

OFFICE OF THE CITY CONTROLLER



**PUBLIC WORKS AND ENGINEERING DEPARTMENT
PURCHASING CARD ACTIVITY
FINANCIAL RELATED AUDIT**

Sylvia R. Garcia, City Controller

Judy Gray Johnson, Chief Deputy City Controller

Steve Schoonover, City Auditor



OFFICE OF THE CONTROLLER
CITY OF HOUSTON
TEXAS

SYLVIA R. GARCIA

May 17, 2002

The Honorable Lee P. Brown, Mayor
City of Houston, Texas

SUBJECT: Public Works and Engineering Department
Purchasing Card Activity – Financial Related Audit (Report No. 01-14)

Dear Mayor Brown:

The City Controller's Office Audit Division has completed a Financial Related Audit of the Public Works and Engineering Department Purchasing Card (P-Card) activity. The audit objective was to assist management with the assessment of the adequacy of internal controls related to P-Card activity within the Department. In addition, the audit evaluated compliance with City administrative procedures, executive orders, and departmental standard operating procedures.

The report, attached for your review, concluded that internal controls over the P-Card activities are adequate to provide Department management with reasonable assurance that activities are performed in accordance with applicable City administrative policies and procedures and executive orders, except for the findings presented in the body of the report. Draft copies of the matters contained in the report were provided to Department officials. The views of the responsible Department officials as to actions taken or being taken are appended to the report as Exhibit I.

We appreciate the cooperation extended to our auditors by Department personnel during the course of the audit.

Respectfully submitted,


Sylvia R. Garcia
City Controller

xc: City Council Members
Albert Haines, Chief Administrative Officer
Oliver Spellman, Jr., Chief of Staff, Mayor's Office
Jon Vanden Bosch, Director, Public Works and Engineering Department
Philip Scheps, Director, Finance and Administration Department

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EXECUTIVE SUMMARY

- There are no established criterion or minimum requirements to qualify for a Purchasing Card (P-Card). An Internal Cardholder Agreement Form (Exhibit 1 to Executive Order 1-42) is submitted by an “authorized approver” (typically the employee’s supervisor or someone in his/her reporting chain) to the P-Card Coordinator, who establishes the single purchase and total monthly purchase limits. However, the form does not include a field to justify the employee’s need for a P-Card.
- P-Card Approving Managers (supervisors who review and approve P-Card purchases and P-Card bank statement activity) do not receive training defining their roles and responsibilities related to monitoring P-Card activity, including reviewing and approving monthly bank statement reconciliations. Failure to train Approving Managers may result in inappropriate P-Card purchases in violation of Executive Order (E.O.) 1-42.
- Hazardous materials were purchased without obtaining the proper approvals outlined in Administrative Procedure (A.P.) 5-3 and A.P. 2-14, presenting potential hazards to City employees, pollution of the environment, and violation of Federal, State, and Local Government laws and ordinances.
- Audit testing revealed that contract purchases were not reported consistently to the P-Card Administrator as required in E. O. 1-42.
- Two of 20 (10%) single purchases from non-contract vendors exceeding \$750 were not supported with bid documentation. In addition, testing revealed bid splitting for two of 28 (7%) sets of transactions tested.
- The Department does not have a work order system in place that allows for the reconciliation of purchased parts and materials to work orders.
- Testing revealed nine monthly P-Card statements that were not signed by the cardholder, Approving Manager and/or P-Card Coordinator in the appropriate signature blocks.

SCOPE AND PURPOSE

We have completed a financial related audit of the Public Works and Engineering (PW&E) Department's Purchasing Card (P-Card) activity. The audit's objectives are to evaluate the Department's compliance with applicable City of Houston administrative policies and procedures, ordinances, executive orders and the Department's own standard operating procedures related to P-Cards. The audit evaluated the adequacy of internal controls related to the processing of P-Cards. The audit scope period was from January 2000 through December 2000.

The scope of our work did not constitute an evaluation of the overall internal control structure of the Department. Our examination was designed to evaluate and test compliance with procedures and the adequacy of internal controls related to P-Card financial related activities. This was a financial related audit executed in accordance with Generally Accepted Government Auditing Standards.

Department management is responsible for establishing and maintaining a system of internal controls to efficiently and effectively perform financial related activities, and to adequately safeguard assets as an integral part of the Department's overall internal control structure. The objectives of a system are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or theft, and that transactions are executed in accordance with management's authorization and are recorded properly.

Because of inherent limitations in any system of internal accounting controls, errors or irregularities may occur and not be detected timely. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions, or that the degree of compliance with procedures may deteriorate.

CONCLUSION

Based on the results of our audit, we conclude that internal controls over the P-Card activities at PW&E's various Divisions are adequate to provide management with reasonable assurance that P-Card activities are performed in accordance with applicable City of Houston administrative policies and procedures, ordinances, and executive orders, except for the findings presented in the body of the report.

Scott Haiflich
Auditor-in-Charge

Rudy Garcia
Audit Manager

Steve Schoonover
City Auditor

INTRODUCTION

The Deputy Assistant Director (DAD) of Contract Management in the Public Works and Engineering Department (PW&E) is responsible for overseeing the PW&E P-Card activity. Specifically, the DAD monitors the issuance of P-Cards to the employees; appoints the P-Card Coordinators; distributes the monthly Wells Fargo statements to the P-Cardholders for review; monitors the purchasing activities of the P-Cardholders; ensures that the Strategic Purchasing Department receives notification that the activity is reconciled and in compliance with Executive Order 1-42 (E.O. 1-42); and holds monthly meetings with P-Card Coordinators to address current P-Card related issues.

As of August 17, 2001, PW&E had 268 active P-Cards. P-Card purchases for the period January 2000 through December 2000 was approximately \$2.1 million. Since the P-Card program began, 94 cards have been cancelled. Of the 94 cards, five were cancelled due to non-compliance with City administrative procedures and executive orders, one was cancelled due to the cardholder making personal purchases, and no fraudulent use of cards was identified.

AUDIT FINDINGS AND RECOMMENDATIONS

PURCHASING CARDS

BACKGROUND

PW&E is the City's largest user of P-Cards. In May 2000, PW&E had 253 P-Cardholders. The majority of cardholders were assigned a \$1,000 single purchase limit, and all are assigned a \$5,000 monthly purchase limit. From October 1998 (the start of the P-Card pilot program) through May 2000, PW&E completed 12,670 P-Card transactions. Average monthly P-Card expenditures for the period July 1999 through May 2000, totaled approximately \$146,000. P-Card expenditures are recorded in the Advantage 2000 System (System) based on a merchant category code assigned to each vendor, and linked to a specific accounting object code.

E. O. 1-42, *Purchasing Card Policy and Procedures*, is the document which established "procedures for procuring goods and/or services using a Purchasing Card". Administrative Procedure (A.P.) 5-2 is the document which established "procedures for procuring goods and services that are consistent with E.O. 1-14, *Procurement and Payment Policies*, and procedures for changes in the procurement process that resulted from organizational and system changes".

E.O. 1-42, Section 5.2.3, requires Approving Managers (supervisors who approve monthly P-Card bank statements) to:

- Review and approve P-Card applications prior to submission to the Departmental Purchasing Card Coordinator (P-Card Coordinator).
- Review receipts and monthly bank statement reconciliations prior to submission to the P-Card Coordinator.
- Recommend suspension or cancellation of a card to the P-Card Coordinator when considered necessary.
- Notify the P-Card Coordinator when a cardholder is terminated so the card will be collected and purchasing privileges terminated.

E.O. 1-42, Section 7.0 allows P-Cards to be used to purchase any item and/or service for “immediate use” not prohibited by the executive order, another policy or procedure approved by the Mayor, or an ordinance of the City of Houston.

I. P-CARD JUSTIFICATION

FINDING

There are no established criterion or minimum requirements to qualify for a P-Card. An Internal Cardholder Agreement Form (Exhibit 1 to E.O. 1-42) is submitted by an “authorized approver” (typically the employee’s supervisor or someone in his/her reporting chain) to the P-Card Coordinator, who establishes the single purchase and total monthly purchase limits. However, the form does not include a field to justify the employee’s need for a P-Card.

RECOMMENDATION

We recommend that PW&E’s Deputy Assistant Director of Contract Management, along with the Finance and Administration Department’s P-Card Administrator, develop minimum requirements to qualify for a P-Card.

Perhaps a committee minimally made up of the P-Card Administrator and all the P-Card Coordinators from the departments participating in the pilot program should form to assist in the development of the P-Card administrative procedure currently being drafted. The committee should also consider P-Card findings presented in this report, as well as other concerns

raised by P-Card Coordinators, when developing the new administrative procedure.

II. P-CARD APPROVING MANAGER TRAINING

FINDING

P-Card Approving Managers (supervisors who review and approve P-Card purchases and P-Card bank statement activity) do not receive training defining their roles and responsibilities related to monitoring P-Card activity, including reviewing and approving monthly bank statement reconciliations. Some Approving Managers had not even attended the basic P-Card training. Failure to train Approving Managers may result in inappropriate P-Card purchases in violation of E. O. 1-42.

RECOMMENDATION

We recommend that PW&E management discuss with the P-Card Administrator the need for training Approving Managers to define their roles and responsibilities for monitoring P-Card activity.

III. HAZARDOUS MATERIALS

BACKGROUND

A.P. 5-2, Section C.1, states that the “Purchase of toxic, hazardous or restricted materials must be approved by the department’s emergency coordinator and the City’s HAZCOM Compliance Officer (HCO), the Administrator of Accident Prevention and Loss Control, or the Risk Manager unless materials are on approved contract pursuant to A.P. 2-14”. Listed among the hazardous materials are paint, fertilizer, and other similar products. The various PW&E Divisions are responsible for a variety of activities including, but not limited to, the maintenance of vehicles, operation of water and wastewater facilities, and ground maintenance at various City facilities.

FINDING

Hazardous materials were purchased without obtaining the proper approvals. Three of the 62 P-Card transactions tested were for items containing chemicals. These three transactions occurred without obtaining approval from the City’s HazCom Officer or an appropriate Division Safety Officer. Failure to comply with administrative procedures may result in potential hazards to City employees, pollution of the environment, and violation of Federal, State and Local Government laws and ordinances.

RECOMMENDATION

We recommend the Department comply with A.P. 5-3 and A.P 2-14, by obtaining the required approval for hazardous materials prior to purchase. A copy of the approval should be attached to the P-Cardholder's monthly statement. Additionally, we recommend this requirement be included in P-Card training.

IV. P-CARD CABLE SERVICE PURCHASES

BACKGROUND

The City's franchise agreement with Time Warner allows for one free cable connection and one free ongoing monthly service per City facility. The Finance and Administration Franchise Agreement Section is responsible for monitoring and initiating cable service connections throughout the city.

FINDING

Testing revealed two cardholders paying for monthly cable television service fees to Time Warner with P-Cards. The Finance and Administration Franchise Agreement Section was not aware of the cable connections. Additionally, a monthly recurring charge does not qualify as an immediate use purchase and should not be paid with a P-Card. The use of P-Cards to purchase monthly cable service does not allow for adequate control over monitoring compliance with the terms and conditions of the franchise agreement with Time Warner.

RECOMMENDATION

We recommend that PW&E management instruct cardholders to discontinue purchasing recurring monthly services, such as cable television service, with P-Cards.

V. REPORTING CONTRACT PURCHASES

BACKGROUND

E.O. 1-42, Section 12.0, *Using the Card* states, "The Cardholder determines if the item is a contract purchase and reports the purchase to the Purchasing Card Administrator", through the completion of an Exhibit 4 form, which is included as an attachment in E.O. 1-42.

FINDING

Contract purchases were not being consistently reported to the P-Card Administrator as required. Six of 23 (26%) employees

interviewed did not know that the Exhibit 4 forms were required, or that the forms were to be forwarded to the P-Card Administrator. This constitutes a serious internal control weakness in accountability over spending the funds approved by Council.

Completion of the Exhibit 4 form and submission to the F&A Strategic Purchasing Division is necessary to report contract purchases made by P-Cardholders. Failure to submit Exhibit 4 forms for purchases against particular contracts results in overstatement of the remaining balances on those contracts, and could result in total contract purchases in excess of approved amounts.

RECOMMENDATION

We recommend that PW&E's management reemphasize the purpose and importance of completing and forwarding Exhibit 4 Forms to the P-Card Administrator as required by E.O. 1-42.

VI. BID REQUIREMENTS

BACKGROUND

E.O. 1-40, an amendment to A.P. 5-2, requires that bids be solicited for purchases in excess of \$750 up to \$15,000. P-Cardholder purchases from non-contract vendors within the above dollar range are required to solicit bids and maintain records of those bids.

FINDING

Two of 20 (10%) single purchases exceeding \$750, from non-contract vendors, were not supported with bid documentation. Testing also revealed bid splitting for two of 28 (7%) sets of transactions tested for bid splitting. Specifically, we found recurring P-Card payments to a mowing and landscape maintenance company that exceeded \$750 and the projected annual cost totaled \$9,840. This service requires bid solicitations. In addition, two cell phones were purchased from the same vendor on the same day totaling \$1,202. Therefore, bids should have been solicited for the purchase of the cell phones. Failure to obtain bids when required is a violation of A.P. 5-2 and can result in procurement inefficiencies.

RECOMMENDATION

We recommend that management emphasize the bid requirements to P-Card users and inform them of the bid splitting violations and possible ramifications for non-compliance.

VII. P-CARD PURCHASES RECONCILIATION TO WORK ORDERS

BACKGROUND

Maintenance and construction activities typically include work order systems which enable management to prioritize, plan and monitor projects. One of the critical features of a well-controlled work order system is the ability to account for parts and materials used during a project.

FINDING

The Department does not have a system in place that allows for the reconciliation of parts and materials purchased to work orders. The audit team was not able to trace parts and materials purchased with P-Cards to specific work orders. The inability to reconcile parts and materials purchased to work orders is a significant control weakness. Typically, work order related items are parts and materials that can be easily sold to salvage yards and parts vendors. Failure to control work order related purchases invites the theft of items that can be easily sold.

RECOMMENDATION

We recommend that PW&E management consider taking steps to develop or purchase and implement a work order system, if cost effective, that adequately controls work order projects. P-Card approving managers can then trace parts and materials purchased with P-Cards to related work orders and establish accountability for such items.

VIII. CHAIN OF COMMAND REPORTING

BACKGROUND

E.O. 1-42, Page 1 of 6, Section 4.5, *Approving Authority*, states that the approving authority will be “the person responsible for the budget activity level that the Cardholder is assigned. The person will be a manager/supervisor in the reporting chain for the individual Cardholder.”

FINDING

The Utility Customer Services Division does not comply with E.O. 1-42. Specifically, the Approving Manager reviews monthly statements of P-Cardholders that are not in his chain of command.

Approving Managers who review monthly statements of cardholders who are not in their chain of command, may not be

aware of the purchasing needs of those cardholders, and therefore, may not be able to determine if the justification for the purchases are valid.

RECOMMENDATION

We recommend that Department Management comply with E.O. 1-42 and review P-Card users' reporting chains of command and ensure that monthly statements are reviewed by appropriate managers/supervisors.

IX. MONTHLY STATEMENT RECONCILIATION SIGNATURES

BACKGROUND

E.O. 1-42, Sections 14.0 *Monthly Bank Statements and Reports* and 15.0 *Reconciliation of Card Purchases*, require that monthly P-Card statements be reconciled, signed by the P-Card Coordinator, and reviewed by the Approving Manager. Monthly statements include signature blocks for the cardholder, Approving Manager and P-Card Coordinator.

FINDING

Monthly P-Card statements were not properly signed by the cardholder, Approving Manager and/or P-Card Coordinator. Specifically, we found five statements that were not signed at all, three statements that were not signed by Approving Managers, and one statement in which the P-Card Coordinator signed for herself and the Approving Manager. Signatures by cardholders, Approving Managers, and P-Card Coordinators are necessary to provide evidence that statements were reconciled and properly approved.

RECOMMENDATION

We recommend that management reemphasize the importance of the monthly statement reconciliation process and that statements be properly signed.

EXHIBIT 1



CITY OF HOUSTON

Public Works and Engineering
Department

Interoffice

Correspondence

To: Sylvia R. Garcia, City Controller
Office of the City Controller

From: Jon C. Vanden Bosch, Director
The Department of Public Works & Engineering

Date: March 29, 2002

Subject: **CONTROLLER'S AUDIT: FINANCIALLY
RELATED AUDIT OF P-CARD PROGRAM IN
DEPARTMENT OF PUBLIC WORKS AND
ENGINEERING**

We have completed our response to your financially related audit of the Department of Public Works and Engineering's P-Card Program. Listed below are the issues addressed in the report.

P-CARD JUSTIFICATION

Recommendation: PW&E's Deputy Assistant Director of Contract Management along with the Finance and Administration Department's P-Card Administrator, develop minimum requirements to qualify for a P-Card. Perhaps a committee minimally made up of the P-Card Administrator and all the P-Card Coordinators from the departments participating in the pilot program should form to assist in the development of the P-Card administrative procedures currently being drafted. The committee should also consider P-Card findings presented in this report, as well as other concerns raised by P-Card Coordinators, when developing the new administrative procedure.

Response: Disagree. Currently as part of our procedures, P-Cards are issued to operations based on expressed needs (immediate consumption, emergency situation, etc). The Approving Manager of the budget organization requesting a card represents the minimum level of approval within the organization. It is this person's responsibility to review and formally approve via signature before submitting the P-Card application to the department P-Card Administrator. Recommendations made in this report will be shared with the P-Card Committee reviewing administrative procedures.

P-CARD APPROVING MANAGER TRAINING

Recommendation: PW&E management discuss with the city-wide P-Card Administrator the need for training Approving Managers to define their roles and responsibilities for monitoring P-Card activity.

Response: Agree. Currently, the only formal training available to Coordinators and Approving Managers is that which is provided to P-Card holders. The need for a structured program was suggested to the City P-Card Administrator by the department and a well-structured program was developed. The first class will be held in April 2002.

**Views of Responsible
Officials**

EXHIBIT 1

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Controller's Audit: Financially Related Audit of P-Card Program

HAZARDOUS MATERIALS

Recommendation: Department comply with A.P. 5-2 and A.P. 2-14 by obtaining the required approval for hazardous materials prior to purchase. A copy of the approval should be attached to the P-Cardholders monthly statement. Additionally, this requirement should be included in the P-Card training.

Responses: Disagree with the first recommendation. The Strategic Purchasing Division of the Department of Finance and Administration advised that the referenced requirement for obtaining prior HazCom Officer approval for each chemical purchase does not apply to products covered by City contracts because they already have blanket approval regardless of the manner in which the product was purchased. Further, the department is in compliance. Additionally, for those chemicals not under a contract, a P-Card holder in PW&E must always pick up a Material Safety Data Sheet (MSDS) and attach it to the purchase receipt and monthly statement. This subject is already covered during P-Card Training.

Agree with the second recommendation. It is understood that A.P. 5-2 is currently being revised. Upon completion, the Department will incorporate the revised guidelines into the P-Card training curriculum.

P-CARD CABLE SERVICE PURCHASES

Recommendation: PW&E management instruct cardholders to discontinue purchasing recurring monthly services such as cable television service with P-Cards.

Response: Agree. While the City P-Card Administrator stated that payment of this charge is permissible under the provisions for Executive Order 1-42, the Deputy Director of the Resource Management Division of the Department of Public Works and Engineering, issued instructions that this practice was to cease immediately within the department and all parties were to begin using payment vouchers for these charges.

REPORTING CONTRACT PURCHASES

Recommendation: PW&E management reemphasize the purpose and importance of completing and forwarding Exhibit 4 Forms to the P-Card Administrator as required by E.O. 1-42.

Response: Agree. We will reemphasize the purpose and importance of completing and forwarding Exhibit 4 as required by E. O. 1-42 at our P-Card Meetings.

BID REQUIREMENTS

Recommendation: Management emphasize the bid requirement to P-Card users and inform them of the bid splitting violations and possible ramifications for non-compliance.

Response: Agree. The nature and consequences of bid splitting are emphasized as part of P-Card training. Dependent on whether the bid splitting is intentional, flagrant, or unintentional, cards may be revoked or suspended. In those cases where bid splitting has been determined within PW&E's P-Card program, cards have been permanently revoked.

*Views of Responsible
Officials*

EXHIBIT 1

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PW&E Financially Related Audit of P-Card Program

P-CARD PURCHASES RECONCILIATION TO WORK ORDERS

Recommendation: PW&E management take steps to develop or purchase and implement a work order system that adequately controls work order projects. P-Card approving managers can then trace parts and materials purchased with P-Cards to related work orders and establish accountability for such items.

Response: Agree. The department is in compliance with Executive Order 1-42.12 which states that "Cardholder will annotate on the receipt, the purpose of the purchase." However, we will also begin requiring users to list work orders, project numbers or any other identifiers that relate to the actual use of the purchased product on the receipt. In addition, we will explore linking work orders with P-Card usage to ensure accountability and traceability of materials.

CHAIN OF COMMAND REPORTING

Recommendation: Department Management comply with E.O. 1-42, review P-Card users' reporting chains of command, and ensure that monthly statements are reviewed by appropriate managers/supervisors.


Response: Agree. Utility Customer Service (UCS) will begin requiring each cardholder's immediate supervisor to sign an in-house form, which will be used to track future P-Card purchases.

MONTHLY STATEMENT RECONCILIATION SIGNATURES

Recommendation: Management reemphasize the importance of the monthly statement reconciliation process and that statements be properly signed.

Response: Agree. We will continue emphasizing the need for accuracy in the statement reconciliation process and that those statements be properly signed.

If you have any further questions, please contact Waynette Chan at (713) 837-0249 or Godwin Okoro at (713) 837-0347.



Jon C. Vanden Bosch

JCV:wc

cc: Waynette Chan, Senior Assistant Director
Godwin Okoro, Audit Manager

*Views of Responsible
Officials*