



**Compliance Audit 2020-02
Accounts Payable Timeliness**

January 2021

Director of Internal Audit
Elizabeth Somerindyke

Senior Internal Auditor
Rose Rasmussen

Internal Auditor
Amanda Rich



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Provide independent, objective assurance and consulting services designed to add value and improve the City of Fayetteville’s operations.

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Mailing Address: 433 Hay Street, Fayetteville, NC 28301

EXECUTIVE SUMMARY

In accordance with the Fiscal Year 2020 Audit Plan, Internal Audit conducted an audit of the timeliness of accounts payable (AP) processing. The purpose of the audit was to determine if adequate internal controls were in place to process payments in an efficient and timely manner.

The Accounts Payable Division is responsible for paying approved invoices to previously approved vendors, within specified vendor payment terms. This process is dependent on the efforts of City departments who validate the goods and services were satisfactorily received or performed and process the invoices for submission to the Accounts Payable Division in a timely manner.

The scope of the audit included AP invoices totaling approximately \$2.4 million from various suppliers and entities from January 1, 2019 to December 31, 2019. The scope of the work specifically excluded procurement card transactions, utility bills and health care costs, as these payments are generally drafted automatically.

The Office of Internal Audit concluded that there were two noteworthy areas of opportunity around timeliness of payments and controls for ACH payments. For a detailed explanation of each of the findings please refer to the appropriate finding contained in the body of this Audit Report.

1. Key performance indicators and policies for the timely payment of invoices had not been established.
2. ACH processing lacked internal controls.

BACKGROUND

The City's accounts payable function is decentralized from the Finance Department, Accounts Payable Division. The voucher entries to pay vendors and contractors after goods or services have been received are executed by accounts payable representatives in each department which are due to the Finance Department Accounts Payable Division by Friday at 4:00 PM for a check to be issued the following Friday. The Accounts Payable Division reviews the voucher entries and processes the payments. The Accounts Payable Division has three full-time equivalents (FTEs) dedicated to the payment function.

The role of the Accounts Payable staff in reimbursing vendors is only a part of the process to appropriately pay for the goods and services acquired by City staff. Purchasing and receiving of goods and services is performed by all departments in the City. Department staff procure goods and services through the Purchasing Division of the Finance Department, which provides a centralized approach for bid specification and solicitations for any apparatus, supplies, equipment, and materials for all departments. In order for the Accounts Payable Division to effectively carry out its duties, they have to collaborate with other departments, to include the Purchasing Division within the Finance Department.

AUDIT OBJECTIVES

The objectives of this audit were to evaluate policies and procedures relating to the accounts payable process and determine if internal controls over accounts payable disbursements are adequate and effective with respect to responding to risks within the City regarding the reliability and integrity of financial and operational information, effectiveness and efficiency of operations, safeguarding of assets, and compliance with laws, regulations and contracts.

AUDIT SCOPE

The scope of the audit included invoices processed from January 2019 to December 2019. Based on a 95% confidence level and a 5% tolerable deviation, Internal Audit selected 381 invoices by random sample or auditor judgement to review.

AUDIT METHODOLOGY

In order to accomplish the objectives of the audit, the Office of Internal Audit performed, but were not limited to, the following:

- Interviewed personnel from the Finance Department;
- Reviewed the City of Fayetteville General Contracting and Purchasing Practices and Procedures, North Carolina General Statutes and any other applicable memorandums or directives related to accounts payable for compliance;
- Reviewed invoices and associated documentation; and
- Considered risk of fraud, waste and abuse.

FINDINGS, RECOMMENDATIONS, AND MANAGEMENT'S RESPONSES

Finding 1

Key performance indicators and policies for the timely payment of invoices had not been established.

Criteria: Based on the Performance Management Framework for State and Local Governments developed by the ICMA, the use of performance management provides insight on how well an organization performs. More importantly the data can be used to make informed decisions and promote operational effectiveness and efficiencies.

Principle 12 of the GAO's Standards for Internal Controls requires management to implement control activities by documenting what is expected through policies and periodically review for continued relevance and effectiveness in achieving the stated objectives or addressing related risks.

Condition: Accounts payable did not have key performance indicators or policies established defining timely payment of invoices.

Based on information available from the sampled invoices, the average number of days for the Finance Department to issue payment were:

- 84 days from invoice date, and;
- 70 days from due date.

Defining timely payment as 30 days or less from the invoice date, 43% of the invoices sampled were considered timely.

Internal Audit noted the timeliness of payment improved when invoices were initially received by the Finance Department.

Cause: The Finance Department had key performance indicators, however, indicators for timely payment of invoices had not been established.

Internal Audit noted the following as possible conditions that allowed for untimely payment of invoices:

- Decentralized accounts payable process where invoices are not emailed or mailed to a centralized location for accountability.
- Purchase orders were not obtained by City departments prior to obligating purchases, as required by North Carolina General Statute 159-28 and City Policy #120. Therefore, purchase orders were issued after the invoice was received causing a delay in payment.

Effect: Commitments not encumbered prior to purchase and delayed vendor payments could result in overspending. Delayed payments could negatively impact the City's reputation or cause relationships to be

strained with vendors. Ultimately the City would not be able to take advantage of early pay discounts or negotiate discounts for timely payments, if available.

Recommendation

The Finance Department should:

1. Establish and monitor policies and key performance indicators (KPI) for the timely payment of invoices.
2. Modify or create a process for streamlining the receiving of invoices within individual departments in order to expedite vendor payments.
3. Communicate all requirements and implementation methods to ensure compliance.

Management's Response

1. We concur. Management is in full agreement with the recommendation. Management will define timely payment of invoices as 75 days from invoice date. We recognize that Net 30 is widely considered standard payment terms but due to decentralized operations, we will work toward Net 30 as a future aspirational goal. Policies will be updated to reflect the 75 day period and a 75 day KPI will be launched to measure performance. The KPI will be measured monthly to ensure invoice payments are in line with goals and to identify areas of improvement.
2. We partially concur. Management is in agreement with a portion of the recommendation. Accounts payable is a decentralized operation and Finance has limited control. However, we will use our authority to lead an effort for streamlining the receiving of invoices and improving the timeliness of vendor payments. Finance staff will resume enhanced departmental training following the pandemic. Training will highlight review of policy, policy updates and the importance of monitoring policy for compliance. Procedural reviews and a general reevaluation of the accounts payable process will be initiated. To ensure clarity we will discuss and determine accountability and responsibility for each task in the accounts payable process. Training will include a demonstration of established KPIs in real-time to validate the effectiveness of the department's efforts. Our goal is to encourage and promote a culture of appreciation and compliance with policies and procedures that will effectively improve the payment process.
3. We concur. Management is in full agreement with the recommendation. Management will communicate requirements and implementation methods by issuing updated policies, offering in-depth and all-inclusive training and through direct communication with departmental staff and management.

Responsible Party: 1) Christine Pressley, AP Supervisor 2) Jay Toland, CFO

Implementation Date: April 1, 2021

Finding 2

ACH processing lacked internal controls.

Criteria: Principle 10 of the GAO's Standards for Internal Controls requires control activities to be designed by management to achieve objectives and respond to risks, to include management controls over information processing by controlling access to data, files and programs.

Controls should be in place to ensure data exported from JD Edwards for ACH (Automated Clearing House) processing is read only and an independent review is completed after payments are submitted. User access should be limited to information technology through authorization such as providing a unique user identification or token to authorized users.

Condition: Payments were made to vendors by paper check or ACH. The ACH process required the Finance Department Accounting Technician to generate reports and make edits in JD Edwards followed by an

upload of the payments for processing by the financial institution. The JD Edwards file used for uploading, which includes the amount of payment and the vendor's bank account number and routing number, was exported to a document that was not in a 'read only' format and could be edited before submitting to the financial institution for processing.

Following the aforementioned ACH payment process, there was no additional review of JD Edward files to the ACH report submitted to the financial institution to ensure the vendor's bank account information was accurately exported to the financial institution.

A token code is required to log into the City's bank account to upload ACH payments. The token code was assigned to an employee but was shared by Finance Department, Accounts Payable personnel.

Cause: ACH processing for payments is becoming more prevalent amongst vendors. The process was recently implemented by the City and is ever evolving, but departmental instructions in place had not been updated to mitigate risks and no formal departmental policies were developed.

Effect: There is a risk of payment and/or bank account information being altered during ACH payment processing with the inability to determine the employee that completed the ACH data upload to the financial institution.

Recommendation

1. Procedures in the Finance Department should be implemented to require an independent review of ACH payments after the information is uploaded and sent to the financial institution for payment.
2. Personnel in the Finance Department, Accounts Payable Division should each have a unique token code for the financial institution when processing ACH payments.

Management's Response

1. We concur. Management is in full agreement with the recommendation.
A process is currently in place for independent review and matching of printed checks to system generated reports and source documents prior to mailing. The ACH payment review will be an addition to this process in order to comply with and improve internal control.
2. We concur. Management is in full agreement with the recommendation.
Additional tokens have been ordered and employees will be assigned a unique token for creating unique authentication credentials. System access will be granted based on assigned roles.

Responsible Party: 1) Christine Pressley, AP Supervisor 2) Jay Toland, CFO

Implementation Date: March 1, 2021

CONCLUSION

Internal Audit has concluded work on the audit of accounts payable timeliness. Based upon test work performed, Internal Audit concludes:

1. Defining timely payment as 30 days or less from invoice date, only 43% of the invoices sampled were paid within 30 days or less from the invoice date. Key performance indicators (KPI) defining timely payment of invoices should be established. Process streamlining of accounts payable could improve the timeliness of vendor payments.
2. Internal controls over the ACH process should be evaluated and updated, to include adequate review of ACH payments once files have been submitted to the financial institution for payment.

Internal Audit identified additional areas creating risks for the City of Fayetteville. These were not part of the conducted audit but will need to be addressed as the City migrates to the Oracle Cloud ERP to ensure highly effective implementation and efficient use of the new finance system:

1. Timely record transactions ensuring general ledger dates are accurate. Transactions should be timely and accurately recorded to maintain the relevance and value for financial analysis and management decisions.

Although the management responses are included in the audit report, Internal Audit does not take responsibility for the sufficiency of these responses or the effective implementation of any corrective actions.

Internal Audit would like to thank Department personnel for their assistance and numerous courtesies extended during the completion of this audit.

Distribution:

Audit Committee

Douglas J. Hewett, City Manager

Telly Whitfield, Ph.D., Assistant City Manager

Jay Toland, Chief Financial Officer