



**Program Evaluation and Audit**

***Purchasing Card Review***

5 May 2010

# INTRODUCTION

## Background

The Metropolitan Council currently contracts for Purchasing Card (PCard) services with Bank of America. Bank of America's PCard computer system (Works) provides data mining on all purchases, which allows review of purchases for split transactions, inappropriate vendors, purchases over transaction limits, and unusual purchases.

Through the system, the Metropolitan Council can block certain types of vendors and flag other types of vendors that are not normally used for work related purchases. Attempts to make purchases over a card's spending limit, and attempts to split single transactions into two or more in order to circumvent a card's limit are also flagged by the computer system and either blocked or reported to the PCard administrator and back up administrator. The bank computer will also automatically decline the purchase. Any attempts to make purchases at vendors who have been flagged as "unusual" result in an automatic alert to the PCard administrator and back up administrator. Identification of possible split transactions is also provided by a report run monthly by the PCard administrator.

Before fully implementing the PCard program, a small number of PCard users were recruited to take part in a pilot program in 2006. Following the pilot program, Program Evaluation and Audit (Audit) evaluated the pilot, including internal controls, procedures, and oversight. Audit made a recommendation to expand the PCard program in a controlled fashion. Today, the program contains nearly 200 PCard users and over 70 approving managers.

To receive a PCard, a Metropolitan Council employee fills out an application form that is then sent to the employee's direct supervisor who reviews and approves the application and assigns a transaction limit. Next, the application is submitted to a division's General Manager for review and approval. Using the fully approved application, the PCard Administrator then submits an online card application through the bank system.

All cardholders and approving managers are required to attend a training session and to sign an agreement of individual responsibilities before being issued a card. To use the PCard, cardholders act as they would with a credit card. PCards are accepted at all vendors who take Visa. PCard users are required to keep a receipt or packing slip to document their purchase. After a purchase is posted, the computer system automatically sends the cardholder an email notice to electronically review the transaction. If the amount the bank reported matches the receipt, the card user is to approve the purchase through the PCard computer system. Depending on a manager's expectations and the cardholder's needs, the cardholder can add reference notes as to the nature of the purchase and update the tax status for possible payments to the State. After a purchase is approved, an email is automatically sent to that user's approving manager who either approves or declines the transaction. If a manager has any inquiries as to the legitimacy of the purchase, the manager is to question the cardholder.

At the end of the month, each PCard user prints out a list of all transactions from the computer system and compares it to the receipts. If there are no discrepancies, the cardholder signs the printout and sends it, along with the receipts, to the approving manager for the manager's final review and approval. If the manager approves all transactions, the manager will then sign the printout and forward the paperwork to the PCard administrator. Currently, the PCard administrator also reviews all receipts and printouts prior to payment to the Bank of America.

## **Purpose**

Program Evaluation and Audit reviewed the PCard program, including the program's effectiveness, internal controls, user satisfaction, and capability for expansion. Audit also researched the means in which the Council attains the financial rewards offered through the contract with Bank of America.

## **Scope**

The audit reviewed the effectiveness of the PCard program and determined whether the internal controls in place are sufficient in regards to the Council's purchasing and procurement policies and procedures. Individual PCard transactions and reconciliation forms were reviewed for three payment cycles in 2009.

## **Methodology**

### *Data Collection*

Interviews were conducted with:

- PCard Administrators and their direct managers, staff involved in managing PCard controls, and purchasing managers

Surveys were administered to:

- PCard users
- Cardholder managers

The following information was reviewed:

- PCard User Manual
- Training materials for managers and cardholders
- Documentation associated with the PCard, including: invoices, packing lists, shipping documents, receipts, monthly statements, and reconciliation forms
- PCard procedures and policies
- Council's contract with Bank of America

## *Analysis*

The following program elements were evaluated for the presence of adequate controls:

- General PCard transactions for three billing cycles within 2009. Within these files, the following components were evaluated:
  - Proper documentation for monthly reconciliation
  - Proper enforcement of tax payments
  - Safety of the current PCard filing and recordkeeping procedures
  - Timeliness of the monthly invoice submittal process
- Implemented security measures including:
  - Disputing process for billing errors
  - Managerial and administrative oversight of the PCard program
  - Internal controls regarding card access and removal of access
- The Works Payment Manager Database
  - Ease of use and clarity
  - Internal controls of the software

## **Assurances**

This evaluation was conducted in conformance with *Government Auditing Standards* and the *International Standards for the Professional Practice of Internal Auditing* of the Institute of Internal Auditors.

# OBSERVATIONS

1. *Overall, cardholders and managers are satisfied with the PCard program and support its expansion.*

In the survey administered by Audit, over 80% of respondents are satisfied with the initial training offered by the PCard Administrator as well as the ease of use of the Works software. Nearly, 75% of PCard managers strongly supported the further expansion of the PCard program and provided generally supportive statements in the comments section. Both managers and cardholders have suggested that the program has made purchasing generally more efficient and easier compared to purchase orders.

2. *In late 2009, the PCard program reached the necessary volume of spending to begin receiving rebates from the Bank of America.*

One of the benefits of the PCard contract is that Bank of America provides rebates once a certain spending level is met. For the first three years, the program has been unable to meet this goal. However with the increasing number of users and the implementation of a main Contracts and Procurement Unit (CPU) card, the goal has been attained and the Council has received its first rebate from the Bank of America, thus increasing the payback from the PCard program. The rebate of \$20,730.81 for the activity in March 2009 thru February 2010 amounted to 101 basis points (1.01%). After discussions with Bank of America in late 2009 Council staff were able to establish a higher rebate than the original contract provided (40 basis points) by converting to a consortium option. This option did not exist in the initial implementation process.

3. *A significant proportion of managers and cardholders are not exercising the necessary oversight for the PCards under their control.*

The PCard program was designed with an emphasis on the oversight roles of the cardholder and manager in an effort to curtail the inherent risk that any point of service payment system presents to an organization. Audit's review of Works reports and a random sample of cardholder files revealed several issues: failure to update "use" tax status, late sign-offs/submissions, and approval of purchases that are deemed ineligible. These issues reveal internal control weaknesses that illustrate the ineffectiveness of individual managers' oversight.

After a card user makes a purchase and approves that purchase, an email is automatically sent by the PCard computer system to the approving manager instructing the manager to either approve or decline the transaction. The approving manager is to make sure the purchase is legitimate and question the card user if they have any doubts. Approving managers are also required to review all purchase receipts and invoices at the end of the billing cycle to guarantee that only legitimate items were purchased. Because the PCard computer system does not display an itemized list of purchased goods when managers

approve transactions, it is important for managers to review itemized receipts and invoices to be certain that the cardholder purchased only authorized items during the course of an otherwise valid transaction.

If the manager approves the purchase before receiving the receipts and other documentation, a significant internal control weakness is created because the cardholder could be purchasing prohibited items along with approved items. As the key internal control, it is vital that approvers follow all PCard procedures for reviewing transactions. Although the PCard administrator currently reviews all packets and transactions, the managers usually know best what kinds of transactions are appropriate for the cardholders reporting to them.

The following tables demonstrate the presence of unpaid Minnesota State excise taxes, late submittal of packets, and procurement of ineligible goods.

**Table 1. Unpaid State Excise Taxes**

Month	# Transactions where Use Tax was not paid at point of purchase	#/(%) Transactions where Use Tax status was not updated by Cardholder/Manager	Tax Owed	Total # Transactions	% Transactions Unpaid Use Tax (Prior to Administrator's updates)
Jun-Jul	72	43 (59%)	\$1,450	629	7%
Jul-Aug	100	35 (35%)	\$2,123	903	4%
Aug-Sep	106	48 (45%)	\$1,988	801	6%

**Table 2. Late Submissions**

Month	# Packets	# Late	% Total
Jun-Jul	113	7	6%
Jul-Aug	122	8	7%
Aug-Sep	125	11	9%

**Table 3. Ineligible Purchases**

Month	Total # Packets	# Packets Sampled	# Ineligible Purchases	\$ Amount	% of Total # of Transactions
Jun-Jul	113	32	2	\$105.24	0.3%
Jul-Aug	122	40	0	\$0	0.0%
Aug-Sep	125	36	1	\$230.10	0.1%

The PCard manual states that cardholders and managers must

- “obtain and reconcile all receipts, packing slips and other documentation to Bank of America’s Cardholder Statement and provide same to PCard Administrator for review and storage, in accordance with established due dates.”
- “identify any purchase for which sales tax was applicable but not charged and mark the transaction as ‘Subject to Use Tax’ in Works.”
- “ensure the PCard is used for legitimate business purposes only.”

Without proper oversight, the Council may unknowingly pay for an item unrelated to Council business. Failure to pay use tax may also result in the levying of fines from the State of Minnesota.

The history of the PCard program shows that the disciplinary actions highlighted in the PCard Manual are vague and rarely applied. The manual states “Failure to comply with program guidelines may result in temporary suspension of the card, permanent revocation of the card, notification of the situation to management, and/or further disciplinary measures up to and including termination.” Although one card was turned off by Treasury for non-compliance, no other discipline has been taken for any other policy violations. Without specifically stating when these disciplinary actions will be employed or when a progression of discipline will be utilized, the terms of application are unclear and the penalties are rarely, if ever, imposed. As a result, they provide no deterrence for violating PCard policies and procedures.

4. *The PCard Administrator is currently completing a 100% review of every cardholder’s monthly statement.*

The PCard program is designed to have cardholders and managers act as the primary levels of internal control, each performing adding a separate stage of control. The PCard Administrator is presently adding an internal control by way of the 100% review process. When the program was implemented, it was expected the Administrator’s reviews would eventually be of a sampling nature rather than 100% of cards every month.

Since some PCard managers and cardholders have not been as effective as was needed in their oversight duties, the PCard Administrator has been correcting their errors through the use of the 100% review process. With the implementation and clarification of managerial and cardholder accountability measures, these instances should decrease thereby decreasing the overall risk of the program.

One concern about 100% PCard account reviews is the amount of time spent by the PCard Administrator at the expense of her other duties. However, the PCard Administrator stated that the current process has steadily improved in terms of effectiveness and efficiency (less time spent on each packet) since her appointment to this position.

The Administrator now spends about three days per month reviewing packets and transactions. In a typical month, administration of the PCard program requires about 105 FTE hours (Administrator-102 and Assistant-3). This number excludes managers’ time and is generally grouped in the following key duties:

- A. 57% Customer service (phone and email support, problems, etc.)
  - B. 25% Packet and transaction review (24 hours or 3 days)
  - C. 10% Training and related
  - D. 8% Reporting and Accounting
- 100% Total

However, the PCard program is currently expanding at a rate that will render this process impractical with current staffing and resource levels, if not impossible, in the near future. Although the Administrator expressed concerns about the poor oversight that some current managers provide in the program, it is understood that changes need to be made within the area of Administrator review if successful program expansion is to occur.

- 5. Although managers expressed concern about how many PCard holders is too many to supervise, there is no correlation between the number of cardholders supervised and the level of errors made.*

Currently there is no limit in place to the number of PCards a manager can supervise. While nearly half of the reviewing managers only oversee one card, there are cases where a manager is the primary level of oversight for as many as twelve cards. Audit did not find that this impacts their ability to accurately provide the necessary oversight. However, in the manager survey, some managers voiced concerns about managing too many PCards and the amount of time dedication needed to provide effective oversight. Thirty-one percent of managers suggested that overseeing three cardholders would be ideal. Yet this review showed that managers overseeing a large number of PCards (as compared to those with fewer PCards) had a similar level of errors, thereby suggesting that managing a specific number of PCards does not lead to additional policy violations.

- 6. The Merchant Category Codes (MCCs) have improved and rarely block legitimate purchases.*

In the survey, very few cardholders voiced concerns about the unnecessary blocking of vendors or the inability to make purchases needed to ensure efficiency within their departments. This is likely due to significant progress being made in ensuring that valid MCCs are no longer blocked, so MCCs are no longer viewed as an issue.

- 7. A small number of PCard users expressed concerns regarding their single and monthly transaction limits.*

A small percentage of PCard users felt their spending limits, both daily and monthly, were too low. This is an issue that PCard users need to address with their approving managers. With the approving manager's consent, the PCard Administrator will increase the spending limit on the PCard as it is deemed necessary. Essentially cardholders must continue to voice these concerns to their approving managers if it is hampering their job efficiency in any way.



8. *There was one instance where a PCard cardholder allowed an employee other than the cardholder to utilize their PCard.*

The PCard cardholder survey administered during this audit presented this question to respondents: ‘Has another person used your PCard to complete a transaction?’ Out of a total of 125 respondents, six individuals responded with ‘yes.’ Upon further review, five of the six did not violate PCard procedure as they were referring to another individual receiving the purchased item. However, one individual stated, “If an employee is ordering a part over the phone from a company that we do not have an account with, they will use my PCard number over the phone to charge the item.”

The PCard manual states that a PCard cardholder may “not allow other individuals to use his/her Purchasing Card.” An individual may only use a PCard if they are the designated cardholder, which is defined as the following, “an employee of the Council who has been authorized to use the Purchasing Card to execute purchase transactions on behalf of the Council.” Allowing another individual to utilize a PCard without authorization circumvents the oversight process, which could lead to unauthorized use of Council funds. By cardholder and manager agreements, both the cardholder listed on the PCard and the approving manager are ultimately responsible for all activity that occurs on the cardholder’s PCard.

# CONCLUSIONS

1. *The PCard program provides an efficient, cost effective, and financially beneficial manner in which to make micropurchases.*

In general, the expansion of the PCard program has resulted in a reduction of paperwork for users as well as the amount of manual processing (e.g. paper logs, manual reconciliations, etc.), and expedited the purchasing process for users and suppliers alike. It can also enhance certain types of transaction security and reporting, and it has recently provided the Council with a rebate from the bank. Rebates from Bank of America are another incentive to continue expanding the program. However, wider usage can increase the potential for card fraud, both internal and external.

PCard users, as well as managers, have consistently reported satisfaction with the program. The PCard substantially reduces the amount of time it takes to make a micropurchase, according to cardholders. It immediately puts a pre-defined level of purchasing power in the hands of the cardholder. The program also expands the universe of vendors from whom the Metropolitan Council may make micropurchases. The increased choice of vendors allows (but does not guarantee) PCard users to find the best price and service for goods.

2. *Clarity of responsibilities and enforcement of procedures are needed to ensure that PCard transactions are effectively controlled.*

The PCard Works system and PCard Administrator have been very effective in monitoring cardholder activity, but the practices of cardholders and approving managers indicate the need for further training and enforcement of PCard procedures. Although Audit found no instances where fraud occurred, this review demonstrated that some PCard users have not followed basic procedures such as updating use-tax and submitting monthly reports on time. Although the PCard administrator does not believe that these procedural violations were committed maliciously, they indicate the need to improve the accountability of the cardholders and approving managers, as well as provide greater deterrents to reduce the rate of violations of PCard procedures.

# RECOMMENDATIONS

Program Evaluation and Audit recommendations are categorized according to the level of risk they pose for the Council. 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) PCard policies and procedures relating to cardholder and manager expectations and discipline should be reviewed, strengthened, and communicated for the sake of increasing compliance.**

Although current policies, procedures, and practices have resulted in no PCard-related financial losses to the Council after four years, what constitutes a violation needs to be clearly defined and presented in a clear and appropriate manner to all current PCard cardholders and managers. This should include an update to the PCard manual including a new section regarding manager liability.

Although PCards increase the ease and flexibility with which users may make purchases, there is an inherent risk that comes with a PCard program. Even though we found no fraudulent misuse of any of the PCards, it is important to emphasize that the program also reduces the amount of control that the Metropolitan Council has to oversee purchases. Therefore, it is a critical internal control for PCards that those employees who commit serious violations of PCard policies and procedure be disciplined. Once a definition is developed for a “serious violation”, it may be appropriate for the PCard Administrator to notify the senior leadership team if action is not already defined in existing Council policies or procedures. Discipline, as discussed in the manual, can include anything up to and including discharge for misuse of a PCard.

Ensuring that terms and conditions are uniformly enforced for PCard users and managers establishes a clear message that malfeasance will not be tolerated and an internal control environment that emphasizes accountability.

**Management Response:** *The PCard manual will be updated to include a new section regarding manager responsibility and liability that is in keeping with the spirit of this audit recommendation. Changes will be provided to managers in a separate communication so as to draw attention to the change. Policy and procedure language will be strengthened as needed so as to guide cardholders in their responsibilities. A guiding definition will be developed for a “serious violation” and, where needed, additional guidance will be provided to managers.*

**Staff:** Allen Hoppe and Vicki White

**Timeline:** By September 1, 2010

**2. (Significant) The role of PCard Administrator reviewing monthly statements should be reduced to examining only a sample of statements each month.**

Audit recommends that the reduction of 100% review level could be accomplished by implementing a systematic sampling of cardholders to be reviewed each payment cycle. A random sample of all active users for the cycle at a 95% confidence level with a 5% sampling error and true error rate will yield a representative sample of the entire population, which would provide a reasonable representation of the compliance of all of the PCards. For example, in the month of August when there were 178 active cards, a total of 52 individuals would need to be sampled to ensure an effective representation. Audit staff can train the PCard Administrator on how to implement this process.

If the stated sampling method is to be implemented, it is strongly recommended that oversampling be used for a better approximation of the risk across the entire PCard population. This would entail taking the original sample and placing additional cardholders within the pool. Audit recommends the following individuals be oversampled:

- 1) Purchasing Card cardholders with executive rights. These executive cards have the ability to purchase food, travel, and hotel, which are higher risk for misuse.
- 2) Individual cardholders or cardholders under managers who have shown an inability to comply with PCard policies and procedures. These individuals can be included at the Administrator’s discretion.
- 3) Cardholders in their first three months of service, or first three submissions, whichever comes last.

**Management Response:** *The PCard Administrator will receive guidance from the Audit Department in the implementation of a formal representative sampling method to replace the current complete review practices. Specific review procedures will be developed in line with this audit recommendation.*

**Staff:** *Allen Hoppe and Vicki White*

**Timeline:** *Complete training and implementation by September 1, 2010*

### **3. (Consideration) Continue with plans to expand the number of PCard users.**

With the popularity of the PCard program as high as it is and the advantages that the program offers to the end user, Audit recommends expanding the number of users within the PCard program. All things being equal, the greater the number of transactions going through the PCard program, the more the Council saves on costs versus the traditional processes of accounts payable.

While there is a 101 basis point benefit from rebates on transactions, a much larger return of 3,400 basis points (34%) comes from every transaction that is moved from Accounts Payable to the PCard. According to statistics provided by the National Institute of Governmental Purchasers (NIGP) and others, the estimated savings to be realized from a PCard transaction versus the traditional requisition/purchase order/check process is \$69 per transaction with \$203.47 as the average PCard transaction size.

This would suggest that administrative costs can be reduced by expanding the PCard program and it should result in an increasing amount of opportunities for further rebates from the Bank of America. While the rebate was never the ultimate goal of the program, receiving the rebate does not have a cost to the Council, as these transactions would still be occurring, only under a different manner of procurement.