# Financial Services – Accounts Payable Audit

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# **Report Issued**

August 7, 2024

Audit Report No. 24-05



City of Cape Coral City Auditor's Office

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TO:

Mayor Gunter and Council Members

FROM:

Andrea R. Russell, City Auditor

DATE:

August 7, 2024

SUBJECT: Financial Services - Accounts Payable Audit

The City Auditor's Office conducted a performance audit of the Financial Services Accounts Payable Division. This audit is included as an addition to the City Auditor's approved FY24 Audit Plan at the request of the Financial Services Director. The audit was conducted in conformance with Generally Accepted Government Auditing Standards by the authority granted through City Ordinances 28-02 and 79-10.

We would like to express our sincere appreciation to Financial Services Accounts Payable Division, and Financial Services management and staff for the courtesy, cooperation, and proactive attitude extended to the team members during the audit. If you have any questions or comments regarding this audit, please contact Andrea Russell at 242-3380 or Philip Toby at 242-3381.

C: Michael Ilczyszyn, City Manager Connie Barron, Assistant City Manager Aleksandr Boksner, City Attorney Kimberly Bruns, City Clerk Mark Mason, Financial Services Director Crystal Feast, Deputy Financial Services Director Karen Brennan, Accounts Payable Supervisor **Audit Committee** 

# FINANCIAL SERVICES – ACCOUNTS PAYABLE AUDIT

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# REPORT HIGHLIGHTS

Issued August 7, 2024

### **Objectives**

To evaluate if controls over accounts payable processes are in place and operating as intended to ensure transactions are accurate, complete, and in compliance with applicable laws, regulations, policy, and procedures.

To determine if controls are in place and operating as intended for vendor set-up and maintenance.

### **Background**

The Financial Services AP Division is responsible for overseeing and processing all accounts payable transactions. AP processes an average of 5,100 invoices per month totaling approximately \$30 million and remits payments to vendors via check or Electronic Funds Transfer (EFT). AP processing is decentralized. Detail entry and information is performed by the individual departments that made the purchase.

### WHY THIS MATTERS

Accounts Payable (AP) processes thousands of invoices and remits millions of dollars in payments monthly to City of Cape Coral (City) vendors. Effective process controls and adequate training over the process including proper payment approval and processing, fraud awareness, and vendor master file maintenance help ensure accurate and timely payments to the City's vendors as well as reduce the risk of fraud.

### WHAT WE FOUND

The City Auditor's Office (CAO) conducted a performance audit of the Financial Services Accounts Payable Division. This audit is included as an addition to the City Auditor's approved FY24 Audit Plan at the request of the Financial Services Director.

Overall, there are adequate controls over the AP process; however, improvements are needed in controls over invoice approval and processing for Certified Agency Buyers (CABs), AP staff fraud awareness training, and Vendor Master File Maintenance (VMF). These opportunities for improvement are discussed in further detail in the Findings and Recommendations section of this report. The AP Division processes and pays the City's invoices in accordance with City policies and procedures.

While we noted the above areas of opportunity for improvement, no material control deficiencies were noted.

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# BACKGROUND

The AP Division has six full-time equivalents responsible for the timely and accurate processing of all AP transactions entered by individual city departments. It is AP's responsibility to ensure that each transaction is properly authorized, and invoices are processed accurately. AP processes an average of 5,100 invoices per month and remits payments to vendors via check or EFT.





Based on Financial Services data, AP processed approximately 40,000 invoices and payments of \$312 million in FY22, and approximately 44,000 invoices and payments of \$408 million in FY23.

AP utilizes a software program for invoice approval, entry, and payment. processes many types of payables including monthly recurring bills for utilities and copier services, travel expenses, litigation forfeiture settlements, grants, unemployment payments, and expenditures associated with capital improvements. Each type of payable has its own specific approval workflow and for requirements supporting



documentation, which are detailed in AP Finance policies and procedures. The AP process is decentralized, therefore invoice review, entry, and approval are the responsibility of individual departments prior to AP review and processing of payment.

In addition to managing the City's payables, AP is responsible for maintaining the VMF, reviewing vendor information, and ensuring vendors are active before processing payment. AP also processes changes to vendors to ensure payment, contact, and address information remains up to date. As of 4/12/2024, the City had 4,351 active vendors in the VMF.

# FINDINGS AND RECOMMENDATIONS

Audit 24-05 - Financial Services - Accounts Payable

FINDING 2024-01: Certified Agency Buyers and Accounts Payable Staff Guidance

and Training Needs Improvement

Rank: Medium

### Condition:

AP is decentralized which requires individual departments to enter details of invoice payments into the financial system in a timely manner. The Financial Services AP Division reviews departmental submission and releases for payment if all criteria have been met, including support, proper authorization, and approval. This decentralization also puts the responsibility of the individual department to communicate changes in CABs<sup>1</sup> personnel to the Financial Services AP Division. Finance AP has several policies and procedures in place for processing of invoices; however, no formal training or guidelines exist for individual departments.

AP is required to comply with Florida State Statute (FSS) 218.73, "Timely payment for non-construction services", and FSS 218.74, "Procedures for calculation of payment due dates". FSS 218.73 defines the timeframe a payment is due for a purchase and FSS 218.74 explains that governmental entities should establish procedures for when invoices are marked as received and date. Currently, no procedures exist for CABs outlining the requirement that payments must be paid within 45 days of receiving the invoice nor marking the invoice as received with a date. Without these procedures, the City cannot guarantee compliance with FSS 218.73 and 218.74.

### Test Results - Invoice Processing

AP provides some guidance on procedures to CABs, such as procedures for the manual creation of invoice numbers; however, no detailed information is provided to ensure compliance with FSS. We tested 56 invoices to ensure payment was made within 45 days of the invoice date as required by FSS. As part of this testing, we noted seven (13%) invoices that were paid more than 45 days after the invoice date. Since AP is decentralized, it is the responsibility of individual departments to enter invoices timely to allow for Finance AP review and processing of payments.

### Test Results - CAB Access and User Profile

Currently, there is no policy or procedure in place for AP notification of CAB transfers within City departments. Revoking access for invoice processing lies solely with each department to notify AP and Information Technology Services (ITS). AP and ITS annually review system access reports and ITS will automatically revoke access to individuals who are no longer employed. We reviewed 12 employee positions, considered CABs, who have access to enter invoices. One (8%), who changed from a position with full CAB capabilities to a position that does not require such access, did not have the AP access

<sup>&</sup>lt;sup>1</sup> CABs are responsible for entering purchase and payment data into the financial system.

revoked. Since AP is decentralized, it is the responsibility of individual departments to communicate when CAB roles are changed so access can be revoked timely. This information is not captured on a form when the individual changes departments, but only when they are terminated from City service.

# Fraud Awareness Training for AP Personnel

Finance AP staff complete various trainings, including information relating to internal processes and cyber security that are required by the City or dictated by their position. AP staff do not attend regular external fraud awareness training nor are documented policies and procedures in place regarding fraud awareness and various AP related fraud schemes. Some common best practices, established by The Washington State Auditor's Office and fraud expert Dr. Rocco Lueck, PhD, for fraud awareness training include:

- Annual fraud awareness training
- New hires should complete fraud awareness training during orientation
- Fraud awareness training should constantly be updated to ensure it covers current threats and best practices
- Incorporate lessons on fraud prevention into employee evaluations and reviews

Also, a study<sup>2</sup> conducted by the Association of Certified Fraud Examiners (ACFE) showed "that providing fraud awareness training across the organization reduces fraud costs and duration. Organizations that did not provide such training experienced median fraud losses of nearly double (\$199k) those of organizations that trained employees, managers, and executives (\$100k). Further, frauds were detected earlier in organizations that provided training."

### Criteria:

- FSS 218.73 and 218.74
- Best practices for fraud awareness training
  - The Washington State Auditor's Office; Fraud Expert Dr. Rocco Lueck, PhD;
  - ACFE Occupational Fraud 2024, A Report to the Nations
- Center for Government Innovation, Accounts Payable Guide
  - Improving your processes: Tips for leaders, managers, supervisors, and accounts payable clerks
- AP Policies and Procedures
  - Invoice entry and appropriate supporting documentation
  - Purchase order receiving

### Cause:

- Lack of fraud awareness training program
- Noncompliance with FSS 218.73 and 218.74
- Informal AP guidelines and training to CABs

<sup>&</sup>lt;sup>2</sup> Occupational Fraud 2024: A Report to the Nations, ACFE

### Effect:

- Increased risk of fraudulent AP transactions
- Increased risk of financial loss
- Potential harm to City reputation and trust
- Payments exceed the 45-day requirement due to CABs receiving and entering invoices

### Recommendations:

### 2024-01a:

Establish policies and procedures that addresses AP staff fraud awareness training requirements.

### 2024-01b:

Formalize AP processing guidelines for department management and CABs to ensure compliance with policies and procedures and FSS.

Management Response and Corrective Action Plan:		
2024-01a	Select one of these boxes:  ☑ Agree □ Partially agree* □ Disagree*	
*For partially agree or disagree a reason must be provided as part of your response.		
2024-01a	Management agrees and will update established policies and procedures to incorporate 2 hours of annual fraud awareness training for each position in the AP division. Completion will be required as a new hire and each fiscal year.	
2024-01a	Management Action Plan Coordinator: Financial Services Director	
2024-01a	Anticipated Completion Date: 09/30/2024	
* * *		
2024-01b	Select one of these boxes:  ☑ Agree □ Partially agree* □ Disagree*	
*For partially agree or disagree a reason must be provided as part of your response.		
2024-01b	Management agrees and will formalize training for CABs and other invoice processors to educate on the requirements of the Florida State Statutes 218.73 and 218.74 and lay out procedures for compliance. The training will be incorporated into the annual training currently hosted by the Procurement Division and will be housed in SABA for participants to register. Completion of the training will be required each fiscal year.	
2024-01b	Management Action Plan Coordinator: Financial Services Director	
2024-01b	Anticipated Completion Date: 12/31/2024	

# Audit 24-05 – Financial Services - Accounts Payable FINDING 2024-02: Vendor Creation and Maintenance Need Improvement

Rank: Medium

#### Condition:

New Vendor Creation

There are two ways a vendor can be created in the accounting system; by AP staff or by the vendor utilizing the Vendor Self-Service Portal (VSP) in anticipation of doing business with the City. Many vendor accounts are created by the vendor through VSP. Once a vendor has completed and uploaded required information through VSP, the account is automatically put into 'Self Service" status. The vendor account stays in "Self Service" status until a request is made by a department to change to "Active" status. "Active" status allows the vendor to be eligible to receive information for Invitations to Bid (ITB), Requests for Proposals (RFP), quotes, and to receive future payments. There is one AP Specialist designated to performing the review of the documentation attached to the vendor account, verifying the Tax Identification Number (TIN) to IRS records, and making any necessary changes, such as updating banking information, business name, business address, or contact information. Once this review is done, the vendor account is routed through workflow to Procurement and to the AP Supervisor for review and approval. Once all approvals are obtained in the system, the vendor account will automatically change to "Active" status. The same process is followed when AP manually enters a vendor into the system. The AP Specialist designated to enter and review vendor accounts is also the same individual that acts as AP Supervisor when the AP Supervisor is out or when the position is vacant, which means that the designated AP Specialist may also be approving vendor accounts.

We identified 583 new vendor registrations during the scope of the audit. We tested 60 of these newly established vendors to determine if the process has adequate segregation of duties for the creation, review, and approval of new vendors. Of the 60 new vendors tested, 37 (62%) were reviewed and approved by the same individual. We utilized the same vendor population and sample to test for adequate segregation of duties for entry and approval of changes. Of the 60 new vendors tested, we noted 27 that had at least one change made to the vendor record after the original approval. Changes were made and approved by the same individual in 20 out of the 27 (74%) instances.

### Changes to Vendor Information

Best practices and proper controls over changes to vendor records require a defined method of confirmation with the vendor. This confirmation should be completed by telephone to the number on record in the original vendor file and not with any new phone number, or through email. During the scope of the audit, it was noted that there were no policy or procedures to contact the vendor to verify changes to vendor payment information. A lack of policy or defined procedures can lead to unauthorized changes to vendor information and result in diversion of vendor payments to unauthorized parties. Of the 27 vendors that had modifications to the original record, 21 (78%) had modifications made in the VMF with no verification with the vendor contact. In April 2024, AP developed

a policy for vendor changes requiring staff to verbally confirm EFT changes with the contact listed in the accounting system prior to making the changes in the software.

### VMF Maintenance

The City's Procurement Ordinance 25-23 requires the Procurement Division to "maintain a list of vendors who have a desire to receive invitations for bids and/or requests for proposals or quotes." The VSP interfaces with the AP vendor module in the financial software. This interface allows Procurement and AP utilization of the same vendor module to receive ITBs, RFPs, quotes (for procurement), and payment processing (AP).

As of April 2024, there were 4,351 active vendors in the VMF. There is no formal routine practice of removing inactive or duplicate vendors. No review or updates of the vendor file have been completed since the information was migrated into the new financial accounting software during FY20. A lack of monitoring of vendors and removal or inactivation of vendors with no purchase or payment activity can result in the setup of fraudulent vendors and potential fraudulent payments.

Best practices recommend a review of the VMF at least annually and to deactivate any vendors that have not had activity for a certain period, usually one to two years. There is no documented methodology or policies and procedures in place for determining inactive vendors or a process in place for archiving or purging inactive vendors from the VMF. In order to determine vendors with no recent activity, we compared the list of active vendors to the Vendor Fiscal Year Summary reports which show purchase and payment activity for the vendors in the VMF. We identified 1,938 vendors created in the financial software with no purchase or payment activity noted in the accounting software during the audit scope.

According to management, because of the way vendors are created through the VSP and included in the VMF, deactivation of vendors with no payment or purchase activity would eliminate registered vendors who are eligible to receive future ITBs, RFPs, and guotes.

### **Duplicate Vendors**

The VMF contains information such as the vendor number, "Alpha Sort Name" (used for searching and sorting), "Company Name", and "Doing Business As" name. These name fields are not unique, and some vendors may have identical names yet be independently owned or have a different legal name and TIN. Each individual vendor is required to establish a unique TIN and file a Form W-9. We identified 55 vendors with the same names and reviewed the TIN and W-9 documentation on file.

There were no W-9 forms on file in the current accounting software system for 20 (36%) of the 55 vendors reviewed. The City migrated to a new accounting system during FY20 which required AP to transfer vendor files from the old software system to the new system; however, any supporting documentation included in the vendor file was not transferred to the new system.

An article in the *Journal Of Accountancy*<sup>3</sup> notes that well-rounded vendor management begins "with a thorough scrubbing" of the VMF and having a robust registration process to guard against fraud. The article suggests the following best practices to reduce the risk and exposure to inaccurate and fraudulent payments:

- Establish and maintain a clean vendor master file
- Implement continuous monitoring of vendors and disbursements for potential fraud
- Conduct regular audits on all transactions to identify and recover overpayments due to duplicates, returns, rebates, pricing errors, noncompliance with contract terms, and sales tax errors

### Criteria:

- Ordinance 25-23
- Current and accurate VMF
- Washington State Auditor's Office Accounts Payable Best Practices
- Formal Policy and Procedures for vendor creation, changes, maintenance, and monitoring

#### Cause:

- Lack of formal policies and procedures for vendor creation, changes, maintenance, and monitoring
- Lack of VMF Monitoring and Maintenance
- Noncompliance with Ordinance 25-23
- Lack of segregation of duties for vendor creation, review, and approval

### Effect:

- Potential duplicate payments
- Potential fraudulent vendors in VMF
- Potential fraudulent payments

<sup>&</sup>lt;sup>3</sup> Helen Tueffel, *Journal of Accountancy*, 11/1/2016

### **Recommendations:**

### 2024-02a:

Formally document the process for vendor creation that clearly defines roles and responsibilities and establishes segregation of duties for vendor creation, approval, and proper procedures for changes to the VMF.

### 2024-02b:

Develop and document policies and procedures for monitoring the VMF on a regular basis to minimize inaccurate or fraudulent payments.

# **Management Response and Corrective Action Plan:**

**2024-02a** Select one of these boxes:

□ Agree □ Partially agree\* □ Disagree\*

\*For partially agree or disagree a reason must be provided as part of your response.

2024-02a Management will expand existing written policies and

procedures to include segregation of duties between who makes changes to vendor files and who reviews and posts

said changes.

2024-02a Management Action Plan Coordinator:

Financial Services Director

**2024-02a** Anticipated Completion Date: 09/30/2024

\* \* \*

2024-02b Select one of these boxes:

□ Agree □ Partially agree\* □ Disagree\*

\*For partially agree or disagree a reason must be provided as part of your response.

2024-02b Management agrees and will establish an annual process

for reviewing Vendors in an "Active" status in the VMF. Furthermore, management is currently implementing an external sourcing platform which will allow vendors to register to receive bid invitations and other solicitations from the City. Once implemented, the VMF will be used solely for

payment processing.

2024-02b Management Action Plan Coordinator:

Financial Services Director

2024-02b Anticipated Completion Date: 12/31/2024

### SCOPE

Based on the work performed during the planning and the assessment of risk, the audit covers AP processes for the period of FY22, FY23, and FY24 through March 31, 2024. To evaluate the processes in place we reviewed AP policies and procedures, best practices and observed AP processing in the division and in individual departments.

# STATEMENT OF AUDITING 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.

#### **METHODOLOGY**

To achieve the audit objectives and gain a better understanding of the AP conducted process. we interviews and walkthroughs with key staff. Original records as well as copies were used as evidence and verified through physical examination. Sample sizes and selection were based on the CAO Sample Methodology. We used both random and judgmental sampling for our sample selections. We obtained paid invoices information from AP management to select a random sample of invoices to test for processing and payment in compliance with policy and state statute. Additionally, we applied Benford's Law to the paid invoice data to test for evidence of irregular or fraudulent activity (see APPENDIX A for details on the use of Benford's Law). In order to test for duplicate payments, we stratified the same data to generate the population used for a random sample.

To determine if all AP staff completed fraud awareness training, we reviewed training documentation provided by Financial Services. We also inquired about CAB AP training.

To determine if controls were in place for vendor set up and maintenance, we utilized vendor information in the VMF provided by Financial Services to analyze for duplicate and inactive vendors based on common names and FY activity data. We used random sampling to perform tests to determine if proper segregation of duties are in place for vendor set up, changes, and approval.

## **METHODOLOGY** (continued)

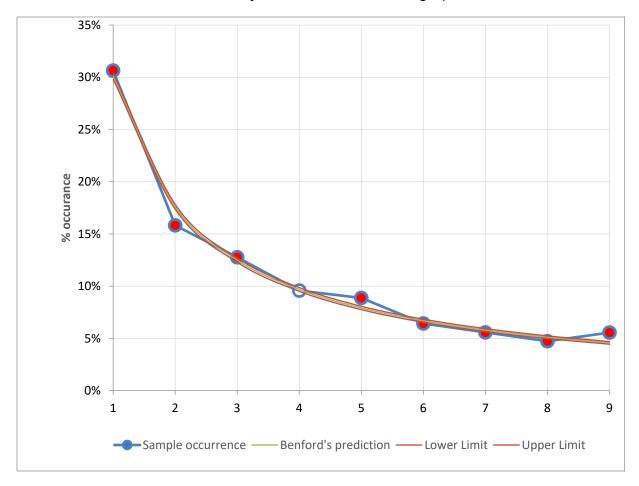
Lastly, we utilized information from ITS to generate a random sample of CABs to determine if access for invoice processing and approval is appropriate for the individual's position. In addition to the random sample, we judgmentally added specific CABs based on system access dates and employee positions. We analyzed the sampled items to test attributes to support the audit objectives.

We also utilized data from the City's financial accounting system as it relates to AP. The financial accounting system is tested by the external auditors as part of the Annual Comprehensive Financial Report. Based on the results of their procedures, no additional data reliance testing was deemed necessary.

Unless specifically stated otherwise, based on our selection methods, and testing of transactions and records, we believe that it is reasonable to project our results to the population and ultimately draw our conclusions for testing, findings, and recommendations on those results. Additionally, for proper context we have presented information concerning the value and/or size of the items selected for testing compared to the overall population and the value and/or size of the exceptions found in comparison to the items selected for testing.

# **APPENDIX A**

Benford's Law, developed by physicist Frank Benford, is a digital analysis technique that can identify irregularities or potential fraud in a set of financial data. Benford's Law states that in a given set of financial data, the leading digit of a number will be a smaller number, like 1 or 2, more often than a larger number such as 8 or 9. According to Benford, the digit 1 will be the leading digit about 30% of the time, while the number 9 will be the leading digit less than 5% of the time. A Benford's Law analysis was performed for all invoice data from the period of the audit scope of FY22 through March 31st of FY24. The results of our Benford's Law analysis are reflected in the graph below.



Our analysis identified that the occurrences of the leading digits 2, 5, and 9, were outside of the predicted distribution. Therefore, we performed a detailed analysis of invoice payment amounts that had a leading digit of 2, 5, or 9. Our tests did not reveal any irregularities or evidence of fraud.

# **APPENDIX B**

### **Finding Classification**

Findings are grouped into one of three classifications: High, Medium, or Low. Those findings that are categorized as low are not included in the report but rather are communicated separately to management. Classifications prioritize the findings for management to address and also indicate the level of testing required to determine if a finding's Corrective Action Plan is fully implemented in accordance with recommendations and Management's Response.

**High**: A finding that is ranked as "High" will have a significant impact on the organization. It is one that *prevents* the achievement of a substantial part of significant goals or objectives, or is the result of noncompliance with federal, state, or local laws, regulations, statutes, or ordinances. Any exposure to loss or financial impact for a High finding is considered *material*. Examples include direct violation of City or Department policy, blatant deviation from established policy and procedure, such as actions taken to circumvent controls in place, material non-compliance with federal, state, or local laws, regulations, statutes or ordinances, or an area where significant cost savings could be realized by the Department or the City through more efficient operations.

High findings require immediate management attention and should take management's priority when considering implementation for corrective action.

**Medium:** A "Medium" finding is one that *hinders* the accomplishment of a significant goal or objective or is the result of non-compliance with federal, state, or local laws, regulations, statutes, or ordinances, but can't be considered as preventing the accomplishment of the goal or objective or compliance with federal, state, or local laws, regulations, statutes, or ordinances. Exposure to loss or potential or actual financial impact is *significant but not material* to the Department or City. Examples include lack of monitoring of certain reports, insufficient policies and procedures, a procedure in place or lack of a procedure that can result in *potential* noncompliance with laws and or regulations.

Medium findings require management attention within a time frame that is agreed upon by the Department and the City Auditor. Priority for implementation of management's corrective action should be considered in light of other High or Low findings.

**Low:** A "Low" finding is one that warrants communication to management but isn't considered as hindering the accomplishment of a significant goal or objective or isn't noncompliance with federal, state, or local laws, regulations, statutes, or ordinances. Financial impact or risk of loss is minimal to none; however, low findings can hinder the effectiveness or quality of department operations and thus are communicated to management separately. Low ranked findings are not included in the final audit report.

The City Auditor's Office will not follow up on the status of Low findings communicated to Management.