December 22, 2016

Audit Committee Members
Mayor McMillan and City Council
City of Clarksville
Clarksville, Tennessee 37040

<u>**Executive Summary of the Purchasing Card Audit 2016**</u>

The following is an executive summary of the objectives, findings and recommendations related to the internal audit report on the City's purchasing card program for the time period July 1, 2014 to July 31, 2016. The full audit report is attached and contains additional details about the audit results, as well as management's responses. The full report also describes the audit methodology and provides more background and statistical information.

<u>Objectives of the audit</u>
The objectives of the audit were to determine the following in relation to the purchasing card program:
- **To determine the adequacy of the design of internal controls**
- **To identify opportunities for cost savings**

<u>Brief Background</u>
The City of Clarksville's Purchasing Department implemented a purchasing card program for departments to use in lieu of traditional purchase orders on low dollar, tax exempt purchases. In addition to reducing the time and cost of processing traditional paper purchase orders, the City also receives an annual rebate based on spending.

During the audit period, the City spent a total of **$6,883,734** among several different types of vendors and services. The City has implemented controls within the purchasing card program to prevent or detect inappropriate purchases, including multiple reviews of monthly purchasing card statements, monthly and single purchase spending limits, and merchant category blocks.

<u>Conclusions of Report</u>
Our audit of the City's purchasing card program for the period of July 1, 2014 to July 31, 2016, yielded the following results related to our original audit objectives.

In certain areas, the internal control structure surrounding the purchasing card program is strong and working effectively based on test procedures performed during this audit. However, the following findings were noted is this area:
- **Purchasing card policy was not specific enough in some areas to allow for consistent application in departments**
- **Span of control for reviewers was not aligned with industry best practices**
- **Potentially unnecessary cards were identified**
- **Training was not always conducted in accordance with the purchasing card policy**

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- Disciplinary and training records needed improvement

Based on the audit results, the auditor believes there are many opportunities to increase cost savings to the City. These cost savings, as well as opportunities to monitor contract compliance with pre-approved vendors, can be realized through analysis of relevant data sets using proper tools. The Purchasing Department must leverage available resources and improve communication with departments about existing purchasing arrangements to maximize savings.

Based on the audit results summarized above, we have made various recommendations for improvement which are detailed in the report. Recommendations include, but are not limited to, the following:
- Improve the existing policy to better align with industry best practices and provide additional guidance to departments in certain areas
- Monitor and effectively manage span of control for reviewers
- Implement improvements to training and disciplinary records and enforce existing two-year update training requirement
- Develop a continuous monitoring plan for purchasing card transactions to identify opportunities for cost savings

The Internal Audit department would like to thank the Purchasing Department for their help and support during the performance of this audit. Their positive attitude facilitated the conduct of the audit and provides the necessary environment for process improvements to take place.

If you have any questions about the audit, the findings, or the recommendations please contact me at 648-6106.

Respectfully,
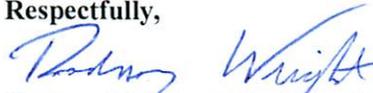
Rodney Wright, CPA, CIA, CFSA
Director of Internal Audit

cc: Charlie Gentry, Chief of Administration
       Laurie Matta, Chief Financial Officer
       Camille Thomas, Purchasing Supervisor
       Meagan Hinton, Accountant, Clarksville Gas & Water
       Sean Newman, Purchasing Manager, Clarksville Department of Electricity

THE CITY OF

CLARKSVILLE
TENNESSEE'S TOP SPOT

Internal Audit Report

Audit Title:	**Purchasing Card Audit 2016**
Department:	**Purchasing**
Audit Period:	**July 1, 2014 to July 31, 2016**

CITY OF CLARKSVILLE
PURCHASING DEPARTMENT
PURCHASING CARD AUDIT 2016
AUDIT #1601

Stephanie Fox
_____
Auditor – Stephanie Fox

Rodney Wright
_____
Director of Internal Audit – Rodney Wright

_____
December 22, 2016
Date

CITY OF CLARKSVILLE
INTERNAL AUDIT REPORT

Purchasing Card Audit 2016
July 1, 2014 to July 31, 2016

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Internal Audit Report

Origin of the Audit

This audit was conducted as a part of the annual audit plan approved by the Audit Committee for the fiscal year 2017. It was performed at the request of the audit committee following discovery of fraudulent use of a purchasing card at Clarksville Gas & Water in early 2016.

Audit Objectives

The objectives of the audit were to determine the following in relation to the purchasing card program:
- To determine the adequacy of the design of internal controls
- To identify opportunities for cost savings

Scope and Methodology of the Audit

The audit covered the time period from July 1, 2014 to July 31, 2016. Test procedures were designed to support the stated audit objectives and provide a high level review of the city-wide purchasing card policy. The procedures were not tailored by department. The scope of this audit excluded transactions by a Clarksville Gas & Water employee which were investigated for fraud in 2016 by the Tennessee Comptroller of the Treasury.

Evidence to support our conclusions was gathered from inquiries of management and staff as well as observations of source documentation and tests of the controls surrounding the purchasing card program. We also considered and evaluated the following components of internal control: the control environment, risk assessment, control activities, information and communication, and monitoring.

Samples were selected from card transaction data and statements were selected using a combination of random methods and auditor judgment. As some audit samples were chosen from different subsets of data and some sampling was judgmental, the results should not be projected to the population.

Statement of Auditing Standards

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

In 2005, the City of Clarksville implemented a purchasing card program to be used by departments as an alternative purchasing method. Purchasing cards are meant to be an efficient and cost effective tool

to expedite the purchase and payment of approved, low dollar, tax exempt purchases. The purchasing card typically increases cost savings by reducing time to process traditional paper purchase orders. In addition to savings in processing costs, the City also receives an annual rebate based on spending. For example, the City received **$39,742.95** in rebates for 2015. The purchasing card program is administered by the City's purchasing supervisor, who provides training, policies and other resources for cardholders, and oversight.

Each purchasing card has certain restrictions to assist in preventing inappropriate card activity, including monthly and single purchase spending limits, as well as merchant category blocks to prohibit use at ATMs, liquor stores, etc.

The City has a purchasing card policy in place, which was last updated in July 2016. The policy details how cards should be used and other administrative details of the program. It is notable that the City Council has recently passed an ordinance to change the purchasing card vendor used by the City, which may change the process significantly.

Statistical Information

During the audit period, the City as a whole spent a total of **$6,883,734.24** on purchasing cards. Illustration 1 below shows the distribution of that total between the four managing accounts[1] of the City, while Illustration 2 shows the monthly spending for each managing account.

Illustration 1

Managing Account	Total Spending on Purchasing Cards
City of Clarksville	$3,966,941.67
City of Clarksville Gas & Water	$1,803,893.32
City of Clarksville-Transit	$227,053.64
Clarksville Department of Electricity	$885,845.61
Grand Total	**$6,883,734.24**

Source: US Bank Purchasing Card Transaction Data

Illustration 2
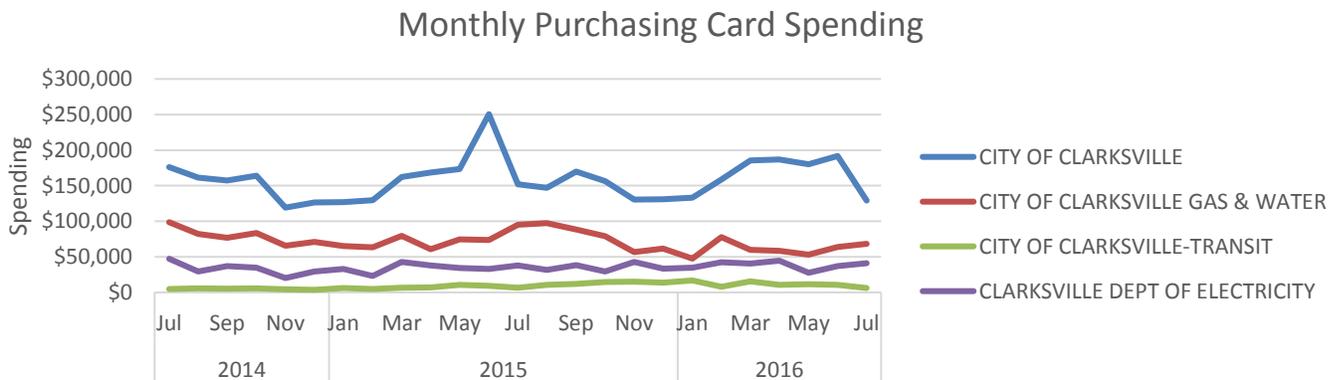
Source: US Bank Purchasing Card Transaction Data

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[1] The City of Clarksville managing account includes all City Departments except Clarksville Gas & Water, Clarksville Department of Electricity and Clarksville Transit.

As of August 24, 2016, there were 351 open purchasing cards. Illustration 3 shows the five departments with the highest amount of cardholders at that time.

Illustration 3

Department	Number of Cardholders as of 8/24/16
Clarksville Department of Electricity	91
City of Clarksville Gas & Water	80
Parks & Recreation	51
Fire Department	24
Street Department	23
All Other Departments	82
Grand Total	**351**

Source: US Bank Purchasing Card Data

Purchasing cards are used by each department to pay for a variety of goods and services.   Illustration 4 below shows the ten vendors with highest payments on purchasing cards through the audit period. The top ten vendors account for about 22% of total spending during the audit period.

Illustration 4

Vendor	Total Spent During the Audit Period
Lowes	$276,637.28
Clarksville Auto Parts	$215,066.83
Best One Tire	$170,679.66
Amazon	$154,306.29
Office Depot	$148,543.13
Dell	$129,750.84
G&C Supply Co, Inc.	$113,352.54
Riverside Parts	$108,206.72
Thomson Machinery	$91,429.44
Kelsan, Inc.	$85,520.54

Source: US Bank Purchasing Card Transaction Data

Results of Audit

Auditor testing and research yielded the following findings and recommendations.

1. **City Departments apply purchasing card policy language inconsistently**

   Criteria:
   - The City's purchasing card policy should be specific enough such that it can be applied consistently through departments.
   - The City's purchasing card policy prohibits split purchases.

Condition:
- **Most individual departments do not have written policies to supplement areas not addressed in the City's policy.**
- **Electronically stored documents are not properly updated to match paper documentation as changes are made through the review process, creating two versions of supporting documentation for the same monthly statement.**
- **Inconsistencies were noted among City departments in the following areas:**
  - **Appropriateness of food purchases**
  - **Acceptable travel expenses, including the method of payment (personal vs. purchasing cards)**
  - **Interpretation of the split purchase definition**
  - **Sufficiency of documentation requirements (The policy was updated in July to include additional documentation requirements.)**

Cause:
- **The City's purchasing card policy does not clearly mandate that written departmental policies are necessary in certain areas.**
- **City policies do not mandate that electronic documentation should be re-scanned when paper documentation is updated.**
- **The City's purchasing card policy gives little or no guidance on areas where inconsistency has been noted.**

Effect:
Inconsistency in applications of purchasing card policy increases the risk of purchases that are not related to an acceptable municipal purpose.

Inconsistency between electronic and hard copy records creates potential issues related to public records requests and other requests for documentation. It also hampers efficiency as both electronic and paper records must be reviewed to determine if all documentation is complete.

Recommendation:
The City's purchasing card policy should be revised to require departments to maintain written policies to supplement city-wide guidance. The policy should specifically outline areas where departmental policies are needed. We recommend that the City Purchasing department review and approve all departmental policies.

The City should develop a process by which electronic documentation is updated.

Additionally, the City's policy should be updated to provide additional guidance in areas of inconsistency noted above. When providing guidance in these areas, consider the following:
- **The City should work with departments to develop baseline guidance on appropriate food purchases to include in the city-wide policy.**
- **Employee use of personal credit cards for city related travel purposes reduces the potential rebate that the City could receive on those expenses. Consider alternatives to employees utilizing personal cards for travel such as requiring one person in a department to book all travel for employees without purchasing cards or adopting limited use cards, such as ghost**

or virtual cards, for travel purposes. Ghost cards or virtual cards are card numbers that are issued either to a particular department for general use or a particular individual for a specified purpose. While ghost cards can be used multiple times, virtual card numbers are single use. Further analysis is needed to determine which method of dealing with travel expenses is best for the City.

- The policy should better define a split purchase and explain why that is prohibited. Additionally, it may be helpful to give some examples of things that would or would not be considered a split purchase.

Management Comments:

Agree _____X_____   **Disagree** _____

Corrective Action Plan: The Purchasing Policy will be updated to include statement(s) requiring individual departments address the purchase policy within their own departmental policies. Statements are already included that all purchases must be for business purposes only. We will include a statement that it also includes purchases of food. We will work with the Finance Office on devising a food purchase policy. We will also encourage departments to discontinue the use of personal credit cards for city travel. The travel policy is not something the Purchasing Department monitors, so we will work with the Finance Office on addressing PCard usage with regards to travel. Split purchases will be further explained in both the PCard policy and the Purchasing policy.

I disagree with the recommendation that the electronic documentation for the PCard statements be updated in Munis. For the purposes of the PCard statements, the hard copy documentation will remain as the document of record. The PCard statements are processed through the Finance Office in a timely manner (sometimes without all hard copy supporting documentation) in order to pay the statement by the due date. Procedures are in place to address any missing documentation or signatures. To rescan the PCard statements in Munis would cause an administrative hardship.

Projected Completion Date: June 30, 2017

Responsible Manager: Camille Thomas

2. **Span of control for some reviewers is not aligned with industry best practices and some existing cards may not be necessary**

Criteria:
- Per the GAO Audit Guide related to government purchase card programs, reasonableness of span of control should include consideration of (1) the number of cardholders assigned, (2) the number and complexity of purchase card transactions being reviewed each billing period, and (3) perhaps the demands of other responsibilities assigned to the reviewer.
- Per the General Services Administration's (GSA) Guide to Best Practices for Purchase and Travel Charge Card Program Management, the ratio of reviewers to cardholders should be manageable. Specifically, the GSA recommends that the ratio should not exceed one reviewer to seven cardholders (assuming an average of six or seven transactions per cardholder per month) or one reviewer to 50 average monthly transactions.

- **The GSA also recommends that the reviewer not be a subordinate of any cardholder under his or her span of control.**
- **Per the GAO Audit Guide, financial exposure for a purchasing card program is the extent of potential loss to the organization from fraudulent, improper, or abusive purchases. Financial exposure includes consideration of the number of purchasing cards, as well as single purchase and monthly credit limits. Limiting these factors can assist an organization in better managing and controlling its purchasing card program.**

Condition:
- **The City does not have any requirements related to span of control for the purchasing card program.**
- **The span of control ratio for 13 reviewers does not meet the GSA recommended ratios of 1:7 cardholders or 1:50 transactions.**
- **There are 14 instances where the reviewer is a subordinate of a cardholder under their span of control.**
- **A list of all cardholders with their associated reviewers was not readily available when requested.**
- **Two employees were found to have two active cards during the audit period. (Note: One of these employees purposefully had two cards. Both additional cards were closed prior to auditor inquiry.)**
- **The following potentially unnecessary cards were identified through an analysis of financial exposure.**
  - **Three cardholders had no card activity during the period**
  - **Six additional cardholders had no card activity during the last year of the audit period**
  - **73 cardholders with accounts opened prior to the last year of the audit period spent $2,500 or less during the audit period**
  - **49 cardholders with accounts opened prior to the last year of the audit period had 15 or fewer transactions during the two-year audit period**
  - **Of 280 cards that have a single purchase limit of $999 or greater, 76 cards had only transactions below $500**

Cause:
- **The City's purchasing card policy does not address span of control, nor does it consider best practices established by the GSA.**
- **Reporting options from the purchasing card program vendor may not be adequate to facilitate all monitoring needs. Additionally, the purchasing card program administrator has not previously kept a full list of cardholders and their associated reviewers.**
- **Program monitoring did not include a review for employees with multiple active cards or cards that are not frequently used.**

Effect:
Reviewers may have a span of control that cannot be effectively reviewed, which may result in inappropriate purchases or other policy violations that are not detected or properly addressed.

Open cards that are not used regularly unnecessarily increase the risk of inappropriate purchases borne by the City.

Recommendation:
- The City's purchasing card policy should specifically address span of control and adopt GSA recommendations for best practices. The purchasing card program administrator should work with departments to align reviewers and cardholders for an optimal span of control for each reviewer. This realignment for proper span of control should include an assessment of and plan to ensure that a reviewer is not a subordinate of the cardholder.
- The purchasing card program administrator should maintain records of all cardholders and associated reviewers. These records should be appropriately monitored for employees with multiple active cards.
- Financial exposure should be analyzed and reduced. Departments should be required to annually recertify that all cards are necessary. Reduction of cardholders will also assist in maintaining appropriate span of control ratios throughout the city. These opportunities may include reducing spending limits for cardholders who spend less or eliminating cards for cardholders who may not need a card.
  - The auditor's initial review of card necessity and appropriateness of spending limits indicated that the City could reduce monthly financial exposure by $244,100 or 14%, while reducing the single purchase financial exposure by $100,485 or 25%.

Management Comments:

Agree ____X____   **Disagree** _____

Corrective Action Plan: The Purchasing Department has already taken necessary steps to determine how many PCards are active within each department and who the reviewer of those cards is. These records will be reviewed on an annual basis. During this process, many PCards have been terminated for various reasons to include little use by employee, no use by employee or no longer a need by the employee. With the transition to a new PCard program financial institution, we will further look into the needs of the departments to further cut down on the number of cards and spending limits and therefore, the potential financial exposure. We will continue to monitor the number of cardholders and the individual spending limit needs on an annual basis. We will also advise departments on the span of control and determine where we may be able to cut down on the number of cards a particular reviewer may control. This office will keep an annual record of all reviewers and how many cardholders they review.

Projected Completion Date: June 30, 2017

Responsible Manager: Camille Thomas

3. **Purchasing card training is not always administered as directed by the City policy**

Criteria:
Per the purchasing card policy, new cardholders shall attend a training session prior to receiving and activating their card. Additionally, all cardholders shall receive updated training at least once over a two-year period.

Condition:

- **The auditor was unable to locate documentation verifying that ten cardholders received appropriate training prior to receiving their card.**
- **Updated training has not been conducted every two years, as directed by the policy.**

Cause:
Cardholders did not obtain training prior to receiving their card or did not appropriately sign in as other training attendees.

The City's purchasing department has not enforced the policy requirement to conduct updated training every two years.

Effect:
Purchasing cardholders may not be appropriately trained to use the purchasing card in accordance with City policy. This may result in inappropriate purchases or other violations of the purchasing card policy.

Recommendation:
The purchasing card program administrator should improve tracking in training records to ensure that all cardholders receive the appropriate training prior to receiving their cards. Additionally, the purchasing department should enforce the existing two-year training requirement in the policy.

Management Comments:

Agree _____ X _____   Disagree _____

Corrective Action Plan: Since taking over the program in 2015, I have maintained a list of all those that attended training. With the transition over to a new financial institution, we will document when employees will need to have a refresher training to comply with the updated training requirement. We will take six months after the transition to develop the process of how and when the updated training requirement will take place.

Projected Completion Date: June 30, 2017

Responsible Manager: Camille Thomas

4. **Disciplinary records for purchasing card policy violations need improvement**

Criteria:
The City's purchasing card policy details the following main disciplinary actions:
- **Initial violation of the policy will result in a 180-day suspension of the purchasing card**
- **Second violation will result in termination of the cardholder from the program**

The City's records of disciplinary actions taken related to the purchasing card program should be adequate to allow the purchasing card program administrator to consistently and correctly apply disciplinary actions, as well as track previous actions taken.

Condition:
- The purchasing card program administrator's disciplinary list is not always inclusive of Clarksville Department of electricity (CDE) and Clarksville Gas & Water (CGW) employees who have violated the purchasing card policy.
- The auditor identified one employee whose card had been suspended due to a personal charge, but who did not appear on the disciplinary records.
- The City currently has records related to disciplinary actions taken within the purchasing policy, however:
  - The data fields available in existing disciplinary records are inconsistent between City General, CDE, and CGW
  - Records are not always clear on the date or reason disciplinary action was taken
- Purchasing card policy is not clear on when the 180-day card suspension begins.

Cause:
The purchasing card policy does not specify how disciplinary records will be maintained or what information will be included therein. Responsibility for maintaining disciplinary records lies with different individuals at City General, CDE, and CGW. CDE and CGW do not always communicate disciplinary actions taken to the purchasing card program administrator.

Effect:
When records are not thorough, disciplinary actions may be applied inconsistently or the wrong action may be applied. Inconsistent application of policies may create future legal risks for the City.

Recommendation:
- Implement a communication plan to ensure that the purchasing card program administrator has a full and accurate list of all employees having a disciplinary action related to violation of the purchasing card policy.
- Standardize information recorded in disciplinary records to include the date disciplinary measures were taken, the date disciplinary action is scheduled to end, and any reason for disciplinary action.
- Strengthen the purchasing card policy to clarify the beginning and ending dates for 180-day suspensions.

Management Comments:

Agree _____X_____   Disagree _____

Corrective Action Plan: We will assist CDE & CGW on a uniform listing of when and why an employee's PCard was suspended as well as ensure that information is effectively communicated to the Purchasing Department. We will require that CDE & CGW provide their suspension list on a monthly basis to ensure our records are complete and up-to-date. We will address when the 180-day suspension begins in the PCard policy.

Projected Completion Date: June 30, 2017

Responsible Manager: Camille Thomas

5. Transaction data should be analyzed to identify opportunities for cost savings

Criteria:
Per the Purchasing Department's website, the purpose of the department is to ensure that taxpayer money is saved by purchasing products and services at the lowest possible cost by way of the bid process.

Condition:
There are opportunities for increased savings within the purchasing card program through the expansion of bidding on certain products or the wider utilization of existing bids and contracts. This may be the case in areas such as shoes, automotive parts, and automotive repairs among others.

Cause:
Prior to the audit, purchasing card transaction data was not analyzed to identify opportunities for savings.

Effect:
The City could be spending more than necessary on certain products or services.

Recommendation:
- Develop a continuous monitoring plan for purchasing card transactions focused on identifying opportunities for cost savings.
- Implement an improved communication plan to disseminate information about existing contracts to departments who may benefit from them.

Management Comments:

Agree _____X_____   **Disagree** _____

Corrective Action Plan: Some areas noted have already been identified and we are currently working with the appropriate departments to come up with clear and concise specifications to send to vendors soon. Others have already been addressed and bids were awarded (i.e. coffee services, printing of city letterhead, etc.). We will continuously monitor where purchases are being made and for what products to determine when items will need to be bid in the future. We will communicate to departments via email when citywide bids/proposals are awarded.

Projected Completion Date: June 30, 2017

Responsible Manager: Camille Thomas

Other Recommendations

During the course of the audit, the auditor reviewed various best practice documents that could be used to make further improvements to the City's purchasing card policy. These best practices were from a variety of sources including the US General Accounting Office (GAO) Audit Guide for

Government Purchase Card Programs, the Government Finance Officers Association (GFOA), the Office of Management and Budget (OMB), and the US General Services Administration (GSA) among others. While we recommend a comprehensive review of those documents, we have included a brief list of some suggestions below.

- Improve and customize current merchant category authorization controls and monitor those controls with annual review
- Require annual recertification from departments on each employee's need for a purchasing card
- Update training requirements and customize training based on level of responsibility within the purchasing card program
- Implement acknowledgements for employees to sign after completing appropriate training
- Develop criteria for deactivating cards that are not regularly used

Management Comments:

Agree _____X_____   **Disagree** _____

Corrective Action Plan: With the transition to the new financial institution, we will be reviewing the MCC code blocks on PCards and continue to review on an annual basis. We will have the capability to block codes per employee instead of all cardholders as a whole. This will allow us to have tighter controls on employees that will use their cards for a limited amount of products and/or services. We will include training for different levels of responsibility for cardholders and those that are reviewers. We will begin an annual review of all cardholders to determine any that no longer have the need for a PCard. We will develop a PCard training acknowledgement for all employees to sign once PCard training is complete. This will be held in the Purchasing Department as an official record.

Projected Completion Date: June 30, 2017

Responsible Manager: Camille Thomas

Conclusion

Our audit of the City's purchasing card program for the period of July 1, 2014 to July 31, 2016, yielded the following results related to our original audit objectives.

In certain areas, the internal control structure surrounding the purchasing card program is strong and working effectively based on test procedures performed during this audit. However, improvements are needed to the City's purchasing card policy to better align with industry best practices and to provide sufficient guidance regarding department level policies. Monitoring and effectively managing the span of control for reviewers, while not currently addressed by the purchasing policy, is essential in reducing risk and improving the effectiveness and efficiency of supervisory reviews and the program itself. In addition to the areas listed above, improvements in training and disciplinary recordkeeping are needed to ensure ongoing compliance with the existing policy.

Based on the audit results, the auditor believes there are many opportunities to increase cost savings to the City. These savings can be realized through use of the right analysis tools and data sets. The Purchasing Department must leverage available resources and improve communication with departments about existing purchasing arrangements to maximize savings.

The Internal Audit Department would like to thank the Purchasing Department for their help and support during the performance of this audit. Their positive attitude facilitated the conduct of the audit and provides the necessary environment for process improvements to take place.

If further information about this audit is desired, please contact Internal Audit at 931-648-6106.