

Performance Audit: Limited Test of Purchase Card Transactions

March 2010

City Auditor
City of Lawrence, Kansas

March 4, 2010

Members of the City Commission

A limited review of purchasing card transactions found that the transaction generally complied with city policies and procedures. The city uses purchasing cards to make small purchases. Employees with city-assigned Visa purchasing cards can “charge” items or services to their cards.

While the review found general compliance, one cardholder’s signed cardholder agreement was not on file with the Finance Department, and two transactions appear to conflict with the city’s purchasing policy that transactions over \$1000 require additional authorization and seeking quotes to ensure the best prices.

When cardholders left city employment, the city asked the bank to cancel their cards in a timely manner. Cancelling cards when employees leave the city reduces the chances of inappropriate purchases.

I make three recommendations intended to strengthen controls over purchasing card transactions. I provided the City Manager with a final draft of the report on February 23. The City Manager’s response is attached.

Kyle Schwartz, an intern in the City Auditor’s Office, compiled information on purchase card transaction limits.

I appreciate the cooperation I received from city staff in completing this project.

Michael Eglinski
City Auditor

Performance Audit: Purchase Card Transaction Test

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Performance Audit: Purchase Card Transaction Test

Results in Brief

The city uses purchasing cards for employees to make small purchases. Employees with city-assigned Visa purchasing cards can “charge” items or services to their cards. Visa then pays the vendor and the city pays Visa. Using purchase cards to make small purchases reduces the administrative costs of purchasing and allows items to be provided quickly.

The review of a small number of purchase card transactions found that the transactions generally complied with city policies and procedures. However, one cardholder agreement was not on file with the Finance Department and two purchases appear to conflict with the city’s purchasing policy that transactions of \$1000 require additional authorization and seeking quotes to ensure the best price.

When cardholders left city employment, the city asked the bank to cancel their cards in a timely manner. Cancelling cards when employees leave the city reduces the chances of inappropriate purchases.

The city’s purchase card policies should address “rewards” programs. Some vendors have programs where customers earn points based on their purchases. After accumulating a certain level of points, the customer earns credit for a future purchase. Rewards programs can benefit the city if city purchases are credited to a city rewards program account.

In addition to ensuring the city takes advantage of rewards programs, employees should not be allowed to make city purchases and receive credit to their own personal rewards accounts. Because personal rewards accounts directly benefit the employee but not the city, they could encourage cardholders to make inappropriate purchases.

The report includes three recommendations intended to strengthen controls over the use of purchasing cards.

Performance Audit: Purchase Card Transaction Test

How the city uses purchase cards

The city uses purchasing cards for employees to make small purchases. Employees with city-assigned Visa purchasing cards can “charge” items or services to their cards. Visa then pays the vendor and the city pays Visa. Using purchase cards to make small purchases reduces the administrative costs of purchasing and allows items to be provided quickly.

Employees throughout the city use purchasing cards to make small purchases. Departments request cards for employees who have authority to make purchases on behalf of the city. Departments submit request forms to the purchasing card program administrator in the Finance Department. Finance then requests the bank to issue the card. The bank sends cards to the program administrator who then provides them to the employee after providing them with training and after the employee signs an agreement that highlights the cardholder’s understanding of the process and their responsibilities. Cards are issued in employees names but all purchases are billed to the city.

The city places restrictions on each card. Cards have both spending and merchant limits. Most city cards fit into two categories. Most cards have a monthly purchase limit of \$5000 and a single transaction limit of not more than \$1000. The standard authorization prohibits cash advances and alcohol purchases. The non-travel policy extends the standard policy to prohibit purchases for hotels, motels, gasoline, and groceries.

City policy allows individual departments to make purchases under \$1000, but requires approval by the City Manager for purchase of more than \$1000. The city generally requires a competitive process for purchases over \$1000.

Review by department supervisors is critical

The city relies on strong supervisory review to ensure employees adhere to purchasing rules and that purchases are appropriate. When supervisors review purchasing logs they:

- Review for correct signatures and use by non-cardholders;
- Review for correct account numbers;
- Ensure supporting documents are available and match purchasing logs;
- Determine purchases are for appropriate City use;
- Review and investigate possible split transactions and other inappropriate transactions;
- Determine prices are reasonable; and
- Determine sales taxes are excluded.

Supervisors are responsible for completing their reviews and ensuring documentation is submitted to the Finance Department in a timely manner.

Results of limited transaction tests

The review of purchase card transactions found that the transactions generally complied with city policies and procedures. However, one cardholder agreement was not on file with the Finance Department and two purchases appear to conflict with the city's purchasing policy that transactions of \$1000 require additional authorization and seeking quotes to ensure the best price. The city's Purchasing Card Guidelines and training should include information about the reason for the current limit to increase the effectiveness of the rules.

The City Auditor reviewed 10 transactions from six departments, comparing the documentation with city rules, evaluating the reasonableness of the purchase, and following up with city staff for clarification. All of the transactions were made in 2009. Specific transactions were selected to provide a cross section of the types of small purchases made by the city. The transaction reviews focused on the departments with the most cardholders and that make the most use of the purchasing cards. The review included transactions from six departments: Fire and Medical, Planning and Development Services, Police, Parks and Recreation, Public Works, and Utilities.

Figure 1 Reviewed transactions

Description	Transaction Amount
Insulation for a building repair	17.96
Tree for replacement related to a water main break	275.00
Plaque recognizing a retiring state employee	95.86
Time cards for recording start and end time for employees	50.00
Registration for online webinar	19.82
Duffle bags for youth sports teams	987.50
Box lunches for a lunch meeting of an advisory board	105.88
Computer parts	639.96
Lab equipment	303.31
Dishwasher	409.00

Transactions generally complied with policies and procedures

The reviewed transactions generally complied with the city’s policies and procedures. City files contained documentation to support that the employee had authority to make the purchase; that they were aware of city policies and procedures; that documentation was available to support the transaction itself; that department supervisors reviewed the purchase and found it to be for the benefit of the city; and that the purchase was below \$1,000 and didn’t include sales tax.

Transaction reviews included reviewing documentation, including the cardholder’s application for a card, the cardholder agreement, the purchase log signed by the cardholder and department management, receipts and other supporting documentation.

Observations

The Finance Department did not have a signed cardholder agreement on file for one of the transactions. Cardholders should sign the agreement that acknowledges they have been issued a card and accept responsibility for property use of the card. The purchase card program administer should retain the signed agreements. In this case, the cardholder recalled signing an agreement but the agreement was not on file with the Finance Department. The cardholder has since signed an agreement which is on file with the Finance Department.

One transaction was part of a “split purchase.” A cardholder placed an order with a vendor and then two minutes later placed another order for the same items. Each individual transaction was below the \$1000 limit, but the combined value of the transactions was \$1,278. By splitting the transaction the cardholder expedited the purchase, but circumvented the city’s purchasing policy requiring additional approval and price quotes.

Another transaction was similar to a split purchase, but involved four purchases spread over three consecutive bills. The cardholder purchased 118 items in four transactions. Each transaction was below the \$1000 limit, but the combined value of the transactions was \$2,428. Had these purchases been made at the same time, the cardholder would have required additional approval and price quotes.

Card transactions generally limited to below \$1000

Authority for making purchases of less than \$1,000 rest with individual departments, but purchases above that amount require the approval of the City Manager. Purchases above \$1,000 generally require a department to obtain at least three price quotes. The purposes of city's purchasing procedures include:

- Provide increased public confidence in the procedures;
- Ensure fair and equitable treatment of all persons who deal with the purchasing system;
- Provide increased economy in city purchasing and maximize purchasing value of city funds; and
- Foster effective broad-based competition.

Split purchases circumvent the city policy. Compared to a purchase card transaction under \$1000, the process for transactions over \$1000 requires more review, more competition, and more time.

Several cardholders annotated their documentation in ways that make tracing the transaction's city benefit especially easy. The cardholder wrote the maintenance work order number on the receipt for insulation. The cardholder wrote the address the tree was planted on the receipt for the tree. Such notations can help supervisors during their review to ensure the purchases are for appropriate city use.

Guidelines and training should emphasize reason for transaction limit

The city's Purchasing Card Guidelines and cardholder agreement describe the \$1,000 transaction limit, but do not describe the reason for the limit. Employees may be more likely to accept rules when they understand the purpose of the rule. When employees perceive rules as without purpose, they are less likely to follow them. Clearly describing the purpose for the transaction limit in the guidelines and agreement and incorporating the information in future training for cardholders and supervisors could reduce the likelihood that cardholders would circumvent the policy.

Transaction limits from other cities

Other cities establish limits on the amount a cardholder may charge for a single transaction. For a group of 12 cities similar to Lawrence, the limits ranged from \$100 to \$5,000 per transaction. In addition, department heads in several cities have the authority to establish specific limits for each cardholder based on need. The typical limit on a card transaction in Lawrence is \$1000.

Most cardholders (76 percent) in Lawrence reported that the limit was adequate to meet the needs of their jobs. About 1 in 5 reported the limit was not adequate. Cardholders completed the survey as part of the *Performance Audit: Small Purchases* (January 2009).

City cancelled cards in a timely manner

When cardholders left city employment, the city asked the bank to cancel their cards in a timely manner. Cancelling cards when employees leave the city reduces the chances of inappropriate purchases.

The City Auditor reviewed records for nine cardholders who left the city since September 2009 and found that the city had requested the bank cancel their cards in a timely manner. By city policy, cardholders and department coordinators are required to notify the purchase card program administrator in the Finance Department when a card needs to be cancelled. The administrator notifies the bank. The administrator also gets a report about personnel transactions and reviews it to identify any changes that he had not already been informed of.

The review suggests the city has taken appropriate steps to strengthen control over cardholders who leave the city. In 2007 and 2008, almost half of cardholders who left the city did so before their cards were cancelled. The January 2009 *Small Purchases* performance audit recommended ensuring cards were cancelled in a timely manner.

City policy should address “rewards” programs

The city’s purchase card policies should address “rewards” programs. Some vendors have programs where customers earn points based on their purchases. After accumulating a certain level of points, the customer earns credit for a future purchase. Rewards programs can benefit the city if city purchases are credited to a city rewards program account. The City

Manager should identify rewards programs the city could benefit from and work with vendors to ensure transactions are credited to the city's rewards account.

In addition to ensuring the city takes advantage of rewards programs, employees should not be allowed to make city purchases and receive credit to their own personal rewards accounts. While the Purchasing Card Guidelines prohibit personal purchases, they do not address benefits that a cardholder could receive through rewards programs. Because personal rewards programs directly benefit the employee but not the city, they could encourage cardholders to make inappropriate purchases.

Recommendations

The City Auditor recommends that the City Manager:

1. Provide cardholders and supervisors with an explanation of the reason for the purchase card transaction limit. The explanation should be included in the Purchase Card Guidelines and in training for cardholders to ensure that cardholders understand both the rule and the reason for the rule.
2. Determine if the city could benefit from "rewards" programs for vendors the city does business with and, as appropriate, work with the vendor to ensure transactions are credited to the city's rewards account.
3. Revise Purchase Card Guidelines to address cardholder use of personal "rewards" programs when making city purchases.

Performance Audit: Purchase Card Transaction Test

Scope, methods and objectives

The City Auditor designed this performance audit to address:

- Did selected purchase card transactions generally comply with city policies and procedures?

The auditor included this project in the audit work plan for 2009 approved by the City Commission.

The City Auditor reviewed city policies and procedures, interviewed staff in the Finance Department, interviewed staff in selected departments that use purchase cards, and reviewed a selection of ten individual purchase card transactions.

The City Auditor selected purchase card transactions from six departments: Fire and Medical, Planning and Development Services, Police, Parks and Recreation, Public Works, and Utilities. The transactions were selected to provide a cross section of the types of small purchases made by the city. The transaction reviews focused on the departments with the most cardholders and that make the most use of purchasing cards. The auditor selected transactions judgmentally. The sample is not random or designed to generalize about the population of all transactions.

An audit intern compiled information on purchase card transaction limits from 15 other cities. The 15 cities were those identified as similar to Lawrence in *Performance Audit: Financial Indicators* (August 2008 and July 2009). Twelve cities provide information.

The City Auditor conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require planning and performing the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives. The City Auditor believes that the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objectives.

The City Auditor provided the City Manager with a preliminary draft of the report on February 12 and a final draft on February 23. The City Manager's written response is included.

Performance Audit: Purchase Card Transaction Test

Management's Response



City of Lawrence KANSAS

CITY COMMISSION
MAYOR
ROBERT CHESTNUT

COMMISSIONERS
MIKE AMYX
ARON E. CROMWELL
LANCE M. JOHNSON
MICHAEL DEVER

DAVID L. CORLISS
CITY MANAGER

City Offices
Box 708 66044-0708
TDD 785-832-3205
6 East 6th
785-832-3000
FAX 785-832-3405
www.lawrenceks.org

March 3, 2010

Michael Eglinski
City Auditor
Lawrence, Kansas

Dear Michael,

Thank you for your report providing a limited test of purchase card transactions. Staff has reviewed the report and is supportive of its recommendations.

It is appropriate to note that the method of the audit was not a random sample. The transactions were selected to provide a cross section of the types of small purchases made by the City. The transaction reviews focused on the departments with the most cardholders and that make the most use of purchasing cards. You selected the transaction judgmentally. The sample is not random or designed to generalize about the population of all transactions.

I believe that you, the Commission and I should discuss a future audit work plan that includes random selection of small purchases so that appropriate generalizations about all transactions can be made, and any necessary improvements implemented.

Again, thank you for your report and we look forward to implementation of the recommendations.

Sincerely,

David L. Corliss
City Manager

