

**Performance Audit:
Direct Payments**

April 2022

**City Auditor's Office
City of Atlanta**

File #22.05



CITY OF ATLANTA
City Auditor's Office
Amanda Noble, City Auditor
404.330.6750

April 2022

Performance Audit:

Why We Did This Audit

We undertook this audit because our June 2021 report, *Forensic Audit Services*, found that control deficiencies in the procurement process allowed a former city executive to make improper payments. We assessed whether controls were in place for the Department of Finance to ensure that direct payments are appropriate.

What We Recommended

To promote compliance with policy and reduce the volume of direct payments, the chief financial officer should:

- revise the Accounts Payable policy to require departments to use micro-purchasing for goods/services under \$5,000
- report dashboard results for each city department to the Finance Executive Committee
- ensure the Accounts Payable policy requires department head approval
- prevent staff who set up one-time vendor profiles in Oracle from creating/approving associated direct payments
- work with third-party vendor to improve the accuracy of the dashboard
- consider auditing the dashboard report quarterly for data reliability
- provide periodic refresher training to departments on dashboard and account coding
- work with city departments to improve consistency in account coding

For more information regarding this report, please use the "contact" link on our website at www.atlauditor.org

Direct Payments

What We Found

The direct payment process allows city departments flexibility to obtain goods quickly, and the ability to procure items that cannot be obtained through the competitive procurement process, such as utility payments and subscriptions. The process, however, carries more risk than other procurement methods such as procure-to-pay or procurement cards. The direct payment process has relatively few pre-purchase controls, because the purchased item has usually already been received before the Department of Finance has an opportunity to review the purchase, obligating the city to make payments to vendors.

Goods and services under \$5,000 could be procured as micro-purchases, which allows goods to be obtained sooner than in a traditional procurement, because it requires one quote rather than the three quotes required for small purchases. The majority of direct payments in fiscal year 2021 were \$5,000 or less, potentially eligible to have been made as micro-purchases. Even though direct payments are risky transactions, departments did not consistently follow, and Accounts Payable did not consistently enforce existing controls outlined in its procedures, such as requiring departments to submit all required documentation and obtaining proper authorizations.

Accounts Payable could also enhance certain controls to make the direct payment process less risky, including requiring department heads to sign off on direct payments and separating incompatible duties so the same Accounts Payable employee cannot both create and approve a direct payment.

Accounts Payable has directed city departments to use a dashboard report to track compliance with policy and to reduce the number of unallowable direct payments. Finance considers unallowable direct payments as those not specifically mentioned in Accounts Payable policy, while allowable direct payments are pre-authorized. We found that the report is not accurate—it includes unpaid and non-direct payment transactions, such as wire transfers, and classifies some allowable direct payments as unallowable, limiting its usefulness.

Management Responses to Audit Recommendations

Summary of Management Responses		
<p>Recommendation #1:</p> <p>We recommend that the chief financial officer revise the Accounts Payable policy to require city departments to use micro-purchasing for goods and services not exceeding \$5,000 that can be procured to pay and provide training to city departments on the updated policy.</p>		
<p>Response: Agree</p>	<p>Status: Started</p>	<p>Estimated Completion Date (M/Y): 03/18/2022</p>
<p>Recommendation #2:</p> <p>We recommend that the chief financial officer report the dashboard results for each city department during Finance's quarterly presentation to the Finance Executive Committee, highlighting the number of unallowable direct payments under \$5,000.</p>		
<p>Response: Agree</p>	<p>Status: Implemented</p>	<p>Estimated Completion Date (M/Y): 05/01/2022</p>
<p>Recommendation #3:</p> <p>We recommend that the chief financial officer ensure the Accounts Payable policy reflects current practices and requires Finance staff to put direct payments on hold status until city departments meet all direct payment requirements.</p>		
<p>Response: Agree</p>	<p>Status: Implemented</p>	<p>Estimated Completion Date (M/Y): 03/18/2022</p>
<p>Recommendation #4:</p> <p>We recommend the chief financial officer require city departments to use the updated Accounts Payable disbursement form, submit required documentation, and ensure all required signatures are present on disbursement forms.</p>		
<p>Response: Agree</p>	<p>Status: Implemented</p>	<p>Estimated Completion Date (M/Y): Ongoing</p>
<p>Recommendation #5:</p> <p>We recommend that the chief financial officer update the Accounts Payable policy to require department heads to approve all direct payments.</p>		
<p>Response: Agree</p>	<p>Status: Started</p>	<p>Estimated Completion Date (M/Y): 02/09/2022</p>

Recommendation #6: We recommend that the chief financial officer establish controls to prevent staff who set up one-time vendor profiles in Oracle from creating and approving associated direct payments.		
Response: Agree	Status: Implemented	Estimated Completion Date (M/Y): 03/18/2020
Recommendation #7: We recommend that the chief financial officer work with the third-party vendor to improve the accuracy of the dashboard by correcting identified discrepancies and validating report data.		
Response: Agree	Status: Implemented	Estimated Completion Date (M/Y): 10/2021
Recommendation #8: We recommend that the chief financial officer update the Accounts Payable policy to ensure that categories of allowable expenses are comprehensive and consider auditing the dashboard report quarterly for data reliability.		
Response: Agree	Status: Implemented	Estimated Completion Date (M/Y): Ongoing
Recommendation #9: We recommend that the chief financial officer update Accounts Payable policy to include the account coding for allowable expenses and provide periodic refresher training to city departments on the dashboard and account coding.		
Response: Agree	Status: Implemented	Estimated Completion Date (M/Y): 03/18/2021
Recommendation #10: We recommend that the chief financial officer direct the Office of Budget and Fiscal Policy to work with city departments to improve their consistency in account coding for direct payment requests.		
Response: Agree	Status: Not Started	Estimated Completion Date (M/Y): First Quarter of FY23



CITY OF ATLANTA

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Dargan Burns, III

April 7, 2022

Honorable Mayor and Members of the City Council:

We undertook this audit of the direct payment process because our June 2021 report, *Forensic Audit Services*, found that control deficiencies in the procurement process contributed to a former city executive's ability to make improper payments. The scope of the audit is fiscal year 2021.

The city's direct payment process allows departments the flexibility to obtain goods and services quickly; however, the process carries more risk than other procure-to-pay methods because requests for purchase are not validated before goods or services are accepted on behalf of the city. Accounts Payable has attempted to reduce the volume of direct payments by directing departments to review a dashboard report, but the report is inaccurate, limiting its usefulness. Our recommendations focus on reducing the number of direct payments, updating Accounts Payable policy, improving Account Payable's compliance with policy in processing direct payments, and ensuring separation of incompatible duties.

The Audit Committee has reviewed this report and is releasing it in accordance with Article 2, Chapter 6 of the City Charter. We sent a draft report to management January 21, 2022, and received their response March 2, 2022. We appreciate the courtesy and cooperation of city staff throughout the audit. The team for this project was Rebecca Robinson and Brandi Bell.

Amanda Noble
City Auditor

Danielle Hampton
Chair, Audit Committee

Direct Payments

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Introduction

Direct payments should be transactions for which competitive sourcing is not possible, such as conference registrations, subscriptions, settlements, and court fees, but departments have used them to pay invoices after the fact instead of getting a purchase order. The city's forensic audit, released in June 2021, identified control deficiencies in the procurement process that allowed a city executive to circumvent controls through the direct payment method. Our audit assesses whether controls are in place to ensure that direct payments are appropriate.

Background

Accounts payable are the city's financial obligations to its vendors for goods and services; the city requires a high level of confidence that the suppliers, amounts paid, and type of goods are accurate and allowable. Typically, departments are required to obtain a purchase order from the city's Department of Procurement prior to accepting any goods or services on behalf of the city. The purchase order process functions as a control to ensure that the city is conducting business with certified vendors, funds are encumbered within budgetary limits, and city funds are being used for approved purposes. This process also provides a basis for matching the receipt of the good or service to the invoice. Vendors are paid as the final step in the process. The city has established exceptions to using purchase orders when the procurement is below a specific amount, or for certain types of expenses. Accounts Payable employees within the Department of Finance's Office of the Controller are responsible for ensuring that vendor invoices are paid.

Direct Payments Intended for Goods and Services that Cannot Be Procured to Pay

The city allows departments to purchase some goods and services without a purchase order using direct payments; these are transactions that cannot be procured to pay. Accounts Payable employees process direct payments after the good or service has been received. In fiscal year 2021, Accounts Payable processed nearly \$126 million in direct payment expenses, which represents approximately 5% of the city's total expenses for the year.

According to Accounts Payable's procedures, the types of goods and services that are allowable as direct payments include:

- **board member expenses** - payment to members for performing duties for a committee
- **conference registration** - fees for employees to attend conferences that will enhance skills and add value to the city
- **court fees** - associated with handling a case, legal representation, or filing fees while operating on behalf of the city
- **credit union payments** - dues paid on behalf of employees
- **garnishments** - court-ordered payroll deductions to pay debts such as child support, levies, student loans, or bankruptcy
- **independent contractor** - payments to a self-employed individual operating as a sole proprietor
- **insurance payments** - payments for the employer portion of medical benefit payments for city employees
- **interview/relocation expenses** - paid on behalf of employees relocating from another location to the city
- **Internal Revenue Service or the Department of Labor** - payments on behalf of the city
- **memberships in professional organizations** - dues and subscriptions to enhance employee professional development
- **outside counsel services** - payments to law firms representing the city
- **settlements** - payment of an official agreement between the claimant and the city
- **subscriptions** - payments for newspapers, magazines, and streaming services
- **union dues** - payments on behalf of the city's union members
- **utilities** - electricity, gas, water/sewage, and garbage disposal

Finance employees told us that they define the allowable direct payments as those that have been pre-authorized according to Accounts Payable policy. The department considers unallowable direct payments as purchases that have not been pre-authorized.

Payment Requests Are Typically Submitted After Purchases Are Made

The direct payment process begins when city departments purchase a good or service and receive an invoice. The department submits supporting documentation to Accounts Payable with a disbursement

form that includes the following information and approvals (see Exhibit 1):

- vendor information
- goods/services received date
- invoice date, number, and total amount
- signatures of requestor and authorizer
- account string
- business justification

Department staff routes the disbursement form, with the supporting documentation, through DocuSign to obtain required signatures. If the invoice amount is less than \$100,000, the requestor and authorizer electronically sign the disbursement form. If the invoice amount is equal to or greater than \$100,000, the disbursement form should be routed to the chief financial officer or deputy chief financial officer for review and approval. The requestor determines to whom DocuSign should route the disbursement form for approval. The department submits the disbursement form and supporting documentation through Oracle Cloud or the Accounts Payable mailbox for processing.

After the department submits the disbursement form and supporting documentation, Accounts Payable employees determine whether the expense is allowable or unallowable. If the payment request is allowable and the vendor who provided the good or service is set up in Oracle, Accounts Payable staff will enter the disbursement request information into Oracle or validate the data if already uploaded by city department staff. Accounts Payable employees then assign the request to the departmental authorizer through Oracle for approval and submit the payment to the vendor. Accounts Payable employees build vendor profiles in Oracle for vendors who are issued one-time payments (for example, for refunds and legal settlements), but Procurement sets up other vendor types in Oracle for Accounts Payable to complete the process.

If Accounts Payable employees determine that the payment request is unallowable, they will place the payment request on hold. If the good or service has not yet been rendered, Accounts Payable would advise the department to obtain a purchase order through Procurement. If goods or services have already been rendered, Accounts Payable employees told us that they require approval of the department head before the request can be removed from on hold and processed.

Exhibit 1: City Disbursement Form Required to Process Direct Payments

 KEISHA LANCE DOTTAMS MAYOR	MOHAMED BALLA CHIEF FINANCIAL OFFICER MBalla@atlantaga.gov																																																																																																																																																																						
AP Disbursement Request Form																																																																																																																																																																							
Vendor Name <u>Holland & Knight LLP</u> Vendor Number <u>701273</u> Vendor Address <u>P.O. Box 864084, Orlando, FL 32886-4084 Atlanta, GA 30327</u>	Invoice Date <u>09/22/2021</u> Invoice Number <u>32778721</u> Invoice Amount <u>39,885.00</u> Invoice Type <u>Immediate Pay</u> Goods/Services Received Date <u>08/31/2021</u>																																																																																																																																																																						
<table border="1" style="width:100%; border-collapse: collapse;"> <thead> <tr> <th>Fund</th> <th>Dept</th> <th>Account</th> <th>Function/Activity</th> <th>Funding Source</th> <th>Project</th> <th>Task</th> <th>Award</th> <th>Exp Type</th> <th>Exp Org</th> <th>Exp Item Date</th> <th>Amount</th> </tr> </thead> <tbody> <tr> <td>1001</td> <td>080101</td> <td>5212001</td> <td>1530000</td> <td>000000</td> <td></td> <td></td> <td></td> <td></td> <td></td> <td></td> <td>13,560.90</td> </tr> <tr> <td>5051</td> <td>080101</td> <td>5212001</td> <td>1530000</td> <td>000000</td> <td></td> <td></td> <td></td> <td></td> <td></td> <td></td> <td>13,162.05</td> </tr> <tr> <td>5501</td> <td>080101</td> <td>5212001</td> <td>1530000</td> <td>000000</td> <td></td> <td></td> <td></td> <td></td> <td></td> <td></td> <td>13,162.05</td> </tr> <tr><td> </td><td> </td></tr> <tr><td> </td><td> </td></tr> <tr><td> </td><td> </td></tr> <tr><td> </td><td> </td></tr> <tr><td> </td><td> </td></tr> <tr><td> </td><td> </td></tr> <tr><td> </td><td> </td></tr> <tr><td> </td><td> </td></tr> <tr><td> </td><td> </td></tr> </tbody> </table>												Fund	Dept	Account	Function/Activity	Funding Source	Project	Task	Award	Exp Type	Exp Org	Exp Item Date	Amount	1001	080101	5212001	1530000	000000							13,560.90	5051	080101	5212001	1530000	000000							13,162.05	5501	080101	5212001	1530000	000000							13,162.05																																																																																																												
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Request Date <u>9/24/2021</u> Employee Name <u>Falathia Peterson-Reid</u> Authorized Receiving Employee's Signature <u>Falathia Peterson-Reid</u> Fund Availability Certification The undersigned certifies that funds are encumbered for all purchase order invoices and available at the budget adoption level for all other invoices as indicated herein.	JUSTIFICATION: <u>Disparity Study</u> Chief Financial Officer/Deputy Chief Financial Officer _____ Date _____																																																																																																																																																																						
Business Manager/Director/Commissioner <u>Maecher Bailey</u> <u>9/24/2021</u> Business Manager/Director/Commissioner _____ Date _____	Hold Check Code _____ Pay Alone _____																																																																																																																																																																						

Source: Auditor's screenshot of disbursement form from Oracle

Direct Payment Process is Riskier Than Procure-to-Pay Methods

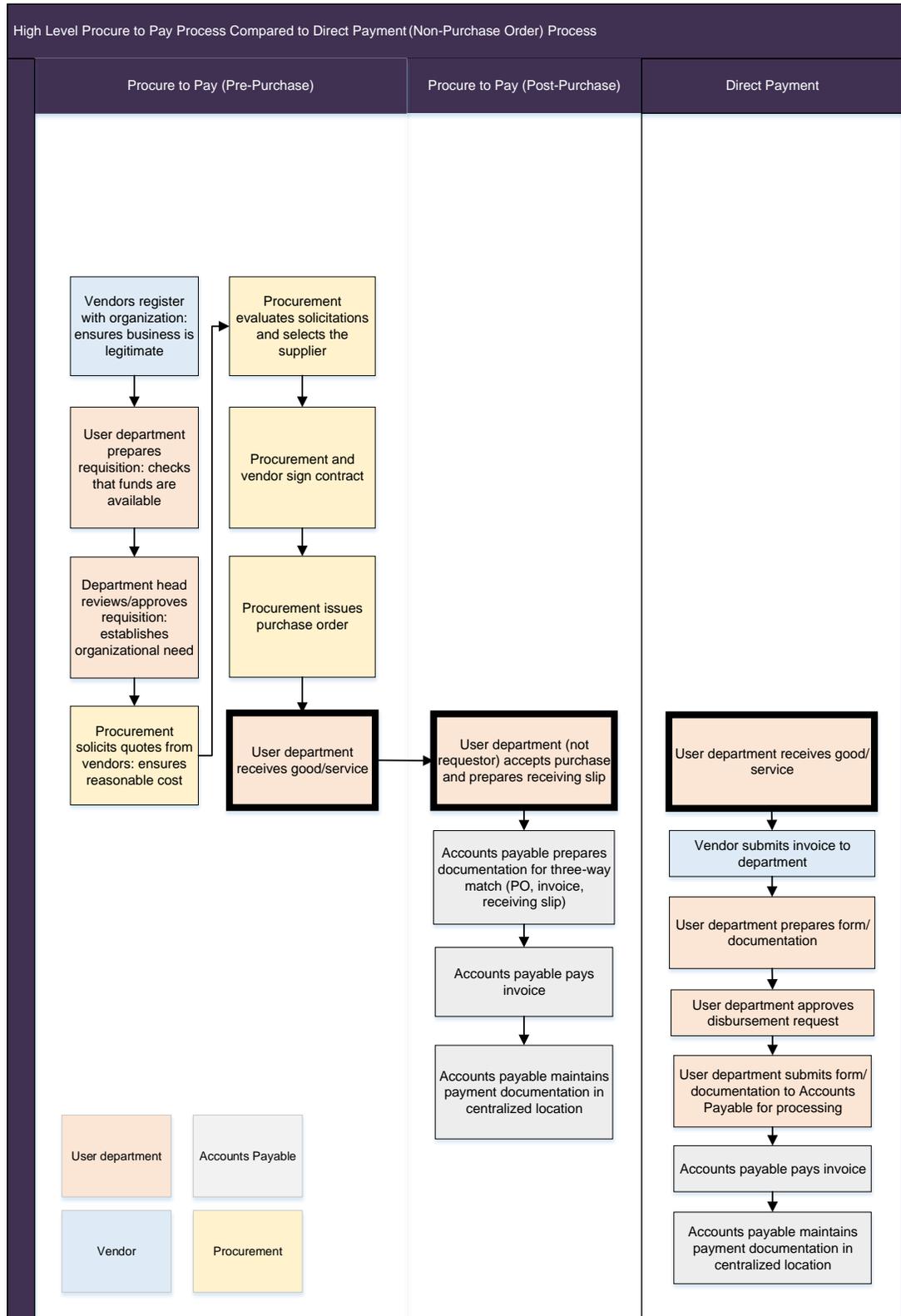
The direct payment process lacks pre-purchase procedures that procure-to-pay methods include, making it riskier than those. Procure-to-pay procedures allow for requests to be validated before goods or services

are accepted on behalf of the city and include the following pre-purchase controls:

- vendor registration ensures that the city department is purchasing from a legitimate business
- requisition preparation and approval ensure that funds are available to cover the purchase and that the purchase fulfills an organizational need
- quote solicitation ensures that the department is procuring the good or service at a reasonable cost through competitive bidding

According to best practices, after the good or service has been received, Accounts Payable performs a three-way match of the purchase order, invoice, and receiving slip to verify that the good or service aligns with what was received for the amount to which the parties agreed. The pre-purchase controls involved in the procure-to-pay process are not present in the direct payment process because the validation by Accounts Payable usually begins after the department has already received the good or service and the invoice (see Exhibit 2). The post-purchase three-way match is also impossible because the direct payment process does not require purchase orders and receiving slips for Accounts Payable to process the payment.

Exhibit 2: Direct Payment Validation Begins After Purchase is Made

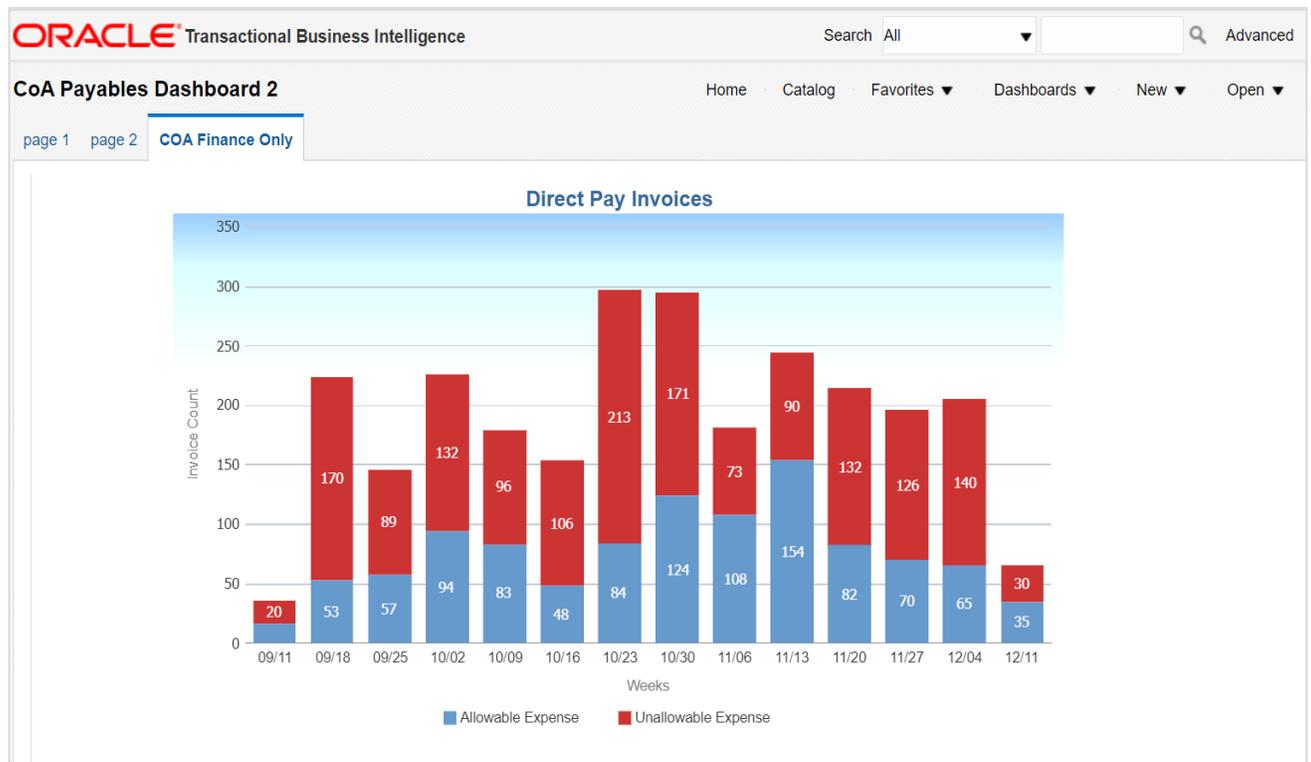


Source: Developed by auditors based on best practices related to procure-to-pay and direct payment processes

City Created Dashboard to Track Direct Payments

In April 2020, the Department of Finance collaborated with a third-party vendor to develop the Accounts Payable Invoice Dashboard. The dashboard is an interactive module in Oracle that city departments can access to review invoice status and processing. A module dedicated to direct payments includes a breakdown of allowable and unallowable direct payment transactions (see Exhibit 3). The dashboard also reports information such as department code, vendor name, invoice amount, invoice description, account code and description, and invoice creation date.

Exhibit 3: Dashboard Shows Number of Allowable and Unallowable Direct Pay Invoices



Source: Auditor's screenshot of the Oracle interface (week ending December 11, 2021)

The dashboard was initially created for Finance to internally monitor the general status of payments, but Finance later rolled it out to city departments and began training employees to use it in September 2020. According to Finance staff, the dashboard was developed in part to reduce the number of direct payments.

Finance also created a dashboard report (Direct Pay Invoices Details), in June 2021, to reflect the information on the dashboard. The dashboard report consolidates direct payment transactions citywide. City

departments are able to download the report from the dashboard interface in Oracle.

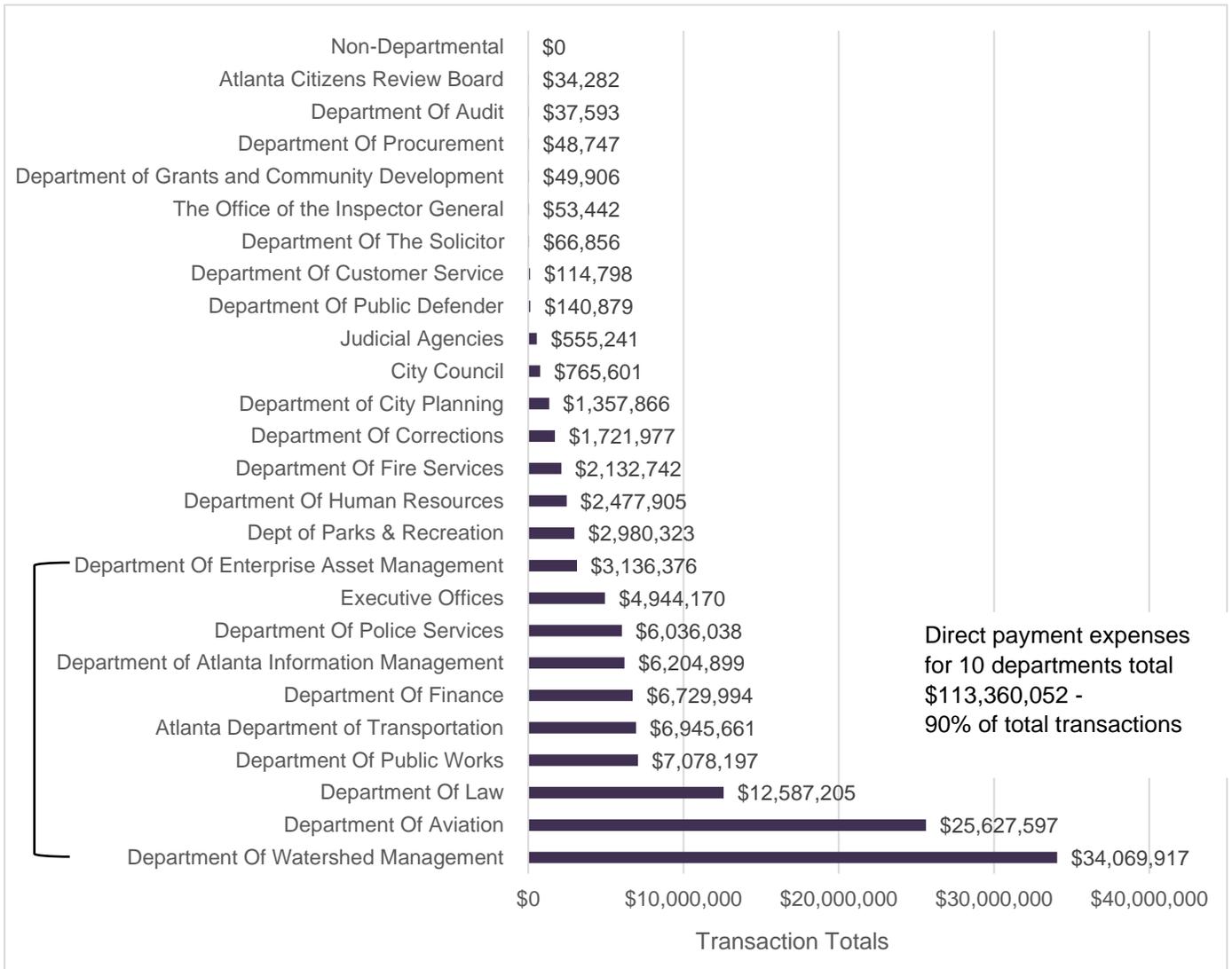
Based on the dashboard report for fiscal year 2021, city departments submitted a total of 10,691 invoices containing 15,723 expense transactions (see Exhibit 4), totaling \$125,898,208 (see Exhibit 5). Invoices can contain multiple line item transactions. The Department of Law had the highest number of transactions during the year, and transactions for the Department of Watershed Management totaled the most, at \$34 million. As shown in Exhibit 5, ten departments accounted for 90% of the direct payment expense.

Exhibit 4: Departments Submitted 15,723 Direct Payment Transactions in FY21



Source: Accounts Payable Dashboard Report, fiscal year 2021

Exhibit 5: Direct Payments Totaled \$126 Million



Source: Accounts Payable Dashboard Report, fiscal year 2021

According to the dashboard report, city departments used the direct payment process for goods and services including, personnel and contracted services, supplies, and capital purchases, and other costs, such as property taxes and board member compensation.

Audit Objectives

This report addresses the following objective:

- Are controls in place for the Department of Finance to ensure that direct payments are appropriate?

Scope and Methodology

We conducted this audit in accordance with generally accepted government auditing standards. We reviewed direct payments citywide for fiscal year 2021.

Our audit methods included:

- reviewing city code regarding the procurement process and Finance’s role in ensuring accounting accuracy
- interviewing Finance staff to understand the direct payments process
- developing flowcharts to illustrate the direct payment and procure-to-pay processes
- examining Accounts Payable policies and procedures to understand the city’s direct payment process and transactions
- interviewing staff from entities with payment processes that are similar to the city’s direct payment process to identify best practices
- comparing the city’s direct payment process to best practices for non-purchase order payment processes, procure-to-pay processes, and procurement cards
- analyzing the dashboard report and randomly sampling 85 paid direct payment expense transactions to assess compliance with Accounts Payable procedures
- selecting a random sample of 65 suppliers who were paid through the direct payment process and reviewing supporting documentation to determine whether duplicate payments were made

Generally accepted government auditing 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 Analysis

Direct Payment Process Poses Risk

The direct payment process allows city departments flexibility to obtain goods quickly, and the ability to procure items that cannot be obtained through the procurement process, such as subscriptions, training, or legal settlements; however, the process carries more risk than other methods such as procure-to-pay or procurement cards. The direct payment process has relatively few pre-purchase controls because the purchased item has usually already been received, obligating the city to make payments to vendors before Finance has an opportunity to review the purchase. Departments are not consistently following direct payment procedures, such as submitting required documentation and having the proper authorizations, which increases the risk that the city may be required to pay for inappropriate purchases.

We found that the majority of direct payments were \$5,000 or less, potentially eligible to have been made as micro-purchases, which requires one quote for services and is tied to a purchase order, providing more controls than direct payments. Direct payments should have greater oversight where possible.

We recommend that Finance tighten controls over direct payments by updating the Accounts Payable policy to require micro-purchasing where eligible and to require department head authorization. If Finance modifies its procedures to require qualifying purchases to be made using the micro-purchase method, it would reduce the number of direct payments and lessen the administrative burden on department heads to approve these payments.

Over Three Quarters of “Unallowable” Direct Payments Might Have Been Processed as Micro-Purchases

Accounts Payable processed 10,691 direct payment invoices during fiscal year 2021; 5,936 were classified as “unallowable” in the dashboard report. We found that 4,685 (79%) of these invoices that city departments submitted for direct payment were under \$5,001, which may have been processed as micro-purchases through Procurement.

According to Section 2-1190.1 of city code, any contract or purchase order for supplies, services, or construction that is \$5,000 or less may be procured using the micro-purchase process. Procurement’s procedures require that to purchase items or services using the micro-

purchase process, city departments must submit a requisition with one quote to Procurement, which will issue a purchase order. Because only one quote is required, departments can obtain a purchase order more quickly than with other procurement methods.

The micro-purchase process is not as rigorous as procure-to-pay, but it does offer some pre-purchase controls. The Accounts Payable policy references the micro-purchase code but does not require departments to use it. Revising the Accounts Payable policy to require departments use micro-purchases for qualifying purchases would significantly reduce the number of direct payments and the associated risk.

We recommend that the chief financial officer revise the Accounts Payable policy to require city departments to use micro-purchasing for goods and services not exceeding \$5,000 that can be procured to pay and provide training to city departments on the updated policy.

We also recommend that the chief financial officer report the dashboard results for each city department during Finance's quarterly presentation to the Finance Executive Committee, highlighting the number of unallowable direct payments under \$5,000.

Departments Are Bypassing Direct Payment Controls

The direct payment process bypasses the pre- and post-purchase controls of the procure-to-pay process, such as written approvals prior to purchase, reconciliation of supporting documentation, and segregation of duties between the requestor and authorizer. Although the direct payment process involves fewer controls than procure-to-pay, departments have not always followed, and Accounts Payable has not always enforced, the procedures outlined in its policy, such as submitting required documentation and having the proper authorizations. Without these, the city could be obligated to pay for inappropriate purchases.

The direct payment process has fewer controls than either procure-to-pay or p-card methods of procurement. Exhibit 6 compares the difference in controls between the direct pay, procure-to-pay, and p-card (procurement card) methods. P-card controls also include establishing single purchase and monthly credit limits and only granting the cardholder access to merchant category code groups that the cardholder needs to meet job requirements. Allowing or blocking certain codes provides protection against unauthorized or prohibited purchases.

Exhibit 6: Direct Payments Have Fewer Controls Than P-cards and Procure-to-Pay

Process Phase	Control	Procure - to-Pay	P-Card	Direct Payment
Controls related to program start-up	Establish and distribute policies and procedures for pre-payment processes	✓	✓	
	Establish and distribute policies and procedures for payment processes	✓	✓	✓
	Provide users with initial and refresher training	✓	✓	
	Span of control relationships between approving officials and purchasers should be reasonable to ensure adequate review		✓	
	Criminal background and credit checks (initial and periodic) on prospective and current cardholders		✓	
Preventive controls for unauthorized purchases	Vendor registration (require SSN/tax ID number and address before adding to master file)	✓		
	Establish practices to identify and communicate prohibited purchases	✓	✓	✓
	Merchant categories blocked to prevent unauthorized purchases		✓	
	Segregation of duties: payment authorization and vendor set-up	✓		
	Approvers should not be subordinates		✓	
Pre-purchase controls	Competitive bidding process (written proposals/quotations)	✓		
	Written approvals prior to purchase (requisition)	✓		
	Pre-purchase request (department authorization)		✓	
	Check budget appropriations prior to purchase	✓		
	Application controls that prevent approval of a requisition/purchase order if budget insufficient	✓		
	Segregation of duties between requestor and authorizer of purchase	✓	✓	
	Prepayment purchasing forms include specific details about purchase	✓	✓	
	Sequentially numbered purchasing forms	✓		
	Copies of purchasing forms supplied to other departments prior to purchase (documentation of authorization)	✓		
	Single purchase and monthly credit limits should be established		✓	
Budgetary controls	Encumbrances established from approved purchase order	✓		
	Encumbrances reviewed for year-end financial reporting	✓		
Post-purchase controls	Receiving slips prepared by person other than purchaser and based on actual goods received	✓		
	Purchasing and receiving areas should be segregated	✓		
	Detailed invoices: supplier, quantity, description, and unit/total price	✓	✓	✓
	3-way match: PO, invoice, and receiving slip (voucher package)	✓		
	Department authorizer approves purchase for payment after goods received/services rendered	✓	✓	✓
	Payments should be mailed directly to vendor and not provided to department	✓		✓
	Periodic review of vendor database for unknown or unusual vendors	✓		

Source: Developed by auditors based on best practices related to procure-to-pay and direct payment processes

The procure-to-pay process also involves reconciling the purchase order, invoice, and receiving slip after the good or service has been received. This control is not feasible through the direct payment process because Accounts Payable processes the payment based on the invoice and disbursement form. Supporting documentation for direct payments do not include purchase orders or receiving slips; however, they require

invoices, authorization by the requesting department, and payments are issued directly to vendors.

Some direct payments lacked required supporting documentation.

We sampled 85 direct payments to determine whether departments followed Accounts Payable policy. Departments submitted the disbursement form, invoice, and business justification for 70 of 85 (82.4%) direct payments in our sample; however, we found:

- 10 of 85 (11.8%) were missing the business justification, with 4 of the 10 missing the disbursement form completely
- 5 of 85 (5.9%) were missing the invoice

Also, the amounts on the disbursement form and invoice did not match in 1 of 85 (1.2%) direct payments. Three of four direct payments missing the disbursement form were utility payments, which may not require a disbursement form according to Finance staff; however, the Accounts Payable policy did not stipulate that the disbursement form is not required for utility payments.

Some direct payments lacked proper authorization. Based on our sample of 85 direct payments, we found:

- 5 of 85 (5.9%) were created and approved by the same Accounts Payable employee
- 5 of 85 (5.9%) were missing the requestor's signature
- 9 of 85 (10.6%) direct payments had the same person as the requestor and approver on the disbursement form

We also found that 1 of 3 (33.3%) allowable direct payments over \$100,000 did not include the chief financial officer's or deputy chief financial officer's signature, as required by policy. Moreover, 5 of 7 direct payments greater than \$20,000 that were classified as unallowable did not have legislation attached or the chief financial officer's or deputy chief financial officer's signature, as required by the Accounts Payable policy. As shown in Exhibit 6, two procure-to-pay controls include written approvals, or a requisition, prior to purchase and segregation of duties between the requestor and authorizer.

Additionally, we found that the disbursement forms that city departments submitted were not uniform, and some did not include a signature line for the chief financial officer or deputy chief financial officer, which may result in requests not being routed for required authorizations.

We recommend that the chief financial officer ensure the Accounts Payable policy reflects current practices and require Finance staff to

put direct payments on hold status until city departments meet all direct payment requirements. We also recommend the chief financial officer require city departments to use the updated Accounts Payable disbursement form, submit required documentation, and ensure all required signatures are present on disbursement forms.

Existing Direct Payment Controls Could Be Enhanced

Finance should update the Accounts Payable policy to address discrepancies and establish more controls over the direct payment process. The policy does not include all categories of allowable expenses or require department heads to sign off on direct payment requests. It also does not provide safeguards against payments to fictitious vendors; Accounts Payable employees can set up vendor profiles and create and approve direct payments to these same vendors.

We recommend that the chief financial officer update the Accounts Payable policy to ensure that categories of allowable expenses are complete, require department heads to approve all direct payments, and work with AIM to establish controls to prevent staff who set up one-time vendor profiles in Oracle from creating and approving associated direct payments.

Policy does not require department heads to approve direct payments. Accounts Payable staff assigns the invoice for departmental approval through the Oracle workflow. In our sample of direct payments, we found that 29 of 85 (34%) were approved in Oracle by employees at a manager level or below. For 3 of these payments, the department head or deputy approved the disbursement form in DocuSign.

Best practices suggest that the department head approve invoices for payment, attesting to the receipt of goods and services and that they are a “true and just” charge. The Accounts Payable policy does not provide guidance on the level of approval required for direct payments in Oracle. Because direct payments are made after goods or services are rendered, obligating the city, the level of authorization should reflect the associated risk. The lack of guidance on approvals could result in improper budgeting, and city departments obligating the city for purchases without department heads’ knowledge.

We recommend that the chief financial officer update the Accounts Payable policy to require department heads to approve all direct payments. If Finance modifies its procedures to also require qualifying purchases to be made using the micro-purchase method, as recommended, it will reduce the number of direct payments and lessen

the administrative burden on department heads to approve these payments.

Finance employees have incompatible duties related to direct payments. Accounts Payable employees told us that certain employees within the department have the capability to set up vendor profiles while also having permissions to create and approve direct payment invoices in Oracle. They also told us that they create vendor profiles in Oracle when they receive direct payment requests for one-time payments, including refunds and legal settlements.

In building the vendor profiles, Accounts Payable staff told us that employees typically enter the vendor's name and address from documentation that city departments provide. If the vendor requires multiple payments, city departments request that Procurement sets up the vendor profile. According to best practices (see Exhibit 6), creating new vendor profiles and authorizing purchases or approving payments should be responsibilities that are not within one employee's purview. The lack of segregation of duties in the direct payment process increases the risk of fraud related to making payments to fictitious vendors.

We recommend that the chief financial officer establish controls to prevent staff who set up one-time vendor profiles in Oracle from creating and approving associated direct payments.

Accounts Payable staff miskeyed invoice numbers, resulting in duplicate payments. We sampled 65 of 643 vendors (10%) who were paid more than one payment through the direct payment process in fiscal year 2021, reviewed supporting documentation, and found 16 duplicate payments totaling \$112,631 to six different vendors.

Oracle has a built-in control to warn Accounts Payable staff of potential duplicate invoices in which the vendor and invoice number are the same. The system control, however, will not prevent staff from creating invoices when the invoice number for the same vendor has been modified. We determined that employees modified invoice numbers when they keyed them into Oracle, such as adding extra characters or changing characters (see Exhibit 7) within the invoice number string, so the information entered into Oracle no longer matched the supporting documentation. Bypassing this system control allowed second payments to vendors for the same invoice. Invoice number alterations, whether accidental or intentional, could result in a duplicate payment and/or indicate fraud. We do not

know whether the city later received credits from vendors for these duplicate payments.

Exhibit 7: Accounts Payable Staff Miskeyed Invoice Number, Resulting in Duplicate Payment

	Invoice Number	Vendor	Invoice Date	Payment Date	Amount
Original invoice number	ZXNZPVKGDY4	Vendor A	09/23/2020	10/12/2020	\$100.00
Modified invoice number	ZXNPVKGDY4	Vendor A	09/23/2020	10/23/2020	\$100.00

Source: Developed by auditors based on sample of vendors from dashboard report

Going forward, these types of errors should be found and corrected. We have worked with the Department of Finance, other city departments, and a third-party vendor to identify high-risk transactions and detect red flags as part of a continuous auditing program. We have established a detective control to identify duplicate invoices with similar invoice numbers from the same vendor and on the same date.

Errors in Direct Payment Reports Reduce Usefulness

The Department of Finance created a dashboard for city departments to view direct payments; however, the data captured in the dashboard are unreliable, partly because Finance did not validate the data, and because departments are not coding direct payments correctly, resulting in allowable direct payments being listed as unallowable and vice versa. To ensure that the city’s accounting records are accurate, and the dashboard can be used for departments to track direct payments, we recommend that the chief financial officer update Accounts Payable policy to include the account coding for allowable expenses and provide periodic refresher training to city departments on the dashboard and account coding. We also recommend that the Office of Budget and Fiscal Policy work with city departments to improve their consistency in account coding for direct payment requests.

Report Intended to Track Direct Payments Is Inaccurate

Although the dashboard is intended to reduce the number of direct payments, based on our analysis of the associated report, the data it provides may be inaccurate. The dashboard report includes unpaid as well as non-direct payments, and also incorrectly categorizes some direct payments as unallowable, based on how city departments code them. Because the data are incorrect, departments are not able to rely on them to track direct payments.

We recommend that the chief financial officer work with the third-party vendor to improve the accuracy of the dashboard and validate the report data.

Dashboard report includes non-direct payments, resulting in unreliable data. The purpose of the dashboard is to inform city departments of the status of their direct payment requests to encourage them to reduce the overall number. We found that the underlying data, however, are inaccurate because they include non-direct payments and unpaid direct payments. The report contained the following transactions:

- wire transfers submitted to the Office of Treasury for processing
- transactions associated with purchase order related invoices
- employee expense report corrections
- credit memos
- cancelled transactions

Finance told us the dashboard report was created by a third-party vendor and the source of the data in the report is based on non-purchase order transactions recorded within Oracle; however, direct payments are not the only transactions recorded in Oracle that are non-purchase order related. For example, the direct payment dashboard report included a wire transfer for nearly \$4.7 million, which was the highest dollar amount of any expense in the dashboard direct payment report. All wire transfers should be processed through the Office of Treasury rather than through Accounts Payable.

Also, Finance staff told us that the data in the dashboard report were not validated by higher levels of Accounts Payable management, who are considered the business owners of the process. Because the report was not properly validated, the data are not completely reliable for monitoring payment status citywide.

We recommend that the chief financial officer work with the third-party vendor to improve the accuracy of the dashboard by correcting identified discrepancies and validating report data.

We found inconsistencies between allowable expenses in the Accounts Payable policy and the dashboard report. We found that the dashboard report categorized 6,920 of 15,723 (44%) direct payments as unallowable (see Exhibit 8). In our sample, however, 5 of 85 (6%) were categorized as allowable in the dashboard report but were not included as allowable in the Accounts Payable policy. These direct payments consisted of service-related payments for property taxes, service

grants, and general liability insurance for non-employees. Also, telephone expenses were classified as allowable within the dashboard report, but they were not included in the utilities category in the Accounts Payable policy. The Accounts Payable policy classifies 15 types of expenses as allowable for direct payment, and Finance staff told us that any expense that is not included in the policy is unallowable.

Some expenses may have been incorrectly classified as “unallowable” because departments miscoded the direct payments. In fiscal year 2021, city departments submitted 6,920 direct payments that were flagged as unallowable (see Exhibit 8). The departments with the highest amount of unallowable direct payments include the departments of Watershed Management and Law. The report indicates that Law, for example, had the highest volume of unallowable expenses, reporting 1,917 of the citywide total of 6,920 (28%) unallowable expenses, which totaled over \$12 million. Department of Watershed Management submitted 493 direct payments (7.1%), totaling over \$15 million in unallowable expenses.

Exhibit 8: Almost Half Direct Payments Flagged as Unallowable in FY21

Population of line items	Allowable Expense	Unallowable Expense	Total
Number of transactions (line items)	8,803	6,920	15,723
Percent of total number of line items	56%	44%	100%
Dollar amount (based on "Invoice Distribution")	\$66,586,613	\$59,311,595	\$125,898,208
Percent of total dollar amount	52.9%	47.1%	100.0%

Source: Developed by auditors based on dashboard report

Most of these direct payments were coded to the consulting/professional services accounts. Law staff told us that the majority of the department’s direct payment invoices were for outside legal counsel services, which is an allowable expense according to the Accounts Payable policy. Because the department is miscoding outside counsel service expenses, they are appearing in the dashboard report as unallowable expenses. Moreover, Accounts Payable management has not validated account coding within the dashboard report against the policy, which could ensure city departments use proper account codes for direct payment purchases.

We reviewed supporting documentation for 85 direct payments and found that some were miscoded in Oracle. We found that 46 of 85 (54%) direct payments were categorized as unallowable; however, the

dashboard report may have improperly categorized 13 of these 46 (28.3%) direct payments as unallowable due to departments miscoding the invoice. The invoices were miscoded to expense accounts such as supplies, consulting and professional services, council members expense, land expense, and travel-related training, which are not included in Accounts Payable policy as allowable, but our review of the invoices indicated that the purchases were for allowable expenses.

Accounts Payable policy does not stipulate the accounts to which disbursement requests should be coded based on its allowable expense categories. Moreover, Accounts Payable employees told us they do not review direct payment account coding for appropriateness. Part of Finance's mission is to deliver a clear and accurate picture of the city's current and future financial position. Miscoded payment requests could result in discrepancies in public financial reporting and the direct payment dashboard, which city departments use to monitor their compliance with the policy.

We recommend that the chief financial officer update the Accounts Payable policy to ensure that categories of allowable expenses are comprehensive and consider auditing the dashboard report quarterly for data reliability. We also recommend that the chief financial officer update Accounts Payable policy to include the account coding for allowable expenses and provide periodic refresher training to city departments on the dashboard and account coding. We further recommend that the chief financial officer direct the Office of Budget and Fiscal Policy to work with city departments to improve their consistency in account coding for direct payment requests.

Recommendations

In order to promote compliance with policy and reduce the volume of direct payments, the chief financial officer should

1. revise the Accounts Payable policy to require city departments to use micro-purchasing for goods and services not exceeding \$5,000 that can be procured to pay and provide training to city departments on the updated policy
2. report the dashboard results for each city department during Finance's quarterly presentation to the Finance Executive Committee, highlighting the number of unallowable direct payments under \$5,000
3. ensure the Accounts Payable policy reflects current practices and require Finance staff to put direct payments on hold status until city departments meet all direct payment requirements
4. require city departments to use the updated Accounts Payable disbursement form, submit required documentation, and ensure all required signatures are present on disbursement forms
5. update the Accounts Payable policy to require department heads to approve all direct payments
6. establish controls to prevent staff who set up one-time vendor profiles in Oracle from creating and approving associated direct payments
7. work with the third-party vendor to improve the accuracy of the dashboard by correcting identified discrepancies and validating report data
8. update the Accounts Payable policy to ensure that categories of allowable expenses are comprehensive and consider auditing the dashboard report quarterly for data reliability
9. update Accounts Payable policy to include the account coding for allowable expenses and provide periodic refresher training to city departments on the dashboard and account coding
10. direct the Office of Budget and Fiscal Policy to work with city departments to improve their consistency in account coding for direct payment requests

Appendices

Appendix A: Management Review and Response to Audit Recommendations

Report # 22.05	Report Title: Direct Payments	Date: February 2022
Recommendation 1: We recommend that the chief financial officer revise the Accounts Payable policy to require city departments to use micro-purchasing for goods and services not exceeding \$5,000 that can be procured to pay and provide training to city departments on the updated policy.		
Risk Category: Process Improvement		Response: Agree
Related Findings: <ul style="list-style-type: none"> Over three quarters of “unallowable” direct payments might have been processed as micro-purchases. We found that 4,685 (79%) of the 5,936 invoices that city departments submitted for direct payment that were classified as "unallowable" were under \$5,001, which may have been processed as micro-purchases through Procurement. 		
Proposed Action: The Department of Finance has been working closely with the Department of Procurement to ensure that the departments are properly trained on the requirements related to the Procurement Policy. The Department of Finance will also ask for assistance from the Commissioners and Department Heads to enforce the Procurement Policy. The current Accounts Payable policy has been updated to recommend the use of micro-purchases for goods and services 08/2021		Current Status: Started
Business Owner: Finance/Procurement		Estimated Implementation Date (M/Y): 03/18/2022
Additional Comments: This coordination effort started 04/01/2020		

Recommendation 2: We recommend that the chief financial officer report the dashboard results for each city department during Finance’s quarterly presentation to the Finance Executive Committee, highlighting the number of unallowable direct payments under \$5,000.		
Risk Category: Process Improvement		Response: Agree
Related Findings: <ul style="list-style-type: none"> Over three quarters of “unallowable” direct payments might have been processed as micro-purchases. We found that 4,685 (79%) of the 5,936 invoices that city departments submitted for direct payment that were classified as "unallowable" were under \$5,001, which may have been processed as micro-purchases through Procurement. 		
Proposed Action: The Department of Finance will incorporate starting with 3Q-FY22 Quarterly Report.		Current Status: Implemented
Business Owner: Finance/Procurement		Estimated Implementation Date (M/Y): 05/01/2022

Additional Comments:

<p>Recommendation 3: We recommend that the chief financial officer ensure the Accounts Payable policy reflects current practices and requires Finance staff to put direct payments on hold status until city departments meet all direct payment requirements.</p>	<p>Risk Category: Process Improvement</p>	<p>Response: Agree</p>
<p>Related Findings:</p> <ul style="list-style-type: none"> Departments are bypassing direct payment controls, such as submitting all required documentation and obtaining proper authorization. 		
<p>Proposed Action: The Accounts Payable team currently rejects direct payments that do not have all the required documentation and signatures for payment. The Department of Finance will continue to ensure instances found without proper documentation/authorizations are redirected back to the submitting agency. Additionally, we will include this information in Accounts Payable Policy.</p>		<p>Current Status: Implemented</p>
<p>Business Owner: Finance</p>		<p>Estimated Implementation Date (M/Y): 03/18/2022</p>
<p>Additional Comments:</p>		

<p>Recommendation 4: We recommend the chief financial officer require city departments to use the updated Accounts Payable disbursement form, submit required documentation, and ensure all required signatures are present on disbursement forms.</p>	<p>Risk Category: Process Improvement</p>	<p>Response: Agree</p>
<p>Related Findings:</p> <ul style="list-style-type: none"> Departments are bypassing direct payment controls, such as submitting all required documentation and obtaining proper authorization. 		
<p>Proposed Action: All Disbursement forms have been updated and placed within DocuSign to be used for Direct Payments. The Accounts Payable team will continue educating the departments on which forms to utilize when processing Direct Payments and the required signatures.</p>		<p>Current Status: Implemented</p>
<p>Business Owner: Finance</p>		<p>Estimated Implementation Date (M/Y): Ongoing</p>
<p>Additional Comments: Accounts Payable will continue with ongoing training.</p>		

Recommendation 5: We recommend that the chief financial officer update the Accounts Payable policy to require department heads to approve all direct payments.	Risk Category: Process Improvement	Response: Agree
Related Findings: <ul style="list-style-type: none"> Existing direct payment controls could be enhanced. Department heads are not required to approve all direct payments. In our sample of direct payments, we found that 29 of 85 (34%) were approved in Oracle by employees at a manager level or below. If Finance modifies its procedures to also require qualifying purchases to be made using the micro-purchase method, as recommended, it will reduce the number of direct payments and lessen the administrative burden on department heads to approve these payments. 		
Proposed Action: The Accounts Payable team has engaged the Financial System Services team to assist with updating DocuSign with the department heads required signature. If the department head is not in the Oracle hierarchy the department head must sign off on the disbursement.		Current Status: Started
Business Owner: Finance		Estimated Implementation Date (M/Y): 02/09/2022
Additional Comments: The Accounts Payable Team has reached out to the FSS team to assist with updating the Direct Payment controls with each Department Head's required signature for payment via a Direct Payment.		

Recommendation 6: We recommend that the chief financial officer establish controls to prevent staff who set up one-time vendor profiles in Oracle from creating and approving associated direct payments.	Risk Category: Process Improvement	Response: Agree
Related Findings: <ul style="list-style-type: none"> Existing direct payment controls could be enhanced. Finance employees have incompatible duties related to direct payments. Accounts Payable employees told us that certain employees within the department have the capability to set up vendor profiles while also having permissions to create and approve direct payment invoices in Oracle. 		
Proposed Action: In the limited instances where Accounts Payable team is required to setup vendor profiles, we have established a process that segregates duties. We will review the desk manual to ensure the controls are documented.		Current Status: Implemented
Business Owner: Finance		Estimated Implementation Date (M/Y): 03/18/2022
Additional Comments: The Accounts Payable Team does have the access to setup vendor profiles and approve the payment (such as refunds). The mitigating control is one Accounts Payable Specialist sets up the vendor profile and a different Accounts Payable Specialist approves/ processes the payment.		

Recommendation 7: We recommend that the chief financial officer work with the third-party vendor to improve the accuracy of the dashboard by correcting identified discrepancies and validating report data.	Risk Category: Monitoring and Reporting	Response: Agree
Related Findings: <ul style="list-style-type: none"> We found that the underlying data in the dashboard report are inaccurate because they include non-direct payments and unpaid direct payments. 		
Proposed Action: The Financial System Services team has corrected the dashboard to ensure only those items that are Pre-Authorized Allowable expenses display in the Direct Payment dashboard form by department.		Current Status: Implemented
Business Owner: Finance		Estimated Implementation Date (M/Y): 10/2021
Additional Comments:		

Recommendation 8: We recommend that the chief financial officer update the Accounts Payable policy to ensure that categories of allowable expenses are comprehensive and consider auditing the dashboard report quarterly for data reliability.	Risk Category: Monitoring and Reporting	Response: Agree
Related Findings: <ul style="list-style-type: none"> We found that the underlying data in the dashboard report are inaccurate because they include non-direct payments and unpaid direct payments. Also, some expenses may have been incorrectly classified as “unallowable” because departments miscoded the direct payments. 		
Proposed Action: The Department of Finance will continue to update the Accounts Payable Policy as new information develops around processes and procedures. Processes/Operations are constantly changing which can make it challenging to compile a comprehensive list of Pre-Authorized Allowable expenses.		Current Status: Implemented
Business Owner: Finance		Estimated Implementation Date (M/Y): Ongoing
Additional Comments:		

Recommendation 9: We recommend that the chief financial officer update Accounts Payable policy to include the account coding for allowable expenses and provide periodic refresher training to city departments on the dashboard and account coding.	Risk Category: Monitoring and Reporting	Response: Agree
Related Findings: <ul style="list-style-type: none"> We found that the underlying data in the dashboard report are inaccurate because they include non-direct payments and unpaid direct payments. Also, some expenses may have been incorrectly classified as “unallowable” because departments miscoded the direct payments. 		
Proposed Action: The Financial System Services team has corrected the dashboard to ensure only those items that are Pre-Authorized Allowable expenses are displayed in the Direct Payment dashboard by the department.		Current Status: Implemented
Business Owner: Finance		Estimated Implementation Date (M/Y): 03/18/2022
Additional Comments: The Department of Finance will work with the departmental Budget Analyst to ensure departments are reviewing their budgets on a quarterly basis.		

Recommendation 10: We recommend that the chief financial officer direct the Office of Budget and Fiscal Policy to work with city departments to improve their consistency in account coding for direct payment requests.	Risk Category: Monitoring and Reporting	Response: Agree
Related Findings: <ul style="list-style-type: none"> We found that the underlying data in the dashboard report are inaccurate because they include non-direct payments and unpaid direct payments. Also, some expenses may have been incorrectly classified as “unallowable” because departments miscoded the direct payments. 		
Proposed Action: The Department of Finance will continue to work with the departmental Budget Analyst to ensure departments are reviewing their budgets on a quarterly basis.		Current Status: Not Started
Business Owner: Finance/The department Budget Analyst		Estimated Implementation Date (M/Y): First Quarter of FY23
Additional Comments:		