TO: Chair and Members
Audit and Administration Committee
WARD(S) AFFECTED: CITY WIDE

COMMITTEE DATE: September 22, 2010

SUBJECT/REPORT NO:
Audit Report 2010-05 - Procurement Card Usage (AUD10022) (City Wide)

SUBMITTED BY:
Ann Pekaruk
Director, Audit Services
City Manager’s Office

PREPARED BY:
Ann Pekaruk 905-546-2424 x4469

SIGNATURE:

RECOMMENDATION

(a) That Report AUD10022 respecting Audit Report 2010-05, Procurement Card Usage, be received; and

(b) That the management action plans as detailed in Appendix “A” of Report AUD10022 be approved and the City Treasurer direct the appropriate staff to have the plans implemented.

(c) That the audit of procurement card usage be included in the annual Internal Audit work plan.

EXECUTIVE SUMMARY

The 2010 Internal Audit work plan approved by Council included the assessment of compliance with specific policies and procedures relating to procurement cards (p-cards) as well as ensuring the accuracy, completeness, authorization and proper recordkeeping in regard to their usage.
In 2009, over $3.2 million was spent by 526 active cardholders. Although no evidence of misappropriation or fraudulent activities was noted in the sample testing, several recommendations to strengthen the control system over policy and procedures non-compliance were made.

The results of the audit are presented in a formal audit report containing observations, recommendations and management responses. In addition, an Addendum is prepared which identifies issues, risks or inefficiencies (not necessarily control deficiencies which appear in the main report) to which management has been asked to respond. The Report and Addendum are attached as Appendix “A” of Report AUD10022.

**Alternatives for Consideration – Not Applicable**

<table>
<thead>
<tr>
<th>FINANCIAL / STAFFING / LEGAL IMPLICATIONS (for Recommendation(s) only)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Financial:</strong> None.</td>
</tr>
<tr>
<td><strong>Staffing:</strong> None.</td>
</tr>
<tr>
<td><strong>Legal:</strong> None.</td>
</tr>
</tbody>
</table>

**HISTORICAL BACKGROUND** (Chronology of events)

This area has not been reviewed since 2004 and, as per best practices, should have a cyclical review standard as it is a subject of high public interest and scrutiny. Procurement cards were approved by Council for review in the 2010 Internal Audit work plan.

The audit fieldwork was completed in July, 2010. The results of this audit are attached as Appendix “A” of Report AUD10022.

The Audit and Administration Committee receives and approves final audit and review reports as part of its responsibilities for the oversight of governance and control.

**POLICY IMPLICATIONS**

By-law No. 09-230, Purchasing Policy #15 – Policy for Procurement Cards, Section 4.15
RELEVANT CONSULTATION

The attached report includes management action plans which reflect the responses of management and staff responsible for the administration of the City’s p-cards – Financial Services, Purchasing and Finance & Administration of the Corporate Services Department. Human Resources, City Manager's Office, provided the action plan for property checklists for terminating employees (#1).

ANALYSIS / RATIONALE FOR RECOMMENDATION

In 2009, 526 cardholders used their procurement cards (p-cards) in over 18,500 transactions to acquire goods and services amounting to $3.2 million. Individual transaction limits generally range between $500 and $15,000 and monthly spending limits range from $500 to $20,000.

The p-card process is highly decentralized. The responsibilities of administering p-card usage and monitoring cardholder and oversight compliance with policies and procedures lie mainly with each individual City department with the help of one corporate Procurement Card Administrator.

The p-card allows purchases to be made more economically with savings and efficiencies realized when cheques are not generated and processed, fewer departments and staff are needed to initiate and process a purchase and goods and services can often be purchased more quickly.

There are certain inherent risks associated with a p-card program. Specifically, p-card purchases are completed before supervision and oversight activities may occur. Accordingly, the City must ensure that adequate detection controls are in place that will identify instances of inappropriate or questionable purchases. Access controls are also needed to prevent unauthorized individuals from obtaining and using account information to make improper purchases.

A sample of transactions was selected for detailed testing by departments, by individuals and by total dollars spent on both a random and judgmental basis.

A formal audit report containing observations, recommendations and management action plans was issued and is attached as Appendix “A” of Report AUD10022.

Vision: To be the best place in Canada to raise a child, promote innovation, engage citizens and provide diverse economic opportunities. Values: Honesty, Accountability, Innovation, Leadership, Respect, Excellence, Teamwork
Thirteen (13) recommendations were included in the Report and Addendum. The main areas for improvement are as follows:

- Developing a detailed corporate property checklist to be used with the Termination of Service checklist to trigger the collection of the p-card upon employee termination;
- Tracking and identifying cardholder delinquencies or infractions (i.e. non-submission of supporting p-card documentation by established deadlines; use of p-card for personal expenses or when a corporate contract is in effect; incorrect GST allocations) and taking appropriate action;
- Ensuring adequacy and completeness of supporting documentation;
- Increasing cardholder awareness regarding items covered under a contract or rebate program;
- Reviewing of the p-card activity by the General Managers to justify continued eligibility for a p-card; and
- Monitoring and quarterly clearing of p-card expenses from clearing accounts.

Management and staff have agreed to all of the recommendations. Specific action plans can be found in the attached audit report.

**ALTERNATIVES FOR CONSIDERATION**

(include Financial, Staffing, Legal and Policy Implications and pros and cons for each alternative)

Not applicable.

**CORPORATE STRATEGIC PLAN** (Linkage to Desired End Results)


**Financial Sustainability**

- Delivery of municipal services and management of capital assets/liabilities in a sustainable, innovative and cost effective manner.

**APPENDICES / SCHEDULES**

Appendix “A” to Report AUD10022.

ap:dt
### CITY OF HAMILTON
INTERNAL AUDIT REPORT 2010-05
PROCUREMENT CARD USAGE

<table>
<thead>
<tr>
<th>#</th>
<th>OBSERVATIONS OF EXISTING SYSTEM</th>
<th>RECOMMENDATION FOR STRENGTHENING SYSTEM</th>
<th>MANAGEMENT ACTION PLAN</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Card Cancellations</td>
<td>That Human Resources (HR) develop a detailed corporate property checklist to be completed in conjunction with the Termination of Service checklist which would include the procurement card to be retrieved and cancelled. The checklist would trigger the collection of the procurement card from the employee and require it to be sent to the PCA for cancellation at the time the checklist and other termination documents are sent to HR.</td>
<td>Agreed. The corporate property checklist will be part of the “Separation of Service Procedure” pursuant to the “Separation of Service Policy”, a corporate Human Resources policy. The revised “Separation of Service Procedure” will be completed by September 30, 2010.</td>
</tr>
</tbody>
</table>
### OBSERVATIONS OF EXISTING SYSTEM

<table>
<thead>
<tr>
<th>#</th>
<th>OBSERVATIONS OF EXISTING SYSTEM</th>
<th>RECOMMENDATION FOR STRENGTHENING SYSTEM</th>
<th>MANAGEMENT ACTION PLAN</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.</td>
<td>Delinquencies and Policy Infractions</td>
<td>That Accounts Payable formalize a policy assigning responsibility to track cardholder delinquencies and procurement card policy infractions to DCCs and outline what action will be taken by the DCC and General Manager (GM) when a set number of delinquencies or infractions have been reached. Such actions may include training, a formal reprimand or revocation of procurement card privileges.</td>
<td>Agreed. During the next Purchasing Policy review, the p-card policy will be changed to include consequences of not following the policy. Changes will be communicated to users. This review is expected to be undertaken in the first quarter of 2011.</td>
</tr>
<tr>
<td>a)</td>
<td>Cardholders are expected to remit approved procurement card statements and supporting documentation by established month end deadlines. Many cardholders are consistently delinquent in providing these items on time. Over 30% of the p-card statements sampled were delinquent with approximately 31% of these delinquent cardholders missing the monthly deadline four or more times in 2009. In a few cases, the cardholder's remote location or seasonal work load were acceptable reasons for being late. As clearing accounts are not reviewed on a regular basis, disputed charges and fraudulent activity may not be identified in a timely manner to seek out insurance claims, cardholder reimbursement or card provider reversal. In addition, expenses will not show against individual budget lines possibly resulting in overspending. For expenses not charged to a clearing account, there is a risk that the Departmental Card Co-ordinator (DCC) will not follow up on the outstanding information.</td>
<td>That Accounts Payable (AP) reinforce the policy regarding the prohibition of the use of procurement cards for personal expenses to all cardholders. Reimbursement after personal use should not be considered as a means to override this restriction.</td>
<td>Agreed. A communication will be sent by the AP section in the 4th quarter of 2010 to all cardholders and approvers reminding them of the policy.</td>
</tr>
</tbody>
</table>
|   | Two incidents in the sample were noted where cardholders used their procurement cards for personal purchases. Even though the cardholders reimbursed the City, use of a City’s procurement card for personal transactions is strictly prohibited. | That when GMs (or designates) and DCCs review and process procurement card transactions, they ensure that:  
- Adequate information is provided to allow for a complete understanding of the nature and purpose of the expenditure; and  
- Entertainment expense information required under the procurement card procedures is documented. | Agreed. Included in the communication above, an explanation of what supporting documentation and information is required and why it is important to both cardholders and approvers will be provided. |
<p>|   | Inadequate supporting documentation was noted for 75 of the 174 transactions tested in detail. In 49 instances, additional information was requested by Internal Audit in order to understand the nature or validity of the expenditure. In 17 instances, entertainment transactions did not note the purpose, nature and/or date of the event and/or attendees, contrary to the policy. In 5 instances, no receipts or supporting documentation were present. Without an adequate explanation of an expenditure’s purpose or the names of individuals attending an event, it is difficult to determine whether expenditures were incurred for business or personal purposes. There is a high degree of public interest in City entertainment and other procurement card expenditures and filed documents should contain adequate detail to stand on their own and support the expenses. | | |</p>
<table>
<thead>
<tr>
<th>#</th>
<th>OBSERVATIONS OF EXISTING SYSTEM</th>
<th>RECOMMENDATION FOR STRENGTHENING SYSTEM</th>
<th>MANAGEMENT ACTION PLAN</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.</td>
<td>Contracted Goods and Services</td>
<td>That Purchasing develop a means to increase awareness of items covered under a contract and ensure all cardholders and DCCs are informed.</td>
<td>Agreed. Purchasing currently provides awareness to staff through outreach programs including eNet broadcasts, in person meetings, rollout meetings with client departments, quarterly Purchasing Newsletters and a corporate contract listing on the Purchasing Resource page on the eNet (which includes a quick reference guide on how to procure from the contract).</td>
</tr>
<tr>
<td></td>
<td>Procurement cards are not to be used when a corporate contract is in effect for an item purchased, unless pre-authorized in writing by the Manager of Purchasing. Of the 174 transactions tested, 7 transactions were identified as products available under a corporate contract for which cardholders did not obtain approval to purchase elsewhere when using a procurement card. For example, office supplies were purchased amounting to approximately $16,000 on 11 procurement cards. However, the City has established a contract to order office supplies online at deeply discounted prices. By not following purchase agreements, the City is paying more for items as discounts are not realized.</td>
<td>That DCCs be charged with the responsibility of identifying procurement card purchases that include any items for which there are corporate contracts and for which there is no evidence of pre-approval. In situations where such purchases occur, the DCC should inform the cardholder and monitor any future infractions as per the terms under Recommendation 2(a).</td>
<td>Agreed. The DCC procedures will be reviewed with emphasis placed on identifying non-compliance and the actions that should be taken - to be performed by F&amp;A Managers by end of 2010.</td>
</tr>
<tr>
<td></td>
<td>Infrequently Used Cards</td>
<td></td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>------------------------</td>
<td>---</td>
<td></td>
</tr>
<tr>
<td>4.</td>
<td>Before granting procurement card privileges to employees, department management should evaluate the employee’s responsibilities to determine whether the availability of a procurement card is warranted. Employees’ eligibility to cards should be reviewed regularly based on their responsibilities and extent of use. The PCA sends usage reports to departments on a monthly basis to provide information to analyze cardholder activity. However, there are no requirements to analyze the reports provided nor to cancel infrequently used cards.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>There were 56 cardholders in the 2009 calendar year who did not incur any transactions. Of these cardholders, 54% (30) were still active as at April 27, 2010.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Another fifty (50) cardholders used their procurement cards less than three times in all of 2009, spending a total of only $26,597. On one occasion, the single transaction incurred by one cardholder was for personal use and no other transactions were incurred on behalf of the City. Approximately 76% of these cardholders were still active as at April 27, 2010.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>The administrative cost of issuing and monitoring under-utilized cards, as well as the increased risk of fraudulent and inappropriate charges, can be avoided if procurement cards are only issued to employees whose duties and usage warrant them.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>That GMs regularly review cardholders’ continued eligibility for procurement cards based on the level of use. The DCCs should ensure this review process occurs and appropriate actions are taken.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>That the PCA investigate a way to produce a report annually to note procurement cards which have not been used in the 12 month period.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Agreed. An annual report will be sent to GMs listing all cardholders who have not used their cards in the past year. They will be strongly urged to have these cards cancelled. Stringent rules cannot be built into the program with respect to cancelling all inactive cards as each business unit has unique situations.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Agreed. The report noted above and an explanation letter will be sent out in February 2011 for the 2010 year by the PCA.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>#</td>
<td>OBSERVATIONS OF EXISTING SYSTEM</td>
<td>RECOMMENDATION FOR STRENGTHENING SYSTEM</td>
<td>MANAGEMENT ACTION PLAN</td>
</tr>
<tr>
<td>----</td>
<td>---------------------------------</td>
<td>----------------------------------------</td>
<td>------------------------</td>
</tr>
<tr>
<td>5.</td>
<td>Procedures Discrepancies</td>
<td>That the procurement card procedure be reviewed and changes made to reflect actual practices, where appropriate. Any changes should be communicated to cardholders, DCCs and GMs.</td>
<td>Agreed. Accounts Payable will make appropriate changes to the procedure to reflect the current practices. This will be done by the end of 2010.</td>
</tr>
<tr>
<td></td>
<td>Discrepancies exist between the documented Procedure for Procurement Card Section 5 Procedure #PR-15, approved on May 26, 2004 and actual practices.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>It was noted on the Maintenance Form located on the S drive that account code changes do not require GM approval. However, procurement card procedures dictate that any changes must be approved by a GM.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Internal Audit noted on numerous occasions that DCC approval signatures were missing from Application and Maintenance Forms, which contradicts the procedures specifying that these documents must originate from the DCC level.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>In addition, although DCCs or cardholders may call or email the PCA when cards are lost or stolen, procedures specify that a Maintenance Form must be completed. This currently does not occur.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>A lack of consistency between written procedures and actual practices can lead to inefficiencies and errors in the procurement card process, as well as confusion for cardholders, DCCs and GMs.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
ADDENDUM

The following items were noted during the course of the audit. Although they do not present internal control deficiencies, they are indicated in this Addendum so management is aware of the issues, risks and inefficiencies and can address them appropriately.

Policy Infractions
1. Over a three-month period, one cardholder from one department incurred 21 transactions on the City's procurement card. Of those transactions, the following deficiencies were noted:
   - 11 instances where additional information was required to assess the nature or validity of the expenditure.
   - 9 instances where GST was recorded incorrectly.
   - 8 instances where the purpose of an entertainment expense or the attendees were not recorded.
   - 6 instances where an inappropriate account number was used.
   - 4 instances where no receipts were present to support credit card charges.
   - 2 instances where pre-approval in writing was not sought by the cardholder to purchase items for which a corporate contract existed.

There were no indications as to the action (or inaction) taken by the DCC or GM to correct this cardholder’s behavior. All statements had been approved by the cardholder’s supervisor. Although this cardholder’s total transactions represent a minimal percentage of total credit card purchases, the lack of adequate management oversight could draw a substantial amount of negative media or public scrutiny. Lack of oversight also creates an opportunity to use the cards inappropriately and may encourage other employees to not follow policies and procedures.

It is recommended:
That consistent cardholder policy non-compliance be addressed as noted in recommendation 2(a) of the main report.

Management Response:
See management response to 2(a) in the main report. The City employee referenced no longer has p-card privileges.

GST Allocation
2. In the detailed testing of 174 individual transactions, the following was identified:
   - In 11 cases, receipts were not present or there was not enough information on the receipt provided to assess whether GST was recorded accurately.
   - In 11 cases, enough information was present to calculate the correct amount of GST and errors were noted.
   - In 2 cases, GST was incorrectly allocated when clearing items from clearing accounts.

Also, GST errors were identified in 4 of 10 process walk-throughs performed. Many of the errors are a result of the reviewing and correcting, where necessary, of the statements in the procurement card system which automatically stipulates GST (sometimes erroneously). Similar issues will continue with the introduction of HST, if not addressed.

Canada Revenue Agency requires adequate documentation to support rebates paid. As well, documentation provided to GST audit consultants should be concise and complete in order to fully realize the benefits of their work.

It is recommended:
That DCCs ensure that invoices and receipts are analyzed thoroughly and corrections made to GST/HST allocations in the credit card system by the month end deadline.

Management Response:
See management response to #3 (second recommendation) in the main report.
Clearing Accounts
3. Clearing accounts used for procurement card expenditures are meant to segregate those transactions requiring additional information or follow up. The accounts should be cleared to expenses, at year end at a minimum, but ideally on a regular month-to-month basis. On the average, it took 2-3 months to clear the transactions examined, with approximately 20% of the items cleared within 5-12 months. Although the accumulated amounts are not significant, the fact that the month end processing procedure and management review did not resolve the uncleared amounts undermines this control.

It is recommended:
That Accounts Payable formalize a procedure assigning the responsibility of clearing the procurement card clearing accounts at least quarterly to the DCCs. The corresponding BAs should ensure this occurs with a documented sign-off.

Management Response:
See management response to #3 (second recommendation) in the main report.

Rebate Program
4. The City has been offered a supplier’s rebate program based on yearly purchases referenced to the City’s trade account number. It could not be determined whether the trade account number was referenced to realize the rebate on procurement card purchases totaling approximately $24,000 in 2009. Also, purchases approximating $308,000 from other vendors offering similar products were incurred using procurement cards. Additional rebates may be realized if:

- The City’s trade account number is referenced for each purchase; and
- Employees are encouraged to purchase items from this vendor rather than other stores not offering similar rebates.

It is recommended:
That Purchasing inform all appropriate cardholders and DCCs of the details of this rebate offer and encourage cardholders to purchase items from this supplier to fully realize the available rebate.

Management Response:
This vendor’s Rebate Program places the onus on employees to know the City account number and to present the number each time they make a purchase; otherwise, there is no rebate given. Staff who make infrequent purchases at this supplier may not remember the details of the program or may misplace the account number and thus the rebate is lost. Purchasing will contact the vendor in the fourth quarter of 2010 to see if the Rebate Program can be amended such that the onus doesn’t fall on the individual staff to remember the Rebate Program details. One alternative to be discussed would be a process whereby the City of Hamilton presents a listing of their p-card purchases with the supplier at year end to be included in the calculation of the annual rebate.