:

- ▶ Spending limits for each cardholder both per transaction and on a monthly basis;
- ▶ Written requests for higher spending limits;
- ▶ Guidelines for making purchases by telephone, or over the internet; and
- ▶ Procedures for handling disputes and unauthorized purchases.

However, the policy also has some glaring omissions, including provisions for pre-authorization, discussion of separation of duties, reconciliation of p-card statements, steps for reviewing p-card utilization, a formal training program for cardholders and supervisors, clear guidance on the purchase of food, and clear guidance on the consequences of p-card violations.

Pre-authorization
The primary benefit of p-cards is the streamlining of the procurement process; however, it should not come at the expense of basic internal controls. There are no provisions in the P-Card policy manual requiring pre-authorization of p-card purchases. Pre-authorization

should involve not just a review of the appropriateness and necessity of the purchase, but verification of available funds in the budget, as well. While the majority of purchases are authorized beforehand, an estimated 40 percent are not. Purchases must ultimately be approved by the department head before being forwarded to the Purchasing Division, but this comes at the end of the process, typically two weeks after goods or services have been purchased.

The lack of pre-authorization by a supervisor or department head increases the risk of fraudulent purchases. Further, it could also lead to budget overruns if multiple cardholders, unaware of the others' activities are out purchasing items that will be charged against the same budget line item. Finally, the lack of pre-authorization places P-Card Processors in an awkward position since they are the first line of review. In situations where a p-card purchase has not been pre-authorized, processors are essentially taking on the role of *de facto* authorizer by processing the expenditure, when in fact they have neither the responsibility nor the authority to act in that capacity.

Separation of Duties
Separation of duties refers to safeguarding an entity's assets by dispersing internal control functions among separate employees, thereby creating a system of "checks and balances." Specifically, this refers to separating the physical custody over assets from the authority to use those assets, and the responsibility to record transactions arising from the use of those assets.

The P-Card program does a fairly good job at separating these "incompatible duties." P-Cardholders, who maintain physical custody over the City's p-cards, cannot authorize their own transactions (with the exceptions noted in the prior section), and do not record their own transactions in AS400, with the following exception.

P-Card Processors, who are responsible for "approving" transactions in AS400, are also in many instances P-Cardholders, themselves. In these instances, P-Card Processors, in their capacity as P-Cardholders should not be entering their own p-card activity into AS400. However, our review of p-card transactions from FY 2012 through FY 2016 found that most of the cardholding processors had indeed "approved" their own transactions in AS400, in violation of the proper separation of duties. This does not mean that P-Card Processors cannot be P-Cardholders. If they are to retain both roles; however, their p-card

activities should be reviewed and entered into AS400 by another employee in order to ensure a proper separation of duties.

Reconciliation of P-Card Statements

GFOA cites as one of its p-card program best practices the timely reconciliation of p-card activity by cardholders and supervisors. However, the City's P-Card program policy manual does not even mention reconciliation. The P-Card Administrator does perform a reconciliation of sorts at the program level, but this is not a substitute for cardholders, and particularly supervisors taking a more active role in the process.

Ideally, cardholders and their supervisors should be reviewing p-card statements, physically or electronically at least monthly to ensure their accuracy. The City of Plano, for example, requires that cardholders reconcile p-card statements on a monthly basis. Failure to do so in a timely manner will result in cancellation of their p-card privileges. The City of Pasadena, Texas requires cardholders to check their account on a weekly basis to process transactions posted. This step is performed by the department's processors under the current City policy. Neither cardholders, nor their supervisors are responsible for reviewing or reconciling account activity, and in general cardholders under the City's current policy have fewer responsibilities than their counterparts under other cities' policies.

The Finance Department is currently working with its Purchasing Division to update and strengthen the City's P-Card policy manual, which will include assigning greater accountability at the cardholder level.

P-Card Utilization

Given the risk-prone nature of p-cards, the number of cards in circulation should be the minimum necessary to achieve the program's objectives. One question that comes to mind in the wake of the former City Auditor's investigation is whether the employee in question should have even had p-card in the first place. The City's P-Card program policy manual does address the issue of utilization in its "Eligibility & Guidelines" section. Specifically, the manual requires departments to limit the number of p-cards to the minimum required to effectively accomplish the department's mission, based on the following criteria: (1) Will the employee's use of a p-card enhance productivity; and (2) Will the employee regularly use the p-card to purchase goods and services.

At the time of our review, the City had 243 p-cards in circulation, for a card-to-employee ratio of about 20 percent, or 1 p-card for every 5 employees. This was within the range reflected in recent surveys of local governments, with large cities reporting a ratio of about 10 percent, and small cities averaging about 30 percent. However, the issue is not necessarily card-to-employee ratio, but the extent to which the cards are utilized. The current policy manual does not have a provision for monitoring p-card activity to ensure that p-cards in circulation are actually being used. For example, the policy manual for the City of Round Rock requires that department directors be notified semiannually of accounts that have been inactive for six months for the purpose of determining if those p-cards should be cancelled.

Our review of p-card activity for the 243 cards in circulation during the audit found that 21 had not been used for at least 6 months. Of those, 2 had not been used for more than 12 months, 6 for more than 18 months, and 1 for more than 2 years. One card had not been used for over three years.

We also analyzed p-card activity for the three-year period of May 2014 through April 2017 to determine the percentage of available credit utilized by the 243 cardholders. We found that 56 of the 243 cardholders (23 percent) used less than 10 percent of their monthly credit limit, as shown in the following chart.

Utilization of Available Credit

- Less than 10 %
- From 10 to 20 %
- From 21 to 30 %
- From 31 to 50 %
- More than 50 %
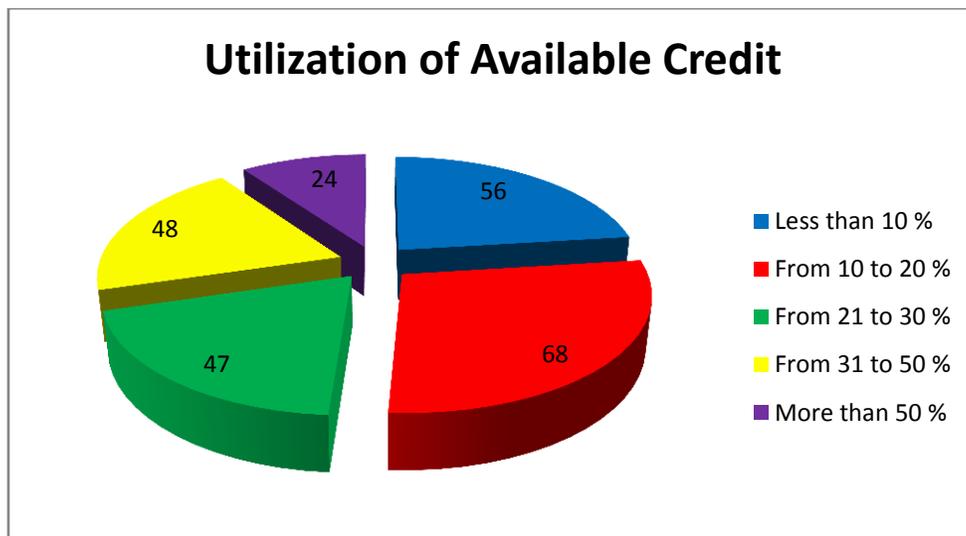
Source: AS400

Of those 56 cardholders, 11 had average monthly expenditures of less than $75, amounting to 2 percent or less of their monthly limit. About

50 percent or 124 of the 243 cardholders had monthly expenditures amounting to 20 percent or less of their monthly limit. Only 24 cardholders or less than 10 percent utilized more than half of their monthly limit. These figures suggest that the City can operate as effectively with far fewer, more fully utilized p-cards.

The City Manager has already taken steps to sharply reduce the number of p-cards in circulation. As of the end of FY 2017, the Purchasing Division had eliminated 87 of the 243 p-cards in circulation bringing the total down to 156. According to the Purchasing Manager, the City Manager called for a second round of reductions are currently in process that will reduce total p-cards in circulation to 76, or about 30 percent of the beginning total. According to the Finance Director, further reductions are anticipated.

P-Card Training Program
The City's P-Card Policy Manual makes no mention of training either in the context of initial training or refresher training for cardholders and supervisors, which is a GFAO recommended best practice. Further the Manual does not require that employees read the City's P-Card Policy Manual before obtaining a p-card. Employees must sign an agreement form that acknowledges that they know where to find the policy. However, there is no provision for verifying that they have actually read and understand the policy before receiving a p-card.

By contrast, the City of McAllen's program policy requires that employees read the City's P-Card Policies and Procedures Manual, review a PowerPoint presentation, and pass an online exam before they will be issued a p-card. Similarly, the City of Plano requires that each potential cardholder attend a procurement class, sign an employee agreement, and sign an ethics form. The City of Round Rock's policy requires that employees attend new user training and sign a cardholder agreement before receiving their p-card. The Round Rock policy requires supervisors to attend p-card training, as well, which is a best practice, given that supervisors are responsible for evaluating the performance of their direct reports.

The Purchasing Division is currently developing training materials, and plans to deliver its first formal p-card training session in January 2018. While P-Cardholders are the original target audience, GFOA best practices recommend that

supervisors and department heads be included in the training, as well.

In addition, the Purchasing Division recently implemented formal monthly meetings for the departments' P-Card Processors to discuss issues pertaining to p-cards, as well as other procurement matters. The meetings have been well-attended and have been well-received by the participants. Ideally, the division will be able to expand upon this model to provide a forum for P-Cardholders, as well.

Food Purchase Policy

As previously mentioned, the City's legacy of permissiveness in the area of food purchases is one that continues to affect its policies and practices. This is reflected in the City's current P-Card program policy, which provides general guidelines on food purchases, but does not specifically prohibit anything, other than alcohol purchases. With regard to social gatherings, such as holiday and retirement parties, the manual states that "*pot-luck is the default for employee office gatherings that involve a meal*." However, there is nothing specifically prohibiting deviation from this policy guidance. As a result, departments are free to ignore the guidance, as some do, without consequence.

By contrast, the City of McAllen provides specific guidance on the purchase of food, stating that "*the Cardholder may not purchase food and/or drinks for employees for department staff meetings*." The policy allows for exceptions when "*hosting an outside speaker, convention, multiple department activity, and/or special events*." The policy does not allow for the use of p-cards for business meals. Similarly, the City of Plano "*does not allow the purchase of food for individual or one-time discretionary breakfast/lunch meetings*." The P-Card Policy Manual for Texas State University at Dallas does not allow food purchases for routine staff meetings or for business meals where only employees and their relatives are present. The State of Oregon provides one of the more robust examples of guidelines on the use of public funds for food purchases.

Departments spent approximately $1,700 on food for holiday and retirement parties in FY 2016, and about $1,600 in FY 2017. In addition, departments spent about $3,000 on coffee supplies in FY 2016, and about $800 in FY 2017. In both cases, FY 2017 showed a decrease in these expenditures from FY 2016, which is a positive sign,

and may be due, at least in part to the Purchasing Division's implementation of a food purchase approval form, which has brought heightened awareness to food purchases.

The difficulty in establishing a precedent for the use of public dollars for workplace amenities is knowing when and where to draw the line. Why is it acceptable, for example, to use public funds for coffee supplies, but not for tea, or juice, or milk, or soda? Similarly, why is it acceptable to use public funds to celebrate the winter holiday season and retirements, but not other holidays and other celebratory milestones, such as birthdays, weddings, anniversaries, baby showers, etc.? We've already seen that former directors in the past were permitted to use their p-cards to purchase flowers and food for Administrative Assistants' Day, indicating a first step down that slippery slope. Ultimately, the City will need to enact and enforce clear policy guidance in this area to address its lingering legacy issue.

Policy Guidance on P-Card Violations
Enforcement of the City's P-Card program policy requires engagement at both the program and department levels to be effective. The program controls the suspension and revocation of p-card privileges, while departments are responsible for taking appropriate disciplinary action. The case referred to the former City Auditor reflected a failure on both parts. The former department head failed to take disciplinary action in response to repeated violations, while executive directors under general services, then under internal services failed to revoke, or even suspend the employee's p-card privileges, in what played out as a six-year "cat-and-mouse" game between the employee and management.

These individuals were not totally at fault for this failure; however, because the policy itself reflects the City's ambivalence towards the enforcement of its own program provisions. For example, the policy states that sharing a p-card with another employee is prohibited, but makes no mention of it in the "non-compliance" section, which covers the consequences for specific p-card violations. As previously mentioned, the policy discourages food purchases for office gatherings, but demurs on the consequences for deviating from that policy. Finally, the manual uses phrases such as "*repeated instances*" and "*multiple incidents*" with regard to "accidental" personal purchases, which conveys a message of leniency towards this abusive practice. It is little wonder then that the employee investigated was repeatedly given a pass on his string of p-card violations.

To ensure program compliance, the City should develop and implement policy guidance that clearly enumerates p-card violations and their associated consequences. The City of McAllen's policy, for example, provides a comprehensive list of prohibited practices, and states that it has a "*zero tolerance*" for p-card violations. Further, it requires department heads to complete an "Employee Disciplinary Report" to document each p-card violation.

With regard to "accidental" personal purchases, the City of Plano's policy advises cardholders to keep their p-cards separate from their personal cards, and states that "*inadvertent use of the card for personal items will not be tolerated, and may require immediate removal of card privileges*." The policy further requires that Department Directors "*will counsel cardholders and their supervisors whenever cardholders are not adhering to all requirements and guidelines of the policy*." The City of College Station's policy reflects zero tolerance for p-card violations, as well. According to the policy, a cardholder's first offense will result in 30-days suspension of privileges, and a second offense will result in permanent revocation of privileges.

Provision for Audit

The current policy contains no provision for audits of p-card activities. This is a GFOA recommended best practice. The P-Card Administrator performs a 100 percent review of all p-card purchases for completeness, accuracy, and appropriateness, and this is a strong control, but there is no trigger mechanism for initiating an audit by the internal auditor or external auditors. The City's fraud policy requires that employees report suspected fraudulent activity. However, there are circumstances that may fall short of fraud, but still warrant review, including many of the internal control issues discussed in this report.

Realignment of Authority

Finally, the City needs to align the authority to manage the program with those responsible for managing the program. The Purchasing Division currently lacks the authority to suspend p-card privileges, even in the face of habitual abuse. In order for the program to function properly, the response to p-card infractions needs to be immediate, both at the program and department levels. Other cities' p-card policies reviewed generally delegated the authority to suspend p-card privileges to those managing the program.

As previously mentioned the six-year run of abusive behavior reported to the former City Auditor revealed a breakdown in the system on all fronts, with regard to the ability to swiftly and effectively respond to incidents of potential abuse. Ideally, a potential p-card violation, be it a lost receipt, failure to submit receipts timely, suspected split purchase, or "accidental" personal purchase would be met with immediate suspension, followed by a review, written acknowledgment of the infraction by the department head, if warranted, and timely resolution of the issue, be it refresher training or permanent revocation of p-card privileges.

Information and Communication – Facilitating the Flow of Information

The P-Card program has a lot of moving parts, e.g., cardholders, processors, supervisors, department heads, program administrator, and purchasing manager, all of whom interact at some level with the internal control system. In order for the system to function effectively, it needs a process to ensure that program participants are aware of their respective roles, their performance, changes in the risk environment, and changes in policy.

The P-Card Administrator serves this purpose to a certain extent as the information hub for the departments' P-Card Processors. For example, the P-Card Administrator held a meeting with the departments' P-Card Processors early in her tenure to discuss ways to ensure processors get all of the information necessary from P-Cardholders to process a payment. In response, the Fire Department's processor developed a form for capturing the needed information. Other departments have either adopted the Fire Department's form, or developed their own method.

The program needs to formalize and expand upon this type of interaction to ensure that management is provided the relevant, measurable data needed to identify potential problem areas or breakdowns in the internal control system. Consider the fact that after 10 years in existence, the program has yet to develop a formal process for documenting and reporting p-card violations. Instead, p-card violations are generally handled informally through email exchanges between the departments and the Purchasing Division. Department heads are not held to account for disciplinary action, or even required to acknowledge in writing that p-card violations have occurred. It does beg the question as to how long previous repeat

offenders would have been allowed to continue their pattern of abuse had the program had a process in place for documenting, reporting, and following up on each p-card violation.

The Finance Department is currently working with its Purchasing Division to develop a formal process for documenting p-card violations, which will require written acknowledgment from supervisors and department heads. This is the first step towards developing a tracking and reporting system for p-card violations.

Monitoring – Looks Good on Paper

The idiom "looks good on paper" refers to something that appears to work in the abstract, but does not necessarily translate to the real world. Once a written policy has been implemented, it needs to be continually monitored and evaluated to ensure that it is functioning as intended. In order to do so, the City must develop a means for capturing and reporting relevant, measurable program data, as mentioned in the previous section. By continually monitoring, evaluating, and correcting deficiencies in the system, as they surface, management stands a better chance of avoiding the kind of system-wide breakdown that culminated in the November 2015 wake-up call.

Conclusion

Local governments' use of p-cards has grown steadily in popularity since their introduction in the early 1990's, and for good reason. P-cards have become a valuable tool for increasing the effectiveness and efficiency of the procurement process. However, with those operational benefits comes increased risk in the potential for fraud and abuse. Internal control weaknesses brought to light in the wake of the former City Auditor's investigation into p-card abuse revealed a broken internal control system that failed on all fronts to deter the abusive practices. The City Manager has already taken significant steps to address these internal control weaknesses. Most important among those is the City Manager's ongoing efforts to foster a "tone at the top" that embraces the importance of internal controls.

Views of Responsible Officials

In accordance with generally accepted government auditing standards, the City Auditor obtained the views of responsible officials throughout

the audit for inclusion in the report. The City Manager agreed with the findings and recommendations in the report (See Appendix C). Corrective actions in progress, or planned by the Administration are reflected throughout the report.

The City Auditor greatly appreciates the cooperation of the City Manager, Finance Director, Purchasing Division, and departmental staff in the completion of this audit.

Recommendations:

The City Auditor recommends that the **City Manager**:

1.   Ensure that the City's P-Card Policy Manual is revised to address the policy weaknesses identified in this report. The revised policy should, at a minimum, accomplish the following:

    a. Establish clear criteria departments must meet to justify the need for additional p-cards.

    b. Require that all p-card purchases be pre-authorized by no less than the next level supervisor.

    c. Require employees to attend p-card training before receiving a p-card, and require employees with p-card violations and their supervisors to attend p-card refresher training.

    d. Ensure proper separation of duties for the authorizing, purchasing, and recording/reconciling functions.

    e. Establish clear, unequivocal guidance on prohibited practices, and their associated consequences.

    f. Require that cardholders reconcile p-card activity at least monthly. Supervisors should review reconciliations.

    g. Establish clear guidance on the use of public funds for non-travel-related purchases of food and refreshments. Generally, purchases of food and refreshments for regular staff meetings, "business" breakfast and lunch meetings between employees are not appropriate, and should be prohibited.

2.   Develop a system for capturing relevant, measurable data, such as p-card violations and p-card utilization to assist management in addressing program deficiencies, as needed.

3.   Establish a process for reporting p-card violations. Reports should be distributed periodically to Department Directors, and the City Manager.

4.   Consider delegating authority to suspend p-cards to the Purchasing Division.

OBJECTIVES, SCOPE AND METHODOLOGY

Objectives
The objectives of the audit were to (1) determine if the City's P-Card program policies are in line with GFOA and other best practices; and (2) assess both the design and implementation of the program's internal controls with regard to their ability to deter and detect the occurrence of fraud and abuse.

Scope and Methodology
The primary focus of the audit encompassed P-Card program activity during the five-year period of FY 2012 through FY 2016, but also included a review of some activity prior to FY 2012. The audit also included some activity in FY 2017 and FY 2018, primarily regarding program improvements in progress.

To address the audit objectives, the City Auditor:

- ▶ Met with the Purchasing Manager, P-Card Administrator and select P-Card Processors to gain an understanding of how program policies have been implemented.

- ▶ Performed a risk analysis of both the design and implementation of internal controls to determine where weaknesses in the process exist.

- ▶ Performed comparative analysis of the City's P-Card Program policies to GFOA, ACFE, and industry best practices, as well as policies of other local governments, including McAllen, TX; Plano, TX; Round Rock, TX; Pasadena, TX, and College Station, TX.

- ▶ Assessed Citibank P-Card activity utilization by reviewing frequency of use, and comparing average monthly expenditures to established credit limits. Assessed reliability of data in AS400 against source documents, and found data to be sufficiently reliable for use in this audit.

- ▶ Reviewed P-Card activity for inappropriate charges.

- ▶ Conducted a survey of P-Card Processors.

Statement of Compliance with Audit Standards

We conducted this performance 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.

GFOA BEST PRACTICES FOR P-CARD PROGRAMS

1.	Instructions on employee responsibility and written acknowledgments signed by the employee.
2.	Ongoing training of cardholders and supervisors
3.	Spending and transaction limits for each cardholder both per transaction and on a monthly basis.
4.	Written requests for increases in spending limits.
5.	Recordkeeping requirements, including review and approval processes.
6.	Clear guidelines on the appropriate uses of purchasing cards, including approved and blocked Merchant Category Codes (MCC).
7.	Guidelines for making purchases by telephone, or online.
8.	Periodic audits for activity and retention of sales receipts and documentation of purchases.
9.	Timely reconciliation by cardholders and supervisors.
10.	Procedures for handling disputes and unauthorized purchases.
11.	Procedures for card issuance and cancellation, lost or stolen cards, and employee termination.
12.	Separation of duties for payment approvals, accounting, and reconciliations.
13.	Regular review of spending per vendor and merchant category codes.

MANAGEMENT RESPONSE

Rec No.	Recommendations	Lead Department	Agree/Partially Agree/Do Not Agree	Estimated Implementation Date
1.	Ensure that the City's P-Card Policy Manual is revised to address the policy weaknesses identified in this report. The revised policy should, at a minimum, accomplish the following: a. Establish clear criteria departments must meet to justify the need for additional p-cards. b. Require that all p-card purchases be pre-authorized by no less than the next level supervisor. c. Require all potential cardholders to attend p-card training before receiving a p-card, and require employees with p-card violations and their supervisors to attend p-card refresher training. d. Ensure proper separation of duties for the authorizing, purchasing, and recording/reconciling functions. e. Establish clear, unequivocal guidance on prohibited practices, and their associated consequences. f. Require that cardholders reconcile p-card activity at least monthly. Supervisors should review reconciliations. g. Establish clear guidance on the use of public funds for non-travel-related purchases of food and refreshments. Generally, purchases of food and refreshments for regular staff meetings, "business" breakfast and lunch meetings between employees are not appropriate, and should be prohibited.	Finance Department	Agree	12/31/2017
2.	Develop a system for capturing relevant, measurable data, such as p-card violations and p-card utilization to assist management in addressing program deficiencies, as needed.	Finance Department	Agree	12/31/2017

Rec No.	Recommendations	Lead Department	Agree/Partially Agree/Do Not Agree	Estimated Implementation Date
3.	Establish a process for reporting p-card violations periodically to Department Directors, and the City Manager.	Finance Department	Agree	12/31/2017
4.	Consider delegating authority to suspend p-cards to the Purchasing Division.	Finance Department	Agree	12/31/2017