

November 17, 2014

Honorable Mayor and Members of the Audit Committee:

An audit of non-payroll checks made to employees was conducted in accordance with the fiscal year 2015 audit plan. The scope of review included all non-payroll checks made to employees with an invoice date of October 1, 2014 to September 18, 2014.

**Background:** The city issues non-payroll checks to employees for a variety of reasons. Table 1 below shows the reasons checks were issued during fiscal year 2014.

Reason	Total Amount	Percentage	Count
Mileage Reimbursement	28,836	50.8%	188
Education Reimbursement	8,487	14.9%	17
Lodging	4,281	7.5%	11
Registration Fee	2,659	4.7%	6
Certification/Membership	2,631	4.6%	21
Item Purchases	2,196	3.9%	22
Coaching/Secondary Job	1,882	3.3%	3
Food	1,829	3.2%	48
Airfare	1,666	2.9%	6
Insurance Premium Refund	775	1.4%	2
Taxi/shuttle/rental car	581	1.0%	8
Parking/tips/tolls	465	0.8%	24
Miscellaneous Services	271	0.5%	9
Gas	232	0.4%	6
<b>Grand Total</b>	<b>\$ 56,791</b>	<b>100.0%</b>	<b>371</b>

The vast majority of these non-payroll checks are to reimburse employees who used personal funds for business-related purchases or activities. Generally, the reimbursement process occurs as follows:

1. An employee retains any receipts or other documentation recording the details of the transaction that needs reimbursement.
2. The employee submits the documentation to the supervisor for approval.
3. After approval an employee within the department creates a field purchase order in the financial system for the reimbursement.
4. In the financial system, the supervisor (or a designee) approves the field purchase order.
5. The accounting department reviews the approved field purchase order then issues the reimbursement.

**Audit Results:** In a typical organization, some of the transactions most at risk of being fraudulent are non-payroll checks issued to employees. The city's purchasing card program in combination with effective policies and procedures has significantly lowered this risk. For example, approximately \$2,347,000 in purchasing card transactions were made in fiscal year 2014 compared to the \$56,791 in checks issued to employees.

High levels of reimbursements are not concentrated around any specific employees. We found that only 15 employees had \$1,000 or more in reimbursements in fiscal year 2014, and no employee's reimbursements made up more than 5 percent of the total reimbursements.

We did find instances where support documentation was insufficient or supervisor review was inadequate. However, this only accounted for \$9,584 of the \$56,791 in non-payroll checks issued to employees (see Appendix A). All of this points to a very low risk of material fraud within the scope of our review.

We did, however, identify one material control deficiency regarding the vendor master file. This and our other findings are discussed in more detail below.

**Employees as vendors:** When employees are to receive non-payroll checks they are set up as vendors in the city's financial system. This set-up opens the city to fraud risk because accounts payable fraud is among the top methods used by individuals to steal money from organizations, and getting on the vendor master file is often the most difficult part of committing the fraud. In the city, this issue is further magnified by the fact that it is often difficult to differentiate employees from actual vendors in the vendor master file.

**Document submissions:** Documentation for reimbursements were found to be sufficient in most cases. In the situations where documentation was insufficient, we found that it was for one of three reasons: (1) documentation was missing, (2) receipts were not itemized, or (3) the form of documentation was deficient.

**Missing documentation.** We found that a total of \$51 were reimbursed without supporting documentation. With the exception of one reimbursement that involved a missing meal receipt, it appears that most undocumented reimbursements involved parking/tips/tolls. Currently, employees may be reimbursed up to \$10 for parking/tips/tolls without receipts. However, in these instances employees were reimbursed for more than \$10 on parking/tips/tolls without receipts.

**Non-itemized receipts.** When employee reimbursements are based on non-itemized receipts, it becomes easier for employees to receive reimbursements for inappropriate purchases since the inappropriate purchases can be hidden among appropriate purchases. We found 12 non-itemized receipts that were reimbursed for a total of \$260. On a related note, we found requests for mileage reimbursements, totaling \$576, which did not state the destinations of each trip. Like non-itemized receipts, this deficiency makes it difficult to determine whether all of the trips were appropriate.

*Deficient documentation.* We found twenty-five instances, totaling \$3,078, where supporting documentation was included, but a receipt was not included. While some documentation is better than nothing, receipts are preferable because receipts show how much money was *actually* spent regardless of any discounts or other changes that may occur after invoicing but before actual payment.

**Supervisor approvals:** Before an employee can be reimbursed, that employee's supervisor should be reviewing the reimbursement request to ensure that amounts are reasonable and that the item being reimbursed for is appropriate. In our review of reimbursements, we found that all reimbursement amounts appeared reasonable, but that the city is inconsistent in determining the types of purchases that are appropriate for reimbursement. Additionally, we found some lapses in the controls on who and when approvals may be made, as well as the forms that are used for reimbursement.

*Departmental inconsistency.* We found that departments are not consistent with each other on what can be reimbursed. For example some departments will only reimburse for meetings mandatory to the job. Other departments will reimburse for non-mandatory meetings, so long as there is some relationship to the city or job. In total, *at least* \$3,522 were reimbursed that would not have been reimbursed by some departments. In order to ensure consistency throughout the city, the city may want to update written policies to go into greater detail regarding the types of purchases and activities that may be reimbursed.

*Who may approve.* We found sixteen instances, totaling \$2,863, lacking a proper supervisory signature accompanying the documentation. Twelve lacked a signature, two were signed by the payee, and two were signed by a subordinate. However, it should be noted that while the signatures may have been insufficient, thirteen of these sixteen reimbursements were approved by a proper supervisor within the financial system. Therefore only \$373 completely lacked proper supervisor approval. We do not believe any of these reimbursements to be illegitimate, nevertheless, these reimbursements should not have been paid until after proper supervisory approval was obtained. Some of these deficient approvals may be caused by a lack of understanding regarding who may approve reimbursements. All checks to employees should be approved by the employee's supervisor. Department directors should have their checks approved by the City Manager's Office. The city manager, city internal auditor, city attorney, and city secretary should have their reimbursements approved by the mayor.

*When to approve.* We found four instances, totaling \$594, where the reimbursement was approved before the transaction occurred. The fact that some supervisors are preapproving but not post-approving runs the risk that employees could add inappropriate items for reimbursement after the supervisor approves.

*Approval forms.* The city use two standard reimbursement forms: one for travel expenses, the other for educational reimbursements. Additionally, there are a variety of department-specific reimbursement forms. It appears that the lack of a standard reimbursement form for non-travel, non-education has occasionally led to departments using inadequate reimbursement forms, or none at all. It is noteworthy that many of the reimbursements lacking approval signatures also lacked a reimbursement form. Therefore, the city may want to consider developing a third catch-all reimbursement form, and then requiring all reimbursement requests include a standard reimbursement form.

**Missing file:** There is one instance where the payment file was missing from the records and therefore the documentation could not be reviewed. This missing file documented a \$126 payment.

**Audit Recommendation:**

Although there were a few instances where documentation and approval procedures could have been done better, the \$9,584 at risk is not a material amount. The cost of ensuring that fraud risk is completely reduced almost always outweighs the benefit. Therefore, we found that the city’s policies and procedures regarding employee reimbursements to be sufficient.

However, the city should avoid mixing employees with regular vendors on the vendor master file. Some employers accomplish this by reimbursing employees through the payroll system. If the city decides to continue to reimburse employees through the accounts payable system, internal controls should be enhanced. A system should be in place to easily identify who is an employee and who is an actual vendor. Also, procedures should be enhanced to ensure that only current employees are active in the system.

**Management Response:**

Management concurs with the recommendation. As the new ERP system continues to be implemented we will determine what options may be available to reimburse employees through the payroll system rather than the Accounts Payable System. Management has put a process in place to ensure that employees are inactivated in the accounts payable system when they terminate employment with the City.

**Appendix A: Audit Results**

<b>Level of Risk</b>	<b>Area of risk</b>	<b>Amount</b>	<b>Amount overlap</b>	<b>Total Risk</b>
<b>High</b>	Missing Files	\$ 125.77	\$ -	<b>\$ 125.77</b>
	Missing Documentation	\$ 51.25	\$ -	<b>\$ 177.02</b>
	Insufficient Supervisor Approval	\$ 372.54	\$ -	<b>\$ 549.56</b>
	Insufficient Approval Documentation	\$ 2,490.34	\$ 20.00	<b>\$ 3,019.90</b>
	Non-itemized Receipts	\$ 260.09	\$ -	<b>\$ 3,279.99</b>
	Preapproval Only	\$ 593.54	\$ 10.00	<b>\$ 3,863.53</b>
	Deficient Documentation	\$ 3,078.00	\$ 735.00	<b>\$ 6,206.53</b>
<b>Low</b>	Department Inconsistency	\$ 3,522.53	\$ 144.66	<b>\$ 9,584.40</b>
<b>Total at Risk:</b>				<b>\$ 9,584.40</b>