



DISTRIBUTION DATE: 4/3/12

MEMORANDUM

TO: HONORABLE MAYOR &
CITY COUNCIL

FROM: Scott P. Johnson
Assistant City Administrator

SUBJECT: City Administration's Clarification
To Accounts Payable Audit Response

DATE: April 3, 2012

City Administrator
Approval

Deanna Johnson

Date

4/3/12

INFORMATION

The City Auditor recently released a Performance Audit called: "Accounts Payable and Duplicative Payments and Other Reportable Matters, FY 2008-09 and 2009-10." The purpose of this Information Memo is to provide clarity to the City Administration's response and correct some of the erroneous information and misleading findings presented in the audit and in a subsequent television news report.

First, it is important to note that the City Administration takes its fiduciary responsibilities very seriously, especially the safeguarding of City assets. To that end, it is very important that the City make payments to City vendors and contractors accurately and timely. We agree with the Auditor that effective administration of payments requires vigilant monitoring by the City Administration, and we are confident that our systems and internal controls are working effectively and as intended.

Second, it is important to acknowledge deficiencies that are identified during any audit and to make a firm commitment to corrective action. This Administration has recently demonstrated its willingness to identify and address any deficiencies—in processes, internal controls or policies—in a transparent and public manner, and when problems or shortcomings are identified, the Administration is committed to taking immediate corrective action.

The City Administration welcomes performance audits conducted in a fair and impartial manner. According to Government Auditing Standards (GAS) issued by the Comptroller of the United States, Report Quality Elements A7.02b, the audit report should be objective, *which "means that the presentation of the report is balanced in content and tone. A report's credibility is significantly enhanced when it presents evidence in an unbiased manner and in the proper context. This means presenting the audit results impartially and fairly. The tone of reports may encourage decision makers to act on the auditors' findings and recommendations. This balanced tone can be achieved when reports present sufficient, appropriate evidence to support conclusions while refraining from using adjectives or adverbs that characterize evidence in a*

way that implies criticism or unsupported conclusions.” In this case we are concerned that despite several meetings with the City Auditor’s staff to clarify points of fact, the audit results present an over-exaggerated and over-emphasized deficiency performance which is grossly misleading.

Using Auditor’s Criteria, City was 99.9988% compliant, Not 25% deficient

Our overall concern stems from the Auditor’s characterization of a 25% error rate based on the use of a “judgmental sample” of 63 invoices. This “judgmental sample” was not a random sample, but a subjective sample that resulted after an extensive computer modeling using the total payments processed of 142,140 during the audit period of Fiscal years 2008-09 and 2009-10. As outlined on page four of the audit report, the auditor narrowed down the number of potential duplicate payments from 142,140 to 63 possible, based on the results of the pre-defined parameters used in the Auditor’s computer model. In other words, by using a software program to detect potential duplicate payments, the audit found 16 payments characterized in the audit as “duplicate or overpayments” out of 142,140 invoices processed during the two-year audit period, resulting in a potential deficiency of approximately 0.0012 percent, as opposed to 25% indicated in the audit. In other words, of the 142,140 invoices processed over the two-year audit period representing approximately \$1.3 billion of payments, **99.9988% were considered compliant**, using the Auditor’s criteria.

Regarding the reported 16 duplicate or overpayments, internal controls and mechanisms which were already in place allowed the payments to be reconciled or recovered, so **there was no monetary loss on the part of the City**. Due to these existing administrative internal controls, with the exception of two duplicate invoices, **these payments were identified and reconciled prior to the audit**, as shown in the attached spreadsheet, as Exhibit A (see column titled, “Refund/Credit Date” and compare to “Audit Notification Date”).

Out of 142,140 Payments, totaling \$1.3 Billion over a 2 Year Period, 2 were duplicate Payments.

Below is an explanation of the 16 invoices characterized in the audit as duplicate payments out of the 142,140 processed during the two-year period under audit:

- ⇒ Six invoices, representing the largest dollar value of the invoices characterized as “duplicate” payments by the auditor, for a total of \$87,500, were related to monthly contractual payments to the City’s employee benefits providers. It is important to clarify that these were not duplicate payments, but instead, in this case, the City paid the providers the amount of the previous month’s invoice to avoid discontinuation of employee benefits, and the providers then issued a credit to the City’s account; this reconciliation was done on a monthly basis. The invoicing process was subsequently resolved before the audit started and procedures were established approximately two years ago to avoid similar situations from occurring in the future.

- ⇒ Eight invoices, totaling \$15,623, are also not accurately described as duplicate payments. In each case either the vendor's or the City's internal controls identified the overpayments and accounts were properly credited in a timely fashion. These were payments made in error related to utility bills, shipping expenses, and supplies in which refunds or credits were issued several months before the audit.
- ⇒ Two invoices were duplicate payments. The audit did reveal two instances of duplicate invoice payments for \$210 each in which the State of California Department of Industrial Relations invoiced the City twice for the same service using different invoice numbers. This error was identified in the audit and has since been reconciled.

Therefore, the total number of duplicate payments was two out of 142,140; and out of \$1.3 billion in payments, the total dollar value of actual duplicate payments was \$420, not \$103,553 as erroneously asserted in the audit.

Recent News Media Characterized 4,000 payments as "Suspect" payments

It should also be emphasized that this audit period covered two years of payments, representing approximately 142,140 invoices. To identify **potential** erroneous and duplicate payments, the audit ran a software program on the 142,140 invoices which identified approximately 4,000 matching payment sets with the same vendor name, invoice amount, and invoice date. These were characterized as "suspect" payments.

It should be noted that it is not unusual, nor is it improper, for a vendor to accurately invoice the City for providing the same service for the same price on the same day at different locations using different invoice numbers. For example, as shown on the attached screenshot, as Exhibit B, from the Oracle financial system, on June 23, 2010, Oaks Environmental Testing conducted soil sampling at three different locations and charged the City \$550 per soil sample on separate invoices. This payment was properly paid and appropriately tracked in our accounts payable system. It is therefore misleading to state that there were 4,000 suspect payments as represented by the Auditor to the news media.

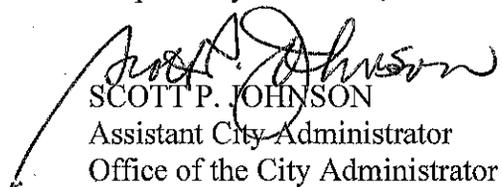
The City Administration is Accountable for any Errors and Committed to take Corrective Action

The City Administration is committed to correcting any errors found immediately, as it has done in each of these cases. It is worth noting that the City's annual financial statement audits conducted by the external auditors do not show any adverse findings in major areas, including accounts payable processing. The Administration's response highlighted a number of controls, policies, and procedures that are followed in the City's payment process.

The time frame of the audit goes back four years, reducing the relevance and timeliness of the findings since they do not accurately reflect current conditions. The City has initiated and implemented several automated controls and system enhancements, including the Procure-to-Pay system. We are also exploring an electronic invoicing system which would have additional controls built in to the system that would prevent duplicate payments and/or unauthorized purchases. We have also included measures in our internal procedures that will prevent duplicate payments.

Once again, the City Administration is committed to a transparent process of evaluating our systems, policies, and procedures, and remains committed to taking immediate corrective action whenever warranted.

Respectfully submitted,


SCOTT P. JOHNSON
Assistant City Administrator
Office of the City Administrator

For questions please contact Osborn Solitei, Controller, at 238-3809.

Attachments:

- Exhibit A. Summary of Duplicate Payments per City Auditor's Report
- Exhibit B. Oracle Screen Shot: Oaks Environmental Testing Invoices

Summary of Duplicate Payments per City Auditor's Report

FY08-09 & FY09-10

Item	Vendor Name	Description/Classification	Amount	Requesting Dept.	Refund/Credit Date	Audit Notification Date
A: Vendor Refunded/Credited funds before the audit started:						
1	Federal Express	Shipper	40.58	DIT	1/18/2010	30-Jul-10
2	Give Something Back	Office Supplies	365.56	DIT	3/10/2010	30-Jul-10
3	AT & T	Telecommunications Provider	2,530.04	DIT	11/1/2008	30-Jul-10
4	Federal Express	Shipper	9.18	DHRM	4/29/2010	30-Jul-10
5	J.C. Nelson Supply	Janitorial Supplier	317.59	FMA	5/19/2010	30-Jul-10
6	J.C. Nelson Supply	Janitorial Supplier	474.12	FMA	11/25/2009	30-Jul-10
7	Nella Oil Company	Fuel Supplier	10,996.84	PWA	12/23/2009	30-Jul-10
8	Patricia Hirota Cohen	Fitness Instructor	900.00	DHRM	2/25/2009	30-Jul-10
		Sub-Total	15,623.91			
B: Vendor - Benefit Plans (Payment applied to next month benefits)						
9	Vision Service Plan	Health Benefits Administrator	548.70	DHRM	1-Jul-10	30-Jul-10
10	Vision Service Plan	Health Benefits Administrator	1,184.21	DHRM	1-May-10	30-Jul-10
11	Vision Service Plan	Health Benefits Administrator	27,721.26	DHRM	1-May-10	30-Jul-10
12	Vision Service Plan	Health Benefits Administrator	3,874.38	DHRM	1-Jun-10	30-Jul-10
13	DeltaCare USA	Health Benefits Administrator	10,852.50	DHRM	10/1/2008	30-Jul-10
14	Vision Service Plan	Health Benefits Administrator	43,328.71	DHRM	8/1/2009	30-Jul-10
		Sub-Total	87,509.76			
C: Vendor Refunded/Credited funds after the audit started:						
15	Dept of Industrial Relation	Elevator Inspector	210.00	Library	2/22/2011	30-Jul-10
16	Dept of Industrial Relation	Elevator Inspector	210.00	Library	2/22/2011	30-Jul-10
		Sub-Total	420.00			
		Total	\$103,553.67			

EXHIBIT A

Type	Supplier	Supplier Num	Invoice Date	Invoice Num	Invoice Amount	Description
Standard	OAKS ENVIRONMENTAL TESTING	88628	23-JUN-2010	1697	550.00	H88E210-10(AF)1801 92ND AVE
Standard	OAKS ENVIRONMENTAL TESTING	88628	23-JUN-2010	1700	550.00	H88E210-10(AF)2127 73RD AVE
Standard	OAKS ENVIRONMENTAL TESTING	88628	23-JUN-2010	1699	550.00	H88E210-10(AF)1727 73RD AVE
Standard	OAKS ENVIRONMENTAL TESTING	88628	23-JUN-2010	1698	550.00	H88E210-10(AF)1801 103RD AVE

1 General		2 Holds		3 View Payments		4 Scheduled Payments		5 Mixed Payments and Approvals	
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Amount Paid		Invoice Status		Approval Status	
USD	550.00	Status	Validated	Approval	Not Required
		Accrued	Yes	Pending Approval	

Summary	
Holds	0
Distribution Total	550.00

Description: H88E210-10(AF)2127 73RD AVE

Buttons: Overview, Distributions

EXHIBIT B