

City Auditor's Office

Vendor Master File Audit

March 2020



City Auditor, Lori Brooks Jaquess, CPA, CIA, CGAP, CRMA
Assistant City Auditor, Susan Edwards, CIA, CFE
Staff Auditor, Matthew Cheadle, CFE





City Auditor's Office

March 6, 2020

Honorable Mayor and Members of the City Council:

The City Auditor's Office has completed the Vendor Master File Audit. The purpose of the audit was to evaluate the controls over the creation and maintenance of vendors in the Vendor Master File.

Management's response to our audit findings and recommendations, as well as target implementation dates and responsibility, is included following the report.

We would like to thank staff from the Finance Department for their full cooperation and assistance during the audit.

Lori Brooks Jaquess

Lori Brooks Jaquess, CPA, CIA, CGAP, CRMA
City Auditor

Attachment

cc: Trey Yelverton, City Manager
Jim Parajon, Deputy City Manager
Gilbert Perales, Deputy City Manager
Jennifer Wichmann, Assistant City Manager
Mike Finley, Chief Financial Officer

Vendor Master File Audit Table of Contents

	<u>Page</u>
Executive Summary	1
Audit Scope and Methodology	2
Background	3
Audit Results.....	4
Detailed Audit Findings.....	6
Audit Recommendation and Response Table	9
Appendix A	11

Executive Summary

The City Auditor's Office has completed an audit of the Vendor Master File. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. The audit objective was to evaluate controls over the creation and maintenance of vendors in the Vendor Master File.

The City Auditor's Office noted strengths in the Finance Department related to the following:

- Segregation of duties over the vendor management and accounts payable processes
- Periodic purges of the Vendor Master File
- Documented procedures for conducting purges of the Vendor Master File

We noted potential opportunities for improvement in the following areas:

- Establishing a review process for the creation of new vendors
- Limiting access to Lawson, the City's Financial and Human Resources System
- Documenting policies and procedures for management of the Vendor Master File
- Retaining documentation of completed purges

Details of audit findings, conclusions and recommendations are included in the following report.

Audit Scope and Methodology

The objective of the audit was to evaluate controls over the creation and maintenance of vendors in the Vendor Master File. The audit covered current practices related to the Vendor Master File and testing was conducted on the vendors included in the file as of June 2019.

To adequately address the audit objectives and to describe the scope of work on internal controls, the following methodology was used in completing the audit:

- Conducted interviews with pertinent employees
- Reviewed relevant policies
- Conducted analytical testing of the Vendor Master File
- Inspected relevant documentation

The audit was conducted in accordance with generally accepted government auditing standards. These standards require that we determine whether internal controls are significant to the audit objective. If internal controls are significant to the audit objective, the standards require that the auditor obtain an understanding of the controls. In understanding and evaluating internal controls the City Auditor's Office adheres to the Committee of Sponsoring Organizations of the Treadway Commission's *Internal Control – Integrated Framework* (COSO Framework) as included in *Standards for Internal Control in the Federal Government* (Green Book).

According to the COSO Framework, internal control is a process effected by an entity's oversight body, management, and other personnel that provides reasonable assurance that the objectives of an entity will be achieved. These objectives and related risks can be broadly classified into one or more of the following three categories: (1) Operations - effectiveness and efficiency of operations; (2) Reporting - reliability of reporting for internal and external use; and (3) Compliance - compliance with applicable laws and regulations.

In planning and performing the audit, we obtained an understanding of the Finance Department's internal controls and assessed the internal control risks significant to our audit objective. We determined the following *internal control components* were significant to our audit objective:

- monitoring
- control environment
- control activities
- information and communication

The deficiencies in internal control that are significant within the context of the audit objective and based upon the audit work performed are stated in the Detailed Audit Findings section starting on page six.

*For further information regarding internal control components and the related principles of internal control, please see **Appendix A**.*

Background

A Vendor Master File is a comprehensive file of information about the City of Arlington's suppliers, which is used for the issuance of purchase orders and for the payment of vendor invoices. The City of Arlington's Vendor Master File is jointly owned by the Accounts Payable and Purchasing Divisions of the Finance Department. Accounts Payable coordinates with City departments to assist with vendor set up and the maintenance of invoices processed through Catalyst, the City's third-party payment provider. The Purchasing Division assigns access rights for the Vendor Master File and manages vendor set up for contracts and P-card vendors.

In order for a vendor to be added to the Vendor Master File, the City requires the vendor name, remit address, terms for payment, and a copy of the vendor's W-9 form. The creation of the vendor in the file generally depends upon the method of procurement. The following outlines how vendors are added to the file:

1. For most purchases, a City of Arlington employee in the department making the purchase completes an online form to request that a vendor be created. Upon receipt of the form, a Catalyst employee creates the vendor and establishes the vendor in Lawson.
2. For formally awarded contracts, the Purchasing Division creates vendors in Lawson.
3. For P-card purchases with new vendors, the Purchasing Division will set the vendor up as a one-time vendor in Lawson. If the vendor is used a second time within the year, the Purchasing Division inactivates the one-time vendor and establishes the vendor as a supplier. Beginning in FY 2020, P-card vendors are no longer added to the Vendor Master File.

There are currently ten individuals who have access to create, edit and/or deactivate vendors in the Vendor Master File. Three individuals are Catalyst employees, four are Purchasing Division employees, and the remaining three employees are system administrators for Lawson in Human Resources and Finance.

The Financial Systems Administrator performs an annual financial data purge. This includes purging inactive vendors from the Vendor Master File. As of June 2019, there were 9,127 active vendor files and 16,699 inactive vendor files in the City's Vendor Master File. The Vendor Master File includes the following types or categories of vendors:

- Suppliers: External businesses or individuals that have provided goods and services to the City. To be set up as a vendor, the vendor must provide the business name, a remit address, a valid W-9 form, and select the payment terms
- Employees: Employees who receive a reimbursement for travel and job-related expenses are also categorized as vendors
- One-time vendors: Vendors that the city purchases goods or services from once in a year or a vendor that is paid with a city P-Card
- HR: Vendors that are paid by Human Resources. Typically, these are vendors that provide benefits to City employees or garnish employee wages
- Refund: External businesses or individuals that are due refunds from the city

Audit Results

Using analytical software, the City Auditor's Office tested the Vendor Master File to identify duplicate vendors, determine if any employees are also suppliers, and determine if any vendors had missing information. We also verified the existence of W-9 forms for the vendors and that the purge of the Vendor Master File was conducted properly.

Duplicate Vendors

Duplicate vendors can create confusion and result in errors when processing invoices and payments. Duplicate vendors can also be used as a method of creating "ghost" vendors in order to facilitate a fraud scheme. The Vendor Master File was tested to determine if there were any vendors that were set up multiple times.

Three tests were completed to identify duplicate vendors. These included a search for duplicate names, duplicate addresses, and duplicate bank accounts. Matches were identified in all three tests completed. After reviewing the matches, it was determined there were 15 instances of vendors with duplicate names and eight instances of vendors with duplicate addresses. There were four instances of vendors with the same bank account. For additional information, please see the Detailed Audit Findings section of this report.

Employees as Suppliers

If an employee is listed as a supplier, it could indicate an employee has been set up as a fictitious vendor, or the details of a genuine vendor have been modified to receive fraudulent payments. Analytical tests were conducted to determine if any suppliers were also employees.

Tests were conducted to match employee names, home phone numbers, addresses, and Tax ID Numbers to the information in the Vendor Master File. There were no matches that resulted from this testing.

Missing Information

A vendor file containing data fields with missing information can be a red flag or indicator that there are phantom or fraudulent vendors. A test was completed to determine if there was any missing information from the Vendor Master File. To be set up as a vendor, a vendor must submit a form that has at least the following information: (1) company name, (2) remit address, (3) payment terms, and (4) a valid W-9 form with a Tax Identification Number.

There were 152 instances in which a vendor was missing one of the four required pieces of information. Other key information, such as phone numbers and vendor representatives, was also missing for 6,345 vendors. A number of misspellings, as well as information entered into incorrect data fields, was also noted. Examples include phone numbers and states entered in the city data field and zip codes having only three or four digits. This is discussed further in the Detailed Audit Findings section of the report.

W-9 Verification

A sample of active vendors was selected to determine if the City or the third-party accounts payable provider had a valid W-9 form on file for the vendors. Of the vendors selected, the third-party provider was able to produce W-9s for all the vendors they set up. Of the vendors set up by City staff, the W-9s included in the files were provided. However, the City staff did not have W-9s for all vendors they set up, because the City retention policy allows W-9s to be purged three years after set-up. Also, some vendors in the sample were created via P-Card transactions, and the vendor would not provide the City staff with a W-9.

Purging of the Vendor Master File

Testing was conducted to determine if all files that should be purged, based on the criteria in the City purge policy, are being purged. Vendors with no activity for five years plus the current fiscal year should be purged annually after the year-end close has been completed. Several vendors, identified as not having any activity for greater than five fiscal years, had not been purged. It was determined that these files had “active comments” or were “orphan records.” The active comments prevent the files from being purged, and the orphan records show that the vendor has a balance even when there are no open invoices. See the Detailed Audit Findings section for further detail.

Detailed Audit Findings

Accuracy of Vendor Master File

Based on testing performed, the City Auditor's Office noted that the Vendor Master File had duplicate vendors, data entry errors, and missing information.

At least 27 vendors appeared to be duplicates that matched on either their name, their address, or their Tax Identification Number or a combination of the three. Additionally, it was noted that the Vendor Master File contained a number of misspelled words and information in incorrect fields. Also, there were 152 instances where some of the required information, such as remit address, taxpayer ID number, or payment terms was missing from the vendor files.

These mistakes are likely due to the lack of a review or approval process for the creation of new vendors in the Lawson system. These types of errors could lead to instances, such as fraudulent payments, duplicate payments to vendors, or vendors not being paid. The Standards for Internal Control in the Federal Government (The Green Book) establishes a framework for internal control that includes a monitoring component. One of the principles of the monitoring component is that "management should establish and operate monitoring activities to monitor the internal control system and evaluate results." As such, a good internal control system would require that someone, other than the individual creating new vendors, review and approve the entry to the Vendor Master File.

Recommendations:

- 1. The City Auditor's Office recommends the Finance Department institute a review process for all entries in the Vendor Master File before the entry is active.*
- 2. The City Auditor's Office recommends the Finance Department correct data entry errors in the Vendor Master File.*
- 3. The City Auditor's Office recommends the Finance Department review the duplicate entries in the Vendor Master File to determine which one should remain active.*

Vendor Information

Currently the City of Arlington does not require certain key information from vendors, such as:

- Physical address
- Contact name
- Telephone number or email address

Best business practices dictate that when a vendor provides a post office box, the organization should also require a physical address to ensure the business is legitimate. By not requiring a physical address with a post office box address, it increases the fraud risk for the City of Arlington. In addition, contact information for the vendor is imperative should any issues arise.

Recommendation:

- 4. The City Auditor's Office recommends the Finance department require a physical address and vendor contact information.***

Lawson Access

Currently there are three system administrators for the Lawson System, one in the Finance Department and two in the Human Resources Department. All three system administrators have complete access to the Lawson system, which controls the Human Resources and Financial system for the City. According to generally accepted IT controls, employee access to systems should be limited to only that data needed to complete assigned job duties. By not limiting individual access, it exposes the city to a higher risk for potential fraud.

Recommendation:

- 5. The City Auditor's Office recommends the Finance Department limit the individual system administrators' access in the Lawson System to either Human Resources or Finance data, but not both.***

Policies and Procedures

There are no written policies and procedures for the management of the Vendor Master File. Finance Department employees stated the current procedures were verbally passed down from previous employees. The Standards for Internal Control in the Federal Government (The Green Book) establishes a framework for internal control that includes a control activities component. One of the principles of the control activities component is that "management should implement control activities through policies." Without documented policies and procedures, continuity of operations can be impacted when there is employee turnover. When employees leave the organization there may not be anyone who can explain how processes are completed and why things are completed a certain way.

Recommendation:

- 6. The City Auditor's Office recommends the Finance Department develop written policies and procedures for the management of the Vendor Master File.***

Reconciliation of Purge Records

In the FY 2019 purge of the Vendor Master File, a number of vendors that should have been purged were not purged. These vendors had active comments and orphan records attached to their file that prevented the purge process from completing. This was due to the fact that a review and reconciliation of the annual purge is not conducted. The Standards for Internal Control in the Federal Government (The Green Book) establishes a framework for internal control that includes a control activities component. One of the internal control principles related to control activities is that "Management should design control activities to achieve objectives and respond to risks." This includes controls related to information processing. In order to assure the accuracy of computerized processes,

information processing controls such as control totals or reconciliations should be in place. Without a reconciliation process, unused vendors can remain active and potentially subject the City to increased fraud risk.

Recommendation:

- 7. The City Auditor's Office recommends the Finance Department conduct an annual review after the purge to ensure that all vendors that should have been purged were purged and investigate any anomalies.***

Retention of Purge Documentation

Documentation related to the annual purge of the Vendor Master File is not retained beyond the latest purge. The Finance Department provided a report documenting a purge was conducted for FY 2019 but did not retain any documentation for the prior years. Their internal policy requires an annual purge. The Standards for Internal Control in the Federal Government (The Green Book) establishes a framework for internal control that includes a control activities component. One of the attributes of the control activities component is that "Management clearly documents internal control and all transactions and other significant events in a manner that allows the documentation to be readily available for examination." Without sufficient documentation, compliance with policy cannot be verified.

Recommendation:

- 8. The City Auditor's Office recommends the Finance Department retain documentation of the annual purge for the current year, and at least the prior two fiscal years, to document consistent compliance with policy.***

AUDIT RECOMMENDATIONS AND MANAGEMENT RESPONSE

RECOMMENDATION	CONCUR/ DO NOT CONCUR	MANAGEMENT RESPONSE	RESPONSIBLE PARTY	DUE DATE
<i>1. The City Auditor's Office recommends the Finance Department institute a review process for all entries in the Vendor Master File before the entry is active.</i>	Concur	Finance understands the importance of this recommendation and will work to ensure these checks and balances are in place when a new ERP system is implemented.	Finance Department	September 2021
<i>2. The City Auditor's Office recommends the Finance Department correct data entry errors in the Vendor Master File.</i>	Concur	Finance staff will work on correcting as much data as it can in the Vendor Master File with the information it has. This will be done in conjunction with the data conversion process to the new ERP software.	Finance Department	September 2021
<i>3. The City Auditor's Office recommends the Finance Department review the duplicate entries in the Vendor Master File to determine which one should remain active.</i>	Concur	Finance will review the Vendor Master File and remove the duplicate entries. This will be done by reviewing the latest spend in Lawson with that vendor and making the other one inactive.	Finance Department	December 2020
<i>4. The City Auditor's Office recommends the Finance department require a physical address and vendor contact information.</i>	Concur	Going forward, Purchasing staff will require a physical address, contact name and phone number before completing set up of a new vendor.	Finance Department	April 2020
<i>5. The City Auditor's Office recommends the Finance Department limit the individual system administrators' access in the Lawson System to either Human Resources or Finance data, but not both.</i>	Concur	This will be reviewed once a new ERP software is implemented. Due to the current organizational structure in both departments and the importance of the position itself, it's imperative that each administrator has a backup in case someone is out.	Finance Department	September 2021

RECOMMENDATION	CONCUR/ DO NOT CONCUR	MANAGEMENT RESPONSE	RESPONSIBLE PARTY	DUE DATE
6. <i>The City Auditor's Office recommends the Finance Department develop written policies and procedures for the management of the Vendor Master File.</i>	Concur	Finance staff will work to create policies and procedures for the Vendor Master File. This will be done with the intent of moving to a new Enterprise Resource Planning (ERP) next year.	Finance Department	September 2021
7. <i>The City Auditor's Office recommends the Finance Department conduct an annual review after the purge to ensure that all vendors that should have been purged were purged and investigate any anomalies.</i>	Concur	Finance staff will review the Vendor Master File after the purge of vendors to ensure all are properly purged and review vendors that may have active comments or orphan records.	Finance Department	Annually
8. <i>The City Auditor's Office recommends the Finance Department retain documentation of the annual purge for the current year, and at least the prior two fiscal years, to document consistent compliance with policy.</i>	Concur	The Finance Department will keep all annual purge documentation for three years. This will also become part of the policies and procedures for the Vendor Master File.	Finance Department	Annually

Appendix A

The Five Components and 17 Principles of Internal Control

Control Environment

1. The oversight body and management should demonstrate a commitment to integrity and ethical values.
2. The oversight body should oversee the entity's internal control system.
3. Management should establish an organizational structure, assign responsibility and delegate authority to achieve the entity's objectives.
4. Management should demonstrate a commitment to recruit, develop and retain competent individuals.
5. Management should evaluate performance and hold individuals accountable for their internal control responsibilities.

Risk Assessment

6. Management should define objectives clearly to enable the identification of risks and define risk tolerances.
7. Management should identify, analyze, and respond to risks related to achieving the defined objectives.
8. Management should consider the potential for fraud when identifying, analyzing and responding to risks.
9. Management should identify, analyze and respond to significant changes that could impact the internal control system.

Control Activities

10. Management should design control activities to achieve objectives and respond to risks.
11. Management should design the entity's information system and related control activities to achieve objectives and respond to risks.
12. Management should implement control activities through policies.

Information & Communication

13. Management should use quality information to achieve the entity's objectives.
14. Management should internally communicate the necessary quality information to achieve the entity's objectives.
15. Management should externally communicate the necessary quality information to achieve the entity's objectives.

Monitoring

16. Management should establish and operate a monitoring mechanism that monitors both internal and external activities that impact the control system and evaluate the results.
17. Management should remediate identified internal control deficiencies on a timely basis.