



Program Evaluation and Audit

***Council-Wide
Accounts Payable Review***

20 October 2010

INTRODUCTION

Background

The Metropolitan Council (Council) purchases goods and services from a variety of vendors, construction contractors and engineering consultants. In addition, it provides grants to local governing entities and transit agencies for regional parks, community development, transit and a variety of other capital and operating expenses. All of these obligations flow through the Accounts Payable (A/P) system as they are processed for payment.

The Council is divided into five major divisions; Regional Administration (RA), Environmental Services (ES), Metropolitan Transportation Services (MTS), Community Development (CD), and Metro Transit, each incurring payment responsibilities. Regional Administration, MTS, CD and ES debts and grants are paid through a centralized Regional Administration A/P department. Transit debts are paid through the A/P department of Metro Transit.

Generally, and in accordance with Minnesota State Statute 2009-471.425, *Prompt Payment of Local Government Bills*, payments are due within 35 days of the date of receipt of a vendor's invoice. However, the Council also enters into contracts with vendors, construction contractors and consultants to which other payment terms have been agreed. The Council also receives funds from the Federal Transit Administration (FTA) requiring compliance with FTA regulations.

Each payment made by the Council, regardless of type, flows through two separate yet integrated A/P systems. About 63 percent of all Council payments require a Purchase Order (PO). The other 37 percent do not, including payments to utilities, to reimburse employees and Council members, for grants provided by the Council to local government agencies, to US Bank for PCard activity, for payments under Metro Transit's Guaranteed Ride Home program and for internal check requests to name a few. About 58 percent of Metro Transit payments require a PO. When a PO is used, Metro Transit enters it into its Txbase system. When an invoice is received it is sent to the appropriate person for signature and returned. Metro Transit A/P personnel then enter the invoice in Peoplesoft Financials (Peoplesoft), setting it up for payment. About 70 percent of RA payments require a PO. When a PO is used, RA enters it into its Oracle WAM system which electronically conducts the three way matching of PO, invoice and payment authorization when the invoice is set up in Peoplesoft. Both Metro Transit and RA A/P processing is then brought together within the Peoplesoft system for final processing and payment.

Assurances

This audit was conducted in accordance with the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing* and the U. S. Government Accountability Office's *Government Auditing Standards*.

Purpose

This review was conducted to determine if adequate controls exist to provide reasonable assurance that (i) payments are made to correct vendors, (ii) payments are made in a timely and contractually efficient manner, (iii) payments are made in the correct amount, (iv) duplicate payments are not made, and (v) that access to vendor files is limited to authorized employees only. This review was also conducted to provide assurance that payments are made in accordance with legislative, regulatory, vendor and contract requirements, as applicable.

Scope

The review was conducted using a sample from the 64,503 vouchers totaling \$566,132,020 processed during the period January 1 through December 21, 2009. It also included a review of legislative and regulatory requirements, administration policies, procedures, Work Instructions and actual practices.

Methodology

To gain an understanding of Council-wide A/P processes, the following methods of inquiry were used:

- A/P personnel were interviewed.
- A/P transactions were sampled and analyzed.
- Organization charts were reviewed.
- A/P access rights were reviewed and analyzed.
- A/P policies, procedures and work instructions were reviewed.
- Vendor specific and standard contract documents were researched.
- Regulatory requirements were reviewed and analyzed.

OBSERVATIONS

Program Evaluation and Audit (Audit) reviewed a stratified random sample of 501 A/P transactions totaling \$218 million from a universe of 64,503 A/P transactions totaling \$566 million processed during the period January 1, 2009 through December 21, 2009. Details of the stratified sample are at Exhibit I.

Non-Contracted Payments

Audit sampled 188 Strata 1 (\$0 to \$100,000) invoices valued at \$245,182 from a universe of 63,683 invoices valued at \$144,990,774. Audit's review of this sample disclosed that:

- Controls over processing RA invoices adequately safeguard Council assets. When a PO is used, payments cannot be made until an exact match by line item is made between the Council's PO, the vendor's invoice and the receiving entry in Peoplesoft. When a PO is not used, the vendor's invoice must be signed by the authorizing party or a signed check/grant payment request is provided.
- Peoplesoft automatically identified when vendors invoiced the Council incorrect sales tax. A/P personnel then adjusted invoices to reflect the proper amount resulting in an estimated savings of about \$18,000 in 2009.
- Vendor discounts were not always taken resulting in the possible loss of an estimated \$53,000 in 2009. Audit and A/P personnel reviewed the largest discount that was not taken. In this instance, an incorrect PO number was used and by the time the error was corrected by the appropriate employee, the discount period had expired.
- Transit taxes, for which the Council is exempt, amounting to an estimated \$31,000 were paid by RA Finance to utility vendors. However, this error was identified by RA A/P personnel and the overpayments were either credited to future invoices or, in the case of the largest utility, documentation of the \$26,000 overpayment was submitted to the Minnesota Department of Revenue for reimbursement.

It was also brought to Audit's attention, independent of this audit, that there had been an instance in which a payment was hurriedly made through the Peoplesoft A/P system that had originated from a PO in the Txbase Purchasing system. In this instance a blanket purchase order (BLPO) was in place, from which release POs were being written for individual pay requests. Normally, a release PO would be drawn from the BLPO before work is done or goods are received. In rare instances, a release PO might be drawn at the time of receipt of an invoice. However, an incorrect release PO number had been used by the project manager who did not realize that she needed a new PO number for each release, and the FTA reimbursement for the invoice had already been drawn through the Electronic Clearing House Operation (ECHO) System. Per FTA regulations, once federal funds are drawn, they must be disbursed within three days. The use of the incorrect PO number by the project manager created a situation where a payment needed

to be made very quickly and there was not a valid PO in place to initiate a payment in TxBase.

TxBase was designed to allow payments for instances in which a PO voucher needs to be voided and reissued or where a PO was not issued at all. However, in this case, the payment had to be initiated in PeopleSoft, because TxBase system controls would not allow a duplicate payment on a previously paid PO number. To make the payment within the federally required timeline, the system control on PO's was bypassed by making a payment through the PeopleSoft system instead. Metro Transit accounting and systems personnel reported that they have reviewed this case and rectified the systems problem. However, the issues remain that one employee used an incorrect release PO and another had already drawn funds from the FTA before having received a proper purchase order for the invoice in question.

Payment Timeliness

Audit sampled 313 out of a possible 820 items in strata 2 (\$100,001 to \$500,000), 3 (\$500,001 to \$1 million) and 4 (over \$1 million) to determine timeliness of Council payments. Strata 1 was not included due to the large number of items and low dollar value of invoices which would likely result in immaterial findings. For example, utility payments were found to be paid early; however, utilities require payment in fewer than 30 days and add penalties if payments are made late. Employee and Council member reimbursements and payments to Council grant recipients are also paid sooner than required; however, it is Council practice to pay reimbursements on the next payment date and to pay out grant funds as soon as they are received from the grantor.

Overall, the Council is paying these sampled invoices an average of two days early with most types of invoices paid between four days early to four days past due. However, ES construction contractor monthly pay requests (11.9 days early) and Northstar vehicle purchases (14.0 days early) are significantly outside this range. As a percentage of individual payment type, this represents variances ranging from 7 to 10 times higher for these two areas than for any other type of payment.

Strata 2, 3 and 4 universes totaled \$421,121,245 with the resultant samples totaling \$217,958,564, resulting in a possible loss of interest revenue of \$257,094.

Environmental Services construction contractor progress payment requests (\$89,222) and Northstar vehicle purchases (\$54,099) account for an estimated \$143,321 (56%) of the \$257,094 loss in interest revenue. The remaining 44 percent is spread over 690 items representing eight other invoice categories, the results of any one category of which are immaterial to the sample as a whole. Therefore, this review of payment timeliness was limited to ES construction contractor progress payment requests and Northstar vehicle purchases. Northstar vehicles were procured through the Metro Transit procurement office and ES construction payments to contractors were made by the RA A/P department.

Construction Contractor Progress Payment Requests

The Council's standard form 0700, *Construction Contract Standard Terms & Conditions*, Section 14.4, Review of Application for Progress Payment, states that, "After presentation of an Application for Payment acceptable to COUNCIL, the amount recommended will become due and payable by COUNCIL to CONTRACTOR within 30 Days." The Council's Authorized Representative (CAR) reviews contractor Applications for Payment for acceptability. Upon determining that the Application for Payment is acceptable, the CAR signs and dates the document and submits it to A/P for payment. The Council has 30 days from the date of the CAR's signature to pay the invoice. However, it is the practice of RA A/P personnel to assume pay requests are initially correct, unless otherwise indicated by the CAR. They are, therefore, normally processed for payment within 30 days of receipt.

Environmental Services invoices are processed through the RA A/P Department. Environmental Services establishes a pay schedule annually and publishes it for all contractors stating when monthly pay requests are due and when payments will be made. This effectively shortens the payment period stated in the contract between the Council and the contractor. According to the published schedule, the contractor is given a week to deliver a preliminary copy to the CAR, the CAR has a week to make any adjustments, obtain a final copy from the contractor and submit that to A/P, and A/P has one week to process the pay request and make payment. As a result, ES has paid its Contractors an average of 12.9 days early. Audit reviewed a random sample of 30 contractor progress payment requests valued at \$14.5 million from a total of 108 pay requests valued at \$45 million. By waiting until contractually required to make payment, ES could have saved an estimated \$89,222 in additional interest in 2009.

Northstar Train Vehicle Purchases

Northstar train vehicle purchase invoices comprised a separate universe of 19 invoices within strata 2, 3 and 4. Audit sampled 14 invoices which were found to have been paid an average of 14 days early resulting in lost interest of about \$40,000. Extrapolating to all 19 invoices included in the Northstar train vehicle invoice universe, Audit estimates total lost interest to be about \$54,000. By contract, payments are due "30 days after receipt of an invoice." Discussions with Metro Transit A/P personnel disclosed that the Council is a grant sub-recipient to the Minnesota Department of Transportation (MnDOT) for purchasing these vehicles. As such, Metro Transit pays the manufacturer and then invoices MnDOT, including interest payable as of the date of Metro Transit's invoice. Therefore, any lost interest by paying its invoices early is included in the subsequent invoice submitted to MnDOT. Unfortunately, MnDOT is reluctant to pay the interest charges and owes the Council \$219,257 for interest due in 2009.

Monitoring Payment Timeliness

Minnesota State Statute 471.425-requires that local units of government, including the Metropolitan Council pay vendor obligations within 35 days. There are provisions that allow for governments to challenge obligations that are incorrect, or improper. Then the unit of government is not required to make prompt payment until the issue is resolved.

Monitoring compliance with the law is one key indicator of A/P performance. However, conversations with RA A/P personnel disclosed that the current Council system for tracking payment timeliness does not do so in accordance with the law. Council data tracks the gross number of payments made within the established timeframe. It does not separate those that are held due to disputes, audits, legal holds or for other legitimate reasons. Such payments artificially inflate the Council's late payment rate.

Peoplesoft A/P Access Rights

Of 251 Council employees having various access privileges to Peoplesoft A/P data, 13 (5%) are not current employees. Discussions with Council employees disclosed that Department Managers, Human Resources and RA Finance Systems Support personnel all play a role in assuring that employees no longer have access to Council systems once they leave Council employment. A "Leaving Service Form" is to be utilized for this purpose; however, the Council has no formal policy regulating this process and the parties involved have differing opinions of how the process is supposed to operate.

Audit also reviewed access privileges for those employees having "create payment" privileges. Those employees having such privileges work either in the RA Finance or Information Systems (IS) departments. Within RA Finance, they include two A/P Account Clerks, the A/P Supervisor, two Business System support personnel and the Deputy Chief Financial Officer. A separate A/R Account Clerk is responsible for entering receivables and applying payments, thus allowing for the separation of duties between payment and receipt.

In addition to the six RA finance employees with access to create payments, five IS employees (two Data Base Administrators and three Application Developers) also have such capabilities along with a generalized "use to run chartfield config" access.

CONCLUSIONS

1. *The internal controls over the Council's Regional Administration A/P processes and systems are generally adequate to safeguard Council assets, including identifying inappropriate sales tax charges. The internal controls over Metro Transit's A/P processes have a weakness, for in one instance in which a release purchase order was required, internal controls within TxBASE were bypassed and a payment was made directly in PeopleSoft to disburse the funds within the FTA required timeline.*

Oracle WAM in combination with Peoplesoft requires the matching of an approved PO, a vendor's invoice and a receiving report including line by line verifications in order for an item to be selected for payment. The system includes controls over incorrect sales tax charges and was used to verify transit taxes that were incorrectly included in utility invoices. TxBASE was designed to allow payments for instances in which a PO voucher needs to be voided and reissued, or for payments where no PO is required. However, that was not the case in the instance cited here where a project manager had written an incorrect PO number on the authorizing document, the invoice was approved and the ECHO draw made based on that number, after which a payment had to be made quickly to comply with federal requirements.

2. *The Council has not taken full advantage of discounts provided by vendors.*

An estimated \$53,000 in additional discounts provided by vendors was not taken in 2009 due to delays in processing invoices. The delays can occur for a number of reasons; however, the largest discount not taken was the result of the requestor writing an incorrect PO number on the authorizing documentation.

3. *The Council pays invoices received from Environmental Services construction contractors before contractually required to do so resulting in lost interest estimated at about \$89,000.*

Environmental Services establishes a pay schedule annually and publishes it for all contractors stating when monthly pay requests are due and when payments will be made. As a result, ES has paid its Contractors an average of 12.9 days early resulting in possible lost interest of over \$89,000 in 2009.

4. *The Council has had difficulty obtaining timely payment from MnDOT for the purchase of Northstar vehicles, including accumulated interest of over \$219,000 that remains unpaid.*

The Council is a sub-recipient to MnDOT for the purchase of Northstar commuter train vehicles. In this posture, the Council pays the invoices presented to it by its vendors and contractors, accumulates the invoices, including interest, and submits a monthly pay

request to MnDOT. MnDOT is slow in paying the invoices and reluctant to pay the interest for late payment. As a result, the Council is owed over \$219,000 for interest charges not paid for 2009.

5. *The Council does not adequately measure the rate at which invoices are paid and therefore cannot monitor its compliance with Minnesota statutory requirements.*

The Council system for measuring timely payment of invoices does not allow for the exclusion of legitimate late payments such as those that are held due to disputes, audits, legal holds or for other appropriate reasons. Therefore, the Council cannot determine the true timely payment rate or monitor whether or not it is in compliance with Minnesota statutory requirements.

6. *The Council's internal controls regarding current employee access to sensitive Peoplesoft A/P systems and past employee access to Peoplesoft information need strengthening.*

Five percent of the people listed with access privileges to Peoplesoft A/P systems no longer work for the Council. In addition, six of 12 employees with "create" payment privileges reside in the IS Department. Considering that two of the six RA Finance Department employees are system support personnel, six may be an excessive number of IS employees to have "create" payment access.

RECOMMENDATIONS

Program Evaluation and Audit recommendations are categorized according to the level of risk of the finding (conditions) they are designed to resolve. The categories are:

- **Essential** – Steps must be taken to avoid the emergence of critical risks to the Council or to add great value to the Council and its programs. Essential recommendations are tracked through the Audit Database and status is reported twice annually to the Council’s Audit Committee.
- **Significant** – Adds value to programs or initiatives of the Council, but is not necessary to avoid major control risks or other critical risk exposures. Significant recommendations are also tracked with status reports to the Council’s Audit Committee.
- **Considerations** – Recommendation would be beneficial, but may be subject to being set aside in favor of higher priority activities for the Council, or may require collaboration with another program area or division. Considerations are not tracked or reported. Their implementation is solely at the hands of management.
- **Verbal Recommendation** – An issue was found that bears mentioning, but is not sufficient to constitute a control risk or other repercussions to warrant inclusion in the written report. Verbal recommendations are documented in the file, but are not tracked or reported regularly.

1. **(Significant) Metro Transit should review the documentation required in order to make an ECHO draw and then make a payment to ensure that all appropriate information is in place and accurate before federal money is drawn or funds are disbursed.**

The initial error here occurred when a project manager did not realize that the PO number he wrote on the invoice for payment was one that had already been used and therefore was not valid. However, the invoice (as approved by the project manager) went through to A/P and the ECHO draw was completed before the error was spotted. At that point, the federal money was on a deadline for prompt disbursement and there were few options left but to make a direct payment through the PeopleSoft financial system. If the invoice had been reviewed more carefully and checked in TxBase, the duplicate PO number would have been noticed and likely remedied before it went any further.

***Management Response:** At the request of Metro Transit Accounts Payable staff, invoice payment processing was modified during the last half of 2009. Invoices that require an ECHO draw are given directly to Accounts Payable staff to be entered into PeopleSoft. Once payment has been set up successfully, the invoices are then given to the Grants Analyst for creation of an ECHO draw so that invoice and purchase order issues are identified before an ECHO draw is made. Metro Transit Finance and Grants personnel will conduct a training session for Metro Transit Capital Project Managers to teach them how to manage the financial aspects of their projects.*

Staff Responsible: Nancy Schantzen

Timetable: June 2011

2. (Significant) Council A/P procedures should emphasize the importance of timely processing of invoices offering vendor discounts.

Vendors provide substantial discounts for early payment of invoices. For example, terms of 1%/10 for paying an invoice 20 days early is equal to an annual interest rate of about 18%. It is in the best interests of the Council to take vendor discounts whenever possible.

The system currently in place for identifying and processing vendor discounts has not adequately worked to assure that all discounts are taken. An error in the PO number used by the requestor resulted in delays in processing an invoice that contained the largest discount identified in Audit's sample with the result that the discount could no longer be taken.

Management Response: The benefit of taking early discounts has been reviewed with Accounts Payable staff and additional emphasis incorporated into the Accounts Payable Operations Manual.

Staff responsible: Chris Houser, Accounts Payable Supervisor (RA/ES); Nancy Schantzen, Accounting Manager (MT)

Timetable: Completed

3. (Significant) The Council should take full advantage of contract payment terms when processing Environmental Services construction contractor monthly payment requests.

The Council negotiates contracts with many of its vendors and contractors. A negotiated contract results in a fair and reasonable instrument for conducting business between the parties. When the Council has negotiated a contract, that contract takes precedence over non-contractual practices or schedules. The Council has negotiated contracts with its ES construction contractors. Those contracts contain payment terms regarding when the Council is required to pay invoices presented to it. However, the Council is paying its ES monthly payment requests prior to the contractually stated payment time. As a result, the Council did not receive an estimated \$89,000 in interest income in 2009.

Management Response: Accounts Payable staff will review contract payment procedures with Environmental Services and Council Procurement to determine whether changes are necessary to assure contract language, published payment schedules and state statutes are consistent.

Staff responsible: Chris Houser, Accounts Payable Supervisor

Timetable: December 31, 2010

4. (Consideration) The Finance Department should consider developing a method to more accurately calculate the Council's prompt payment ratio per Minnesota Statutes 171.425.

Minnesota statute 471.425 requires that all local units of government pay vendor obligations within 35 days of receipt of invoice. The council currently calculates a prompt payment rate. However, the calculations do not allow for legitimate delays that should be exempt from the 35 day deadline, so the ratio is artificially low and not an accurate reflection of the Council's payment practices. Given that this is a performance measure established in statute, Audit advises that it would be worthwhile to consider options for getting a more accurate calculation.

Management Response: Staff will review current financial system functionality and potential modifications necessary to systematically calculate the Council's prompt payment percentage. Potential system modification will be evaluated for cost/benefit of such changes versus a manual sampling to determine just cause for payments outside the 35 day window.

Staff responsible: Mary Bogie

Timetable: 1st Quarter 2011

5. (Essential) The Council should strengthen the internal controls regarding deleting an employee having access privileges to Peoplesoft and other Council systems when that employee is no longer employed by the Council.

Employees leave the Council for many reasons including, retirement, moving, family issues, other opportunities, not meeting work standards and for misconduct. Most employees that leave do so under favorable conditions, with no thought of trying to access Council systems after leaving employment. However, a small number that leave under unfavorable conditions may think otherwise. Therefore, it is an important internal control that the access privileges employees enjoyed while being employed, be immediately rescinded upon termination of employment.

Management Response: Notice of security access changes are received from Human Resources when an employee status changes. Additionally, annual certifications of employee access rights will be used to catch access rights for employees who may have been missed in notification. PeopleSoft (Oracle) recommends users not be deleted from the system, but rather the access rights rescinded for the user (user is locked out).

Staff responsible: Judi Beyer, Business Systems Analyst IV, Financial System Support, Mary Bogie, Deputy Chief Financial Officer

Timetable: Complete

6. (Essential) The Council should review its internal controls regarding IS access to sensitive A/P operations such as “create payments” and other sensitive Council systems.

Information Systems Department personnel provide a valuable service in developing and supporting the systems used by the Council to conduct its business. These employees have detailed knowledge of how systems work and interact with one another.

Accordingly, they hold very sensitive positions within the Council and internal controls must be strong in order to be assured that Council assets are properly protected.

Currently, six IS employees have “create payments” access within the Peoplesoft A/P system. This is in addition to two systems support personnel assigned directly to the RA Finance Department. Eight such system support personnel with such sensitive access appear to be excessive.

Management Response: *IS security access roles have been reviewed and updated as necessary to support the Financial System.*

Staff responsible: *Judi Beyer, Business Systems Analyst IV, Financial System Support, Mary Bogie, Deputy Chief Financial Officer.*

Timetable: *Complete*

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Exhibit I: Universe and Sample Stratification Data – By Amount

<u>A/P Transaction Amount</u>	<u>Size of Universe</u>	<u>Size of Sample</u>	<u>Value of Universe</u>	<u>Value of Sample</u>
\$0 to \$100,000	63,683	188	\$144,990,774	\$ 245,182
\$100,001 to \$500,000	548	161	121,578,514	35,718,237
\$500,001 to \$1,000,000	181	91	117,390,405	59,137,335
\$1,000,001 and above	91	61	182,172,327	123,102,992
Total	64,503	501	\$566,132,020	\$218,203,746

Audit reviewed a stratified random sample of 501 A/P transactions totaling \$218 million from a universe of 64,503 A/P transactions totaling \$566 million processed during the period January 1, 2009 through December 21, 2009. Strata sample sizes were determined using a 95% confidence level with a 2% error rate.

Strata 2, 3 and 4 were further stratified by the type of transaction (benefits, construction contracts, consultant contracts, energy, buses, train vehicles, contracted transit providers, regional park grants and other). In doing so, stratum 2 was increased from 140 to 161 items in order to provide a meaningful sample when the transaction type was very small. For example, the strata 2 universe included only six Northstar train vehicle invoices. Therefore, all were included in the sample.