Audit of

Accounts Payable Procedures

March 6, 2006
Audit of
Accounts Payable Procedures

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Audit of Accounts Payable Procedures

Executive Summary

The Accounting Services Department serves all District schools and departments by using a TERMS Finance software system. Schools and departments are responsible for the initiation of purchases and confirmation of receipt of services and commodities. Accounting Services is responsible for verifying the vendor, authentication of invoices, and department authorization. Payments are not processed until after all purchased items on the invoice are received.

During fiscal year 2005, Accounts Payable processed 298,530 payments for a total of $695,464,438 for procurements of services and goods through purchase orders, vendor blankets, or personal services agreements.

The primary objectives of the audit were to (1) assess the adequacy of controls in accounts payable procedures for payments of goods and services, (2) determine if information on invoices and Purchase Orders (POs) agree with that in receiving reports, (3) determine if payments were made properly and timely, and (4) determine if update access to the TERMS invoice, vendor, and purchase order master files and data was appropriate. The audit produced the following conclusions:

- Accounts Payable does not have a written operating manual containing the required documentation and processes necessary before payments are made.

- Review of 60 sample invoices revealed no significant deficiency. Three payments to vendors could not be substantiated by proof of purchases; and total invoice amount for these three checks was $2,743.

- A Data Processing Request (DPR) was not submitted to document changes made to the master vendor file to prevent inactive vendors from converting to the new computer system. Without a DPR, it is difficult to track why changes occurred and what data and programs were actually modified.

- Access to update invoice and vendor master files was not adequately controlled. Specifically, five employees had update access to create both a vendor and an invoice. Twenty-six employees had update access to the invoice file; they can create records and pay invoices. This access also allowed these 26 employees to void checks. Permitting employees to have access to update both the vendor and invoice files creates a lack of proper separation of duties and increases the risk of irregularities.

District officials agreed to strengthen controls and indicated that they would take appropriate actions.
MEMORANDUM

TO: Honorable Chair and Members of the School Board
   Arthur C. Johnson, Ph.D., Superintendent of Schools
   Chair and Members of Audit Committee

FROM: Lung Chiu, CPA, District Auditor

DATE: March 6, 2006

SUBJECT: Audit of Accounts Payable Procedures

PURPOSE AND AUTHORITY

Pursuant to the District's Audit Plan of 2004-2005, we have audited the Accounts Payable Procedures. The primary objectives of the audit were to (1) assess the adequacy of controls in accounts payable procedures for payments of goods and services, (2) determine if information on invoices and Purchase Orders (POs) agree with that in receiving reports, (3) determine if payments were made properly and timely, and (4) determine if update access to the TERMS invoice, vendor, and purchase order master files and data was appropriate.

SCOPE AND METHODOLOGY

The audit was performed in accordance with Government Auditing Standards by Ellen Steinhoff, CISA, during October through November 2005. This audit included a review of 60 randomly sampled invoices totaling $1,043,191 paid during fiscal year 2005. These sample invoices reflected those processed by Accounts Payable through: (1) Blanket Purchase Orders (POs) of $750+, (2) Normal POs of $750+, and (3) Direct Pay orders of less than $750. These POs were issued for procurement of services and supplies for school construction and maintenance, utilities (copier, phone, electricity), textbooks, computer hardware and software, furniture, food, and food services equipment, etc. The audit included the following procedures:

1. Reviewing related prior audit reports;
2. Interviewing staff of Accounts Payable and Purchasing Departments;
3. Reviewing Accounts Payable Policy and Procedures documents;
4. Reviewing supporting documentation for sample invoices to determine if:
   a. Documentation was sufficient and valid;
   b. Sales tax was not paid;
   c. Merchandise on the invoices was properly received;
   d. Dollar amount on invoices agreed with POs;
e. Computations on invoices were accurate;
f. Vendor address matched payment check address;
g. Quantity, price, merchandise on invoice matched PO; and
h. Purchase discounts were taken.

5. Performing other analytical reviews to determine if:
   a. Payments were made within 45 days;
   b. Duplicate payments were made;
   c. Handwritten checks were limited;
   d. Payments were approved properly;
   e. Vendors paid were in an active status; and
   f. Missing checks were accounted for properly.

The conclusions were brought to the attention of staff during the audit so that necessary corrective actions could be implemented immediately. The draft report was sent to the appropriate departments for review and comments, and the responses are included in the Appendix. We would like to thank staff for their cooperation and courtesy extended to us during the audit. The final draft report was presented to the Audit Committee at its March 6, 2006 meeting.

BACKGROUND

During fiscal year 2005, Accounts Payable processed 298,530 payments, for a total of $695,464,438, for procurement of services and goods through purchase orders, vendor blankets, or personal services agreements.

The Accounting Services Department serves all District schools and departments by using the TERMS Finance software system. Schools and departments are responsible for the initiation of purchases and confirmation of receipt of services and commodities. Accounting Services is responsible for verifying the legitimacy of vendors, authentication of invoices, and department authorization. Accounts Payable staff also performs invoice input, copying, filing, resolving, pulling, and cycling invoices. Thirteen Accounts Payable technicians process invoices. Payments are not processed until after all purchased items on the invoice are received.

There are three major types of purchases:

Direct Pay Invoices. Direct pay invoices have no purchase order associated with them. District staff can order supply type items via a fax, email, or phone call. The threshold for direct pay invoices is currently $750. Direct pay payment include those for travel reimbursements, prepaid hotel registration, Publix direct pay, etc. Requesters for payment can complete a Direct Payment Request (PBSD 1275) Form and forward it to Accounts Payable. With the introduction of Purchasing Cards, Direct Pay transactions are reducing. Currently, about 70% of schools participate in the Purchasing Card program.
Blanket Purchase Orders. Blanket Purchase Orders are issued for a class of products such as office supplies, home economics supplies, shop supplies. Users specify the items and the quantity to be ordered, as they are needed. Most blanket POs are for Maintenance and Transportation Departments issued to larger office and educational supply vendors.

Normal Purchase Orders. Normal Purchase Orders are issued for specific goods or services at specific quantities and specific prices.

CONCLUSIONS

The audit produced the following major conclusions:

1. **Lack of Written Procedures.** There is no written operating manual for Accounts Payable. This manual should contain the required documentation and processes before payments are made. The lack of written procedures increase the risk of inconsistent processes used for transactions and increases the likelihood of operation disruption.

   A formal Accounts Payable manual should be developed and distributed to all employees in the department. For example, processes to handle electronic invoices, expense reimbursement, funds availability checking, capital project invoices, creating Accounts Payable positive pay file, etc. Written procedures are beneficial for training current and new employees.

   **Management's Response:** *Management Concurs.* We understand that a comprehensive procedures manual is essential for the overall operation of the department. Although a fully developed manual is not in place we do have instructional documentation for the critical processes in Accounts Payable. Also we have documented all the as-is procedures in Accounts Payable and all other areas of the department. We intend to develop the comprehensive procedures manual covering this and all other areas once the new Enterprise Resource Planning (ERP) system is completed using the currently documented processes. This will also become part of the ongoing training provided on the new ERP system. (Please see page 7.)

2. **Unsupported Invoice Payments.** The review of 60 sample invoices revealed that three payments to vendors could not be substantiated by proof of purchases:

<table>
<thead>
<tr>
<th>Check #</th>
<th>Check Date</th>
<th>Invoice Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>784770</td>
<td>10/1/2004</td>
<td>$765</td>
</tr>
<tr>
<td>784770</td>
<td>10/1/2004</td>
<td>$772</td>
</tr>
<tr>
<td>776342</td>
<td>7/27/2004</td>
<td>$1,206</td>
</tr>
<tr>
<td></td>
<td></td>
<td>$2,743</td>
</tr>
</tbody>
</table>

   The first two invoices were for copier services from the same vendor and the third invoice was for janitorial services. Accounts Payable should ensure that all invoices are maintained on file.
Management's Response: Management concurs. Supporting documents have to be available to justify vendor payments and for review by various audit personnel. Due to the lack of available storage space we are limited in our capacity to house a full fiscal year of vendor payment documentation. We must rely on the use of outside storage vendors to house our records, which at times results in misfiling of vouchers in the wrong boxes, which very likely might be the reason we couldn't provide the auditor the requested documents in this case. We had multiple audits being conducted at the same time, which could have also contributed to this situation. (Please see page 7.)

3. Changes of Vendor Status not Documented. A new computer system is planned to replace the existing TERMS Finance system, which Accounts Payable uses. This new system is also referred to as an Enterprise Resource Planning system (ERP). To avoid adding 'inactive' vendors to the new system, Accounts Payable determined the vendors who were not utilized by the District for a specific period of time. Status of these vendors was changed from 'active' to 'inactive' via a computer program. However, no Data Processing Request (DPR) was submitted to document these changes to production data and the programs utilized. Without a DPR, it is difficult to track why changes occurred and what data and programs were actually modified.

Without proper documentation, a history to trace changes is not available. A separate DPR should be submitted to document future change to master files such as vendor, invoice, or purchase order. Additionally, the District should establish a procedure limiting the amount of time a vendor can remain in active status if not utilized by the School District for some time.

Management's Response: Management concurs. We acknowledge the importance that Data Processing Requests (DPR) play in the audit trail of programming changes to Information Technology. This request was initiated using an email to expedite the vendor cleanup process following the urgent request from the ERP team. We will comply with the requirement to submit the DPR for future programming requests associated with TERMS reporting.

The PeopleSoft system provides for an archiving process to inactivate vendors from the main vendor file for inactivity based on a range of dates determined by authorized personnel, which will facilitate the process. (Please see page 7.)

4. Update Access to Vendor and Invoice Master Files Not Controlled. Access to update invoice and vendor master files was not adequately controlled. During the audit, we noted that:

A. Five employees had update access to create both a vendor and an invoice. The Auditor General cited instances of incorrect update access to the vendor file in a 2004 report.

B. Twenty-six employees had update access to the invoice file; they can create records and pay invoices. This access also allowed these 26 employees to void checks. One of these
employees subsequently transferred to another department and no longer needs invoice access. One other employee was a temporary employee who no longer works for the District.

Employees should not have access to update both the vendor and the invoice files. The lack of proper separation of duties increases the risk of irregularities.

In addition, although there is a control report of voided checks, the number of employees allowed to perform this task should be limited.

We recommend that the District review and modify, where appropriate, the list of employees having update access to the vendor and invoice master files. Also, procedures permitting update access to temporary employees should be improved.

Management's Response: Management concurs. We currently have 3 permanent employees that have access to update both the vendor and invoice files. It has been determined that a separation of duties is not feasible at this time based on the volume of vendor additions and updates, along with the input of vendor invoices for payment. The other two employees, AP Supervisor and Senior Accounts Payable Technician had temporary access to the vendor file for vendor and voucher cleanup urgently needed for the ERP system. The ability to void checks is embedded into the Accounts Payable security profile. At this time only two employees, Accounts Payable Supervisor and the Senior Accounts Payable Technician have knowledge of the process to void a check in the System. In addition, a voided check or a formal request is required to support the action. Reports are generated when checks are voided to verify accuracy and are reviewed by either the Supervisor or the Senior Technician.

The new ERP system will have a strong security profile builder and steps have been taken by Information Technology Security to enhance operations on this concern. (Please see page 7.)

— End of Report —
Management’s Response

MEMORANDUM

DATE: February 14, 2006

TO: Lung Chiu, District Auditor

FROM: Martin V. Arroyo, Director

SUBJECT: Response to Accounts Payable Procedures Audit

We are responding to the Audit of Accounts Payable during the period October through November 2005. Our responses are under the caption “Management Response” following the Auditor’s conclusions.

The audit produced the following major conclusions:

1. **Management’s Response:**

Management concurs. We understand that a comprehensive procedures manual is essential for the overall operation of the department. Although a fully developed manual is not in place we do have instructional documentation for the critical processes in accounts payable. Also we have documented all the as-is procedures in Accounts Payable and all other areas of the department. We intend to develop the comprehensive procedures manual covering this and all other areas once the new Enterprise Resource Planning (ERP) system is completed using the currently documented processes. This will also become part of the ongoing training provided on the new ERP system.
Management's Response

2. Management's Response:
Management concurs. Supporting documents have to be available to justify vendor payments and for review by various audit personnel. Due to the lack of available storage space we are limited in our capacity to house a full fiscal year of vendor payment documentation. We must rely on the use of outside storage vendors to house our records, which at times results in misfiling of vouchers in the wrong boxes, which very likely might be the reason we couldn't provide the auditor the requested documents in this case. We had multiple audits being conducted at the same time, which could have also contributed to this situation.

3. Management's Response:
Management concurs. We acknowledge the importance that Data Processing Requests (DPR) play in the audit trail of programming changes to Information Technology. This request was initiated using an email to expedite the vendor cleanup process following the urgent request from the ERP team. We will comply with the requirement to submit the DPR for future programming requests associated with TERMS reporting.

The PeopleSoft system provides for an archiving process to inactivate vendors from the main vendor file for inactivity based on a range of dates determined by authorized personnel, which will facilitate the process.

4. Management's Response:
Management concurs. We currently have 3 permanent employees that have access to update both the vendor and invoice file. It has been determined that a separation of duties is not feasible at this time based on the volume of vendor additions and updates, along with the input of vendor invoices for payment. The other two employees, AP Supervisor and Senior Accounts Payable Technician had temporary access to the vendor file for vendor and voucher cleanup for urgently needed for the ERP system. The ability to void checks is embedded into the Accounts Payable security profile. At this time only two employees, Accounts Payable Supervisor and the Senior Accounts Payable Technician have knowledge of the process to void a check in the System. In addition, a voided check or a formal request is required to support the action. Reports are generated when checks are voided to verify accuracy and are reviewed by either the Supervisor or the Senior Technician.

The new ERP system will have a strong security profile builder and steps have been taken by Information Technology Security to enhance operations on this concern.

C: Joseph M. Moore, Chief Operating Officer
Robert Rucinski, Accounts Payable Supervisor