OFFICE OF THE CITY CONTROLLER

PARKS AND RECREATION DEPARTMENT

AUDIT OF DISBURSEMENTS LESS THAN $75,000

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Report No. 2010-14

February 8, 2010

The Honorable Annise D. Parker, Mayor
City of Houston, Texas

SUBJECT: Parks and Recreation Department – Audit of Disbursements Less than $75,000
Report No. 2010-14

Dear Mayor Parker:

The City Controller's Office Audit Division has completed an audit of disbursements less than $75,000 within the Parks and Recreation Department (PARD). The objectives of the audit were to determine whether goods and/or services:

- Resulting in payments of less than $75,000 had proper approvals of requisitions and purchase orders, with adequate segregation of duties;
- Were received and recorded timely;
- Were computed, recorded, and reported accurately and in compliance with applicable State and Federal laws, City of Houston (City) policies and procedures and the City's SAP financial system Blueprint and Flow Diagrams related to the purchasing process.

The audit team identified differences between practices in place within the SAP system and written procedures that support them and/or absences of administrative guidance to support and guide the system's configuration. Because the system was adopted city-wide, and because this was not an Information Technology or Information Systems audit, a modification to the original objectives of the audit was made. This resulted in an expanded scope period which changed from an ending date of June 30, 2008 to August 31, 2008 and a limited scope for procedures performed related specifically to PARD, which contributed to the lengthened timeline to issue the report.

The report, attached for your review, includes 3 findings and recommendations that are specific to PARD, 9 findings and recommendations related to the component inputs (relevant City Departments, Business Process Owners, and the ERP team of ITD) integral to the purchasing process, and corrective actions reported on all recommendations. Where applicable, an assessment of the management response reflecting residual issues or broader implications was also provided.

The team concluded that:

- PARD has an approval process for requisitions and purchase orders for under $75,000 that provides a reasonable assurance for propriety and safeguard. However, since SAP implementation, there remains some critical segregation of duties issues identified in an independent 2006 study that are unresolved, but are partially mitigated using alternative procedures of Departmental management review of system reports.
- PARD has a process in place attempting to assure receipt of goods/services prior to payment for invoices less than $75,000. This process lacks some key controls to ensure accurate information is entered timely. This appears to be correlated to the elimination of centralized receiving in the summer of 2006, and the implementation of SAP and is also amplified by the lack of written internal policies related to the procurement process specific to PARD.
- PARD has a process that provides reasonable assurance of accuracy of calculated amounts for invoices less than $75,000. Date information for receiving of goods/services and invoices however, are not entered into SAP consistently, reliably, nor as currently documented in the SAP blueprint.

Because the City implemented SAP for financial and operational transaction detail and reporting purposes, the most effective remedies related to the conclusions rendered in the report expand beyond PARD. Most notably, procurement related dates entered into SAP are not consistent or reliable, and source documentation is not being scanned or stored for efficient monitoring and effective internal control. The impact of resolving date sensitive application issues that correspond to efficient timing of invoice payments results in a **conservatively estimated annualized cost savings of $3.6 million to the City.**

ITD has proposed a method to facilitate a cooperative effort by developing a Governance Committee as empowered by an Administrative Procedure to be developed by the ERP team. This would include representation from City Department Management, Business Process Owners, the Controller's Office, and the ERP team of ITD.

We commend PARD, Administration and Regulatory Affairs Department and ERP management for their timely efforts and/or proposals of action to remedy the issues identified. We also appreciate the cooperation extended to our auditors by these department's personnel during the course of the audit.

Respectfully submitted,

Ronald C. Green, City Controller

xc: City Council Members
       Anthony Hall, Chief Administrative Officer
       Waynette Chan, Chief of Staff, Mayor's Office
       Joe Turner, Director, Parks and Recreation Department
       Richard Lewis, Director, Information Technology Department
       Alfred Moran, Jr., Director, Administration and Regulatory Affairs Department
       Michelle Mitchell, Director, Finance Department

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EXECUTIVE SUMMARY

SCOPE AND OBJECTIVES

The Office of the City Controller (Controller's Office) has completed an audit of disbursements (payments) under $75,000 within the Parks and Recreation Department (PARD).

Our audit objectives were to determine whether:

- Goods and/or services resulting in payments of less than $75,000 had proper approvals of requisitions and purchase orders, with adequate segregation of duties;
- Goods and/or services resulting in payments of less than $75,000 were received and recorded timely; and
- Payments for goods and/or services less than $75,000 were computed, recorded, and reported accurately and in compliance with applicable State and Federal laws, City of Houston (the City) Policies and Procedures and the City's SAP financial system Blueprint and Flow Diagrams related to the purchasing process.

The original scope was to involve all departments (city-wide) for the period July 1, 2006 through June, 30 2008.

BACKGROUND AND METHODOLOGY

The City acquired a financial and operational software package entitled SAP, which was implemented as the Municipality's Enterprise Resource Planning System in July 2006. This resulted in new approval and recording methods for the City's purchasing processes. Prior to using the SAP system, approval for invoice payment was not stratified based upon amount. Since the implementation of SAP, purchases made pursuant to a contract (Outline Agreement) or purchasing document (PO) whose amount is less than or equal to $75,000 are to be approved for payment at the department level, which makes up the majority of the City's purchasing activity. The Controller's Office continues to approve, release, and pay all invoices over $75,000 and those (regardless of amount) that are:

- Not purchased pursuant to a Purchasing Document (e.g. Miscellaneous invoices);
- Invoices related to capital projects, including retainage (Project invoices); and
- Invoices resulting from legal judgments (Other invoices).

This was the first audit that the Audit Division analyzed processes integral to the SAP system as it applies to the procurement process. Thus, in attempting to meet the specific audit objectives, the audit team gained a sufficient understanding of the system as it pertained to the procurement process, accounts payable, and the related payments for invoices less than $75,000, which contributed to a lengthened timeline in issuing this report. The findings underscore the need for continued commitment to the development of IT professional staff within the Audit Division. The audit team identified differences between practices in place within the SAP system and written procedures that support them. Because the system was adopted city-wide, and because this was not an Information Technology or Information Systems audit, a modification to the original objectives of the project was made. This resulted in an expanded scope period which changed from an ending date of June 30, 2008 to August 31, 2008 and a limited scope for procedures performed related specifically to PARD. Consultation, inquiries and meetings with the Enterprise Resource Planning (ERP) Team from the Information Technology Department (ITD) and other City departments were performed when necessary.

A number of city-wide issues related to the SAP system integral to the purchasing process were discovered, and are presented in this report along with the findings that are specific to PARD. Details of all findings, recommendations and management actions taken are presented after the Conclusions section. Where applicable, an assessment of the management response is provided to reflect residual issues or broader implications of the item identified.

Our audit procedures were designed to meet the audit objectives identified above and to provide recommendations for improvement where appropriate. Departmental management is ultimately responsible for establishing and maintaining a system of internal controls over the purchasing processes as an integral part of the overall internal control structure. The objective of the system is to provide management with reasonable, but not absolute, assurance that administration of the purchasing process complies with all applicable procedures, orders, and laws.

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

PROCEDURES PERFORMED

In order to obtain sufficient and appropriate evidence to conclude on the audit objectives identified above, the audit team performed the following procedures:

- Examined relevant City Policies, Procedures, and Blueprints and State Procurement and Payment Laws and previous Analysis/Reports;
    - Administrative Procedure 5-2, *Procurement Procedures* (AP 5-2)
    - Executive Order 1-14, *Procurement and Payment Policies* (EO 1-14)
    - SAP Blueprint and flow charts
    - Texas Government Code §2251 and §2155
- Performed interviews with relevant Department management and staff to gain an understanding of the procurement process, its risks and underlying internal controls specific to the audit scope and objectives outlined above;
- Performed tests of controls related to SAP Blueprints and the underlying procurement processes; and
- Performed substantive tests of purchase requisitions, purchase orders, goods received and invoices paid during the scope period.
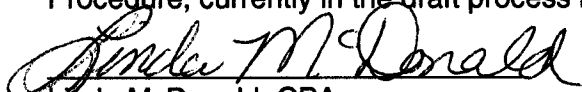
CONCLUSIONS

PARD

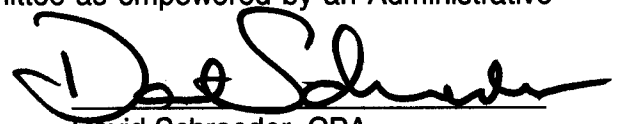Based on the procedures performed in relationship to the audit objectives outlined above, we conclude that:

- PARD has an approval process for requisitions and purchase orders for under $75,000 that provides a reasonable assurance for propriety and safeguard. Since the implementation of SAP, there remains however, some critical segregation of duties (SOD) issues identified in an independent study in 2006 that are unresolved but are partially mitigated using alternative procedures of Departmental management review of system reports. SOD issues should be addressed through a cooperative effort between PARD and ERP Security Team. This could include enhanced role-based security for more efficient monitoring and maintenance.

- PARD has a process in place attempting to assure receipt of goods/services prior to payment for invoices less than $75,000. This process lacks some key controls to ensure accurate information is entered timely. The problems appear to be correlated to the elimination of centralized receiving in the summer of 2006, and the implementation of SAP and are also amplified by the lack of written internal policies related to the procurement process specific to PARD. The controls over the receiving function should be improved by adequate documentation requirements prior to approval and ultimate payment of invoices. Utilizing document scanning and attaching them to the financial system would facilitate more efficient monitoring of this process.

- PARD has a process that provides reasonable assurance of accuracy of calculated amounts for invoices less than $75,000. Date information for receiving of goods/services and invoices however, is not entered into SAP consistently, reliably, nor as currently documented in the SAP blueprint. This impacts the effective management of City funds by losing accurate tracking for timely payment as required by State Law, interest earnings for maximizing the payment period, and negotiations for vendor discounts. Clarification and guidance through policy would provide a foundation to then implement functionality within SAP to utilize date-sensitive analysis, such as late payments and optimal use of funds.

CITY-WIDE

Because the City implemented SAP for financial and operational transaction detail and reporting purposes as noted previously, the most effective remedies related to the conclusions rendered above expand beyond PARD. Most notably, procurement-related dates entered into SAP are not consistent or reliable, and source documentation is not being scanned or stored for efficient monitoring and effective internal control. The impact of resolving date-sensitive application issues that correspond to efficient timing of invoice payments results in a **conservatively estimated annualized cost savings to the City of $3.6 Million**[1].

While each department is ultimately responsible for its own system of assurance, the nature of SAP integrates processes city-wide and therefore highlights the need for expanded interaction and concerted efforts with the applicable city departments, business process owners, the City Controller's Office and the ERP team of ITD. A proposed method to implement and facilitate this process is the formation of a Governance Committee as empowered by an Administrative Procedure, currently in the draft process by ITD.

Linda McDonald, CPA
Auditor-In-Charge

David Schroeder, CPA
Acting City Auditor

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[1] This estimate considered a set of variables based on sample data used in our detailed test work and thus could be analyzed further to narrow the potential margin for error.

DETAIL FINDINGS, RECOMMENDATIONS, AND CORRECTIVE ACTIONS REPORTED

PARD FINDINGS

I. PROCUREMENT PROCEDURES

BACKGROUND

According to AP 5-2, Procurement Procedures, Section 6. PROCEDURES, "All departments must utilize internal purchasing procedures consistent with Executive Order 1-14. Departments must submit their procedures to the City Purchasing Agent for approval."

PARD has four Divisions that purchase goods and services: (1) Greenspace; (2) Recreation and Wellness; (3) Facilities Management and Development; and (4) Management and Finance.

FINDING

PARD does not have internal written procedures related to its purchasing process. The lack of standard procedures has caused confusion and inconsistency in application and practices of purchasing activity within the Department.

RECOMMENDATION

PARD should develop, prepare, and implement written purchasing procedures specific to its business processes that are not covered by City-Wide AP's. These should be submitted to the Strategic Purchasing Division (SPD) of the Administration and Regulatory Affairs (ARA) Department for approval prior to implementation.

CORRECTIVE ACTIONS REPORTED

The Purchasing section is currently working on updating the operating policies and procedures. It is estimated to be completed by March, 2010.

II. MASTER APPROVAL LIST

BACKGROUND

AP 5-2, Section 5. Responsibilities, Subsection A. User Department, Paragraph (1) General responsibilities, Sub-paragraph d. states - "Designate approval authorities and limits in writing and provide the designation to the City Purchasing Agent."

The Master Approval List (List) is a written list prepared by each City department indicating which appointed employees have the authority to approve certain purchases, and the related dollar levels they may approve.

The Controller's Office Operations & Technical Service Division, uses the List in an invoice situation where the approval process spans more than one department. For example, the Controller's Office needs the List for Miscellaneous invoices to assure proper authority to pay, because the business authority (functional manager) may be different than the designated approver in SAP. As a result, the Chief Deputy City Controller over Operations has requested an update to the List as of January, 2010. The frequency of the update process will be determined by the City Controller's Office.

FINDING

The Lists for each department have not been updated since July, 2006. Without current information, invoices may be released for payment without proper approval authority.

RECOMMENDATION

PARD should ensure its List is current, and provide a copy of the list to the Controller's Office Operations & Technical Service Division, along with a copy to the City Purchasing Agent. PARD should also maintain current and prior Lists of authorized employees that have approval privileges, including their dollar limits.

CORRECTIVE ACTIONS REPORTED

PARD updates the Master Approval List when there is a personnel change status (e.g. new hire, retire, termination, transfer, etc.). PARD will ensure that the Master Approval List is current and will update the transaction descriptions to be consistent with SAP.

III. GOODS RECEIVED/DELIVERY TICKETS

BACKGROUND

PARD does not have a central receiving function or written procedures to control the decentralized process of receiving goods and services and ensuring that receipts are properly entered into SAP.

According to Administrative Procedure 5-2 Section 5.A (1) n. through p., user departments are generally responsible to:

n. "Receive goods and/or services purchased and obtain packing slips or other external evidence of delivery."
o. "Immediately inspect goods and/or services received for overages, shortages and damages and verify that they meet specifications."
p. "Submit delivery receipts and other receiving documents in a timely manner."

In general, adequate receiving activity procedures require that documented receipt of goods and services be submitted and maintained to provide evidence that supports the validity of payment transactions. This is commonly performed by a two- or three-way matching process of receiving documentation to invoice support. The SAP Blueprint and process Flow Diagrams require that a copy of delivery tickets be sent to accounts payable.

The Controller's Office Operations and Technical Services Division has been working in conjunction with the ERP team to design and implement functionality that standardizes and clarifies the accurate input of date-sensitive information. This is tentatively planned to be completed during the calendar year 2010.

FINDING

Detail testing of goods and services received identified that PARD is not consistently submitting documented evidence of receipts to Accounts Payable. In addition, the date of goods and services received recorded on receiving documents and entered into the SAP "Goods Received" field has typically been the date of entry, rather than the actual received date. The actual date of goods and services received is important, since it is one component of determining the baseline date, used to calculate the date payment must be processed to avoid late payment of interest. Table 1 below summarizes the results of our sample testing of receiving activity:

* **5 invoices** out of 20 had no delivery ticket (25 %)
* **9 invoices** of 20 were signed as received but no date when received (45 %)
* **6 invoices** of 20 had no exceptions (30 %)

RECOMMENDATION

In order to comply with AP 5-2 and to adequately control the receiving component of the accounts payable process, PARD should develop and implement internal procedures that require processing and supporting documentation of receiving activity in a timely manner prior to payment of invoices. (See recommendation for Finding X to address consistency and accuracy of receiving date information).

CORRECTIVE ACTIONS REPORTED

For each delivery of goods, PARD will ensure the appropriate supporting documentation provided by the vendor (e.g. packing slip, delivery ticket, remittance, etc.) will be maintained at the receiving location. In instances where the vendor does not provide such documents, the receiving person will sign and date a copy of the invoice as proof that the goods were received and/or the services were performed. This documentation will be available for review by Accounts Payable upon request.

SAP SYSTEM AND OTHER CITY-WIDE FINDINGS

The following nine items are inter-related with the ones identified in the previous section, but are reported separately because they will require management decisions beyond PARD in regards to policy, potential SAP reconfiguration, and commitment to provide the necessary resources for their effective implementation.

IV. EFFICIENT VENDOR PAYMENT SCHEDULING

BACKGROUND

The State of Texas has a law commonly called the "payment scheduling law." This law requires state agencies to schedule the timing of their payments so that the state receives the most benefit.

This means that Texas state agencies are not allowed to pay vendors before the payments are actually due, unless the invoice is less than $5,000 or the state has a business reason for paying early. For example, agencies are allowed to make early payments to vendors if the vendor and the agency already have an agreement to make a payment at a certain time, or if the vendor gives the agency a substantial discount for paying early.

The Texas Comptroller's web-site has a written policy regarding the delay of payments and is available to the public on the State's web-site. The policies are based on Texas Government Code, Chapter 2155; and Texas Administrative Code, Title 34, Part 1, Chapter 20

Efficient and effective organizations manage their funds in a manner that reduces costs and maximizes income. Two ways to accomplish this are delaying payment of invoices until due and/or negotiating and taking advantage of early payment discounts.

When a PO is set up within the system, payment terms are defaulted to Net 30.

FINDING

Departments issuing POs have the ability to change the payment terms to expedite remittance of funds to vendors without approval. This often results in the Controller's Office paying a vendor the very next day after the invoice is successfully posted (e.g., instead of state requirement which is the latter of the receipt of an invoice, or receipt of goods or services).

Based on the listing of checks written to vendors identified in finding XI, approximately $78,000,000 was paid for October, 2008. With a potential holding period of 30 days, and using 4.70% annual percentage rate, the interest earnings lost on not holding those funds for the maximum amount of time is approximately $305,000 per month, with an annualized savings potential of $3.6 million[2].

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[2] This estimate is conservative because it does not include all payments to vendors, only those made by checks and considers a set of variables based on sample data used in our detailed test work and thus could be analyzed further to narrow the potential margin for error.

RECOMMENDATION

We recommend the Controller's Office implement a policy and related procedure similar to that of the Texas Comptroller's Office as described in the **BACKGROUND** section of this finding. This will involve a collaborative effort with the ERP team to incorporate changes in SAP and the Treasury Division for input on investment decisions.

CORRECTIVE ACTIONS REPORTED

The Controller's Office Operations and Technical Services Division has been working in conjunction with the ERP team to implement functionality and business processes that freeze the payment terms inherited from the purchase order by not allowing the departments to modify them. The change will result in the application and use of default payment terms being Net 30, unless otherwise indicated in a related contract. This enhancement is expected to be implemented by the end of calendar year 2010.

The ERP team emphasized that to successfully adopt this functionality, contract payment terms that are different than "Net 30", must be entered accurately because the associated POs that are created will utilize those terms. Any errors in data entry will require additional detective controls within the Controller's Office to override payment terms.

ASSESSMENT OF RESPONSE

This situation underscores the need for various City Departments to collaborate with each other on resolving entity-wide issues. Decisions to implement system functionality based on business process as the primary drivers have repercussions and potential implications for other mitigating controls downstream, as reflected in the above finding and response.

V. MAINTENANCE OF CITY ADMINISTRATIVE PROCEDURES (AP) AND EXECUTIVE ORDERS (EO)

BACKGROUND:

EO 1-1 titled "Administrative Procedures" is the Executive Order that identifies the functional area within the City that is responsible for maintaining and updating all APs and EOs. The two critical City policies affecting the purchasing process within the scope of our audit are AP 5-2 Procurement Procedures and EO 1-14 Procurement and Payment Policy, which are maintained by ARA.

Standard business practice recommends that APs and EOs be in place to provide consistency and accuracy in performing various job functions. Having current written procedures:

- Prevents mistakes;
- Saves time;
- Ensures consistency; and
- Improves quality.

FINDING:

The two policies mentioned were last approved and posted as of March 2001. They contain outdated dollar limits (e.g. State Formal Bid Limits, etc.) and discuss the purchasing processes in terms of the FMS system which was replaced with the SAP system in July 2006.

RECOMMENDATION:

ARA should revise City APs and EOs related to the purchasing process to include the most recent criteria. This could include a matrix of the population of documents that are the responsibility of ARA, with a current revision date, along with a commitment for the next planned update.

CORRECTIVE ACTIONS REPORTED

ARA is in the process of assuming the Administrative responsibility currently held by the Finance Department by updating EO 1-1. Draft revisions of AP 5-2 and EO 1-14 were submitted prior to this audit. They have been reviewed by the City's Legal Department and are pending approval by the Chief Administrator's Office within the Mayor's Office. Additionally, ARA has formed a committee that is charged with organizing a status list of City APs and EOs that outlines the current revision and tentative update schedule.

VI. SEGREGATION OF DUTIES (SOD) IN SAP USER ROLES

BACKGROUND

In June, 2006, at the request of the ERP team, an SAP consultant performed a study which included a review of security and authorization roles within the system. There were several high priority SOD issues identified which were recommended to be addressed as follows: "SOD cleanup will need to be addressed as soon as possible after SAP is implemented. SOD risks can be prioritized based on volume of users with the risks, and done gradually. It will need to be a joint effort involved the functional teams working with the business, internal auditing and SAP Security to determine which risks COH wants to manage and how to resolve the issues where those risks have already been included in roles and assigned to users."

FINDING

The City has not thoroughly addressed the issues identified in the June 2006 study noted above.

RECOMMENDATION

Adopt the recommendations outlined in the 2006 study noted above.

CORRECTIVE ACTIONS REPORTED

A quarterly report that shows current user roles and authorities are generated by the ERP team and distributed to the City Departments for review. This process was started in November of 2008 and helps to reduce the risk of potential SOD issues.

VII. SAP BLUEPRINTS/FLOW DIAGRAMS VERSUS SYSTEM OPERATIONS

BACKGROUND:

According to the originally approved SAP documentation when the Purchase Requisition (PR) totals less than or equal to $3,000 only one approval is required; when the PR total is greater than $3,000, the PR requires two approvals.

FINDING:

The SAP documentation does not accurately affect the business process in place for Purchase Requisition Approvals. Currently, the PR must be entered and released on a line-by-line basis. Each unique product or service related to the PR is separately entered. As a result, there may be one or an unlimited number of lines for a single PR. Each line of the PR requires individual approval(s) as outlined below.

Approval Level 1 - A single line item value less than or equal to $3,000 - The only approval is the Cost Center Manager or Designee.

Approval Level 2 - A single line item greater than $3,000 - Two approvals are required: the Cost Center Manager or Designee, and the Department Director or Designee.

Therefore, a PR may be greater than $3,000 in total, but as long as any single line item is less than $3,000, only one approval is required.

RECOMMENDATION:

Modify the documentation to support the changes made to the system or modify the approvals in SAP to be consistent with the underlying documentation.

CORRECTIVE ACTIONS REPORTED

The ERP team stated that the Blueprints and Flow diagrams are updated as business processes change. Requisition Process blueprint will be updated by January 2010 to reflect the $3000 line item approval.

VIII.   SAP APPLICATION GUIDANCE, DOCUMENTATION AND RELATED POLICIES & PROCEDURES

BACKGROUND

System documentation is a critical component of communication with the user base related to the effective utilization of information systems. This takes the form of user documentation, blueprints, flowcharts, policies, procedures, and standards. These support the ongoing application of user training, provide support for decisions related to business processes and the related impact on systems requirements, design, implementation and subsequent modifications (Change Management).

Regarding SAP, the ERP Team issued a detailed set of Blueprints and Flow Diagrams that provide documentation to support various processes, including City purchasing. These purchase-related Blueprints include topics such as:

- Requisitioning;
- Purchasing;
- Accounts Payable; and
- Inventory/Warehousing.

The initial Blueprints are the original design for SAP and will not change; however, if business process owners or the ERP Team determines SAP should operate in a different manner than the original Blueprints describe, changes will be made as reflected by revised versions of Blueprints and related Flow Diagrams.

At one time this documentation was available for viewing on the City's ERP/SAP Intranet web-site which provides general user guidance to City employees.

FINDING

All Blueprints, Flow Diagrams, and other relevant Go-Live documentation are no longer centrally located on the City's ERP/SAP Intranet web-site. The potential impact could result in inaccurate, incomplete, and/or inconsistent data input to the related business processes. (See Findings VI, IX, X and XII)

RECOMMENDATION

In developing solutions to the above finding, the ITD /ERP Team should consider:

Enhancing the existing ERP Intranet Web-site to include:

- The most current application processes as they relate to the various business rules, which would include the original Blueprints, Flow Diagrams, other relevant Go-Live; Implementation decision support; and
- Announce specialized classes as needed due to system design and application modifications.

CORRECTIVE ACTIONS REPORTED

Blueprints and Flow Diagrams used to be available on the ERP Intranet web-site, but were removed to simplify the web-site structure. The ERP team stated that a notice will be posted on the web-site indicating that all Blueprints and Flow Diagrams will be available on CD upon user request.

ASSESSMENT OF RESPONSE

While ERP has and continues to take steps toward training and business process improvements, there still appears to be a disconnection between the business process owners, user groups and the development environment. The most notable example is in the area of reports. SAP is a transaction-based system that has the capability to reflect detailed information. Accessing the information is sometimes cumbersome and has been a catalyst of strong demand for additional reporting capabilities, some of which are within SAP's functionality and some that are not.

IX. INTEREST PAID TO VENDORS FOR LATE PAYMENTS

BACKGROUND   Texas Government Code, Subtitle F, State and Local Contracts and Fund Management, Chapter 2251, "Payment for Goods and Services", details requirements relevant to State and Political Subdivisions of the State (including municipal government) concerning payments to vendors.

According to Section 2251.021, a payment by a governmental entity under a contract on or after September 1, 1987 is overdue on the 31st day after the latter of:

- The date the governmental entity receives the goods under the contract;
- The date the performance of the service under the contract is completed; or
- The date the governmental entity receives an invoice for the goods or service.

This effective date is known as the baseline date. A late payment begins to accrue interest on the 31st day from the baseline date. The rate is one percent plus the prime rate as reflected in the Wall Street Journal on the first day of the preceding fiscal year.

FINDING

The City's SAP financial system baseline date is not configured to automatically determine if payment to a contracted vendor is late based on the Texas Government Code. In addition, SAP is not configured to calculate interest owed to contracted vendors for late payments. This is reflected by a lack of City Policies and corresponding business processes to pay vendors in net 30 (e.g., majority of vendors are paid immediately).

RECOMMENDATION

Coordinated business, operational, and system processes/procedures should be documented and integrated to allow SAP to be reconfigured and more efficiently monitor the payment due dates and any potential interest owed to contracted vendors for late payment. This would also ensure compliance with Texas Government Code.

CORRECTIVE ACTIONS REPORTED

The Controller's Office Operations and Technical Services Division has been working in conjunction with the ERP team to design and implement functionality that standardizes and clarifies the accurate input of date-sensitive information. One of the results is the ability to implement Late Payment Interest Calculations. This is tentatively planned to be completed during the calendar year 2010.

X. TIMELINESS AND ACCURACY OF DATA ENTRY

BACKGROUND

Goods/services received, invoice received dates, and related data entry, are critical to the accurate and timely processing of purchasing activities (as outlined in Texas Government Code, Subtitle F, State and Local Contracts and Fund Management, Chapter 2251 noted in Finding IX above). Also critical to the purchasing process is adequate and on-going training of system users. For example, the invoice dates that should be entered into SAP are the date of actual receipt of the invoice and not the date it is entered into the financial system (i.e. default date in the SAP system).

User training is offered for all primary SAP modules related to functionality that meets the needs of the business processes, while comprehensive course catalogs are posted on the ERP Intranet with calendars of upcoming scheduled classes. The ERP group also employs a feedback and monitoring mechanism that allows class participants to communicate their assessment of various elements of the educational process via the use of customer surveys.

Each Department has BRLs/Super-Users that are subject matter experts responsible for adequate dissemination of system training and assessment of user competence and awareness. Most BRLs were involved in the SAP implementation as the foundation for their development. Each Department should continually evaluate and communicate training needs to the ERP Team.

FINDING

Audit testing revealed 11 out of 40 invoices were entered with incorrect dates. The vendor invoice date was the date of the entry, rather than the date the invoice was received.

RECOMMENDATION

Provide documented and distributed policy along with city-wide training to help ensure consistent and accurate dates are entered into the SAP system related to all modules and transactions. Inaccurate dates contribute to possible missed interest payments to vendors; inability to maximize funds for investment purposes by delaying payments for 30 days; and will prevent the SAP system (if reconfigured to pay interest and delay payments) from accurately evaluating situations. (See Findings VI, VIII, IX and XII)

CORRECTIVE ACTIONS REPORTED

As part of the Vendor Payment Scheduling effort (Section V), the Controller's Office Operations and Technical Services Division has been working with the ERP team to design and implement functionality that standardizes and clarifies the accurate input of date sensitive information. This is tentatively planned to be completed during the calendar year 2010.

XI. EXPANDED USE OF AUTOMATED CLEARING HOUSE (ACH) TRANSFERS

BACKGROUND

The Automated Clearing House (ACH) is a nationwide computer-based interchange for clearing deposits and payments electronically. The ACH Network is a highly reliable and efficient nationwide batch-oriented electronic funds transfer system which provides for the interbank clearing of electronic payments for participating depository financial institutions. The Federal Reserve and Electronic Payments Network act as ACH Operators, central clearing facilities through which financial institutions transmit or receive ACH entries. Using ACH technology can also reduce the burden on our transportation systems and the environment by reducing the fuel used for shipping the checks.

FINDING

Invoice testing revealed significant volume of paper checks still being used to pay vendors. From November 1, 2007 through October 31, 2008, the City issued 41,848 checks, totaling $834 million dollars.

RECOMMENDATION

The City should expand the use of ACH and integrate the necessary steps into the vendor approval process

CORRECTIVE ACTIONS REPORTED

Controller's Office Operations and Technical Services Division is currently working on moving all vendor payments to an ACH platform. As a first step, all City Employees who receive reimbursement for expenses will automatically be moved to ACH beginning February, 2010, using the employees' current bank routing information from HR. Once this is completed, trade vendors will be moved using extensive mailing correspondence. It is targeted for completion by the end of the calendar year 2010.

XII. USE OF ELECTRONICALLY SCANNED SUPPORTING DOCUMENTATION

BACKGROUND:

SAP has the capability to utilize scanned documents that support contracts, purchase orders, receipts, invoices, payments and other relevant transactional data.

FINDING:

The City has not implemented the capability of managing and warehousing supporting documentation in conjunction with SAP and does not have specific and consistent guidance or management policy in this regard.

RECOMMENDATION:

The City should implement and document a process and procedures for scanning supporting documentation in connection with transactions entered into SAP. Based on discussions with various City departments, the primary issue appears to be the lack of storage capacity. This implies the need for financial support from City Council to acquire the necessary hardware and related software to use the current system efficiently and effectively. Having source documentation attached within the system facilitates the following:

- Strong internal controls;
- Efficient detective controls for subsequent review; and
- Allows for advancement to the realization of a paperless environment.

CORRECTIVE ACTIONS REPORTED

The Mayor's Deputy Chief of Staff has been working with the Houston Airport System (HAS) to scan invoice documents upon receipt for supporting payments that require the approval of the Controller's Office. In January, 2010, the rest of the departments will be migrated with an estimated City-Wide completion of second quarter of the calendar year 2010.

ASSESSMENT OF RESPONSE

While scanning the invoices provides some of the critical supporting information, the receiving documents are a necessary component to providing a more complete paperless voucher package. If centralized electronic invoicing is implemented as tentatively planned, it will also help provide a more comprehensive computerized vouching process.