



JACKSON COUNTY

Oregon

Internal Audit Report

**Audit of Expenditures
2010-11**

June 2011

**Presented To The
Jackson County Board of Commissioners
By The
Internal Audit Program**

Audit Team

**Debbie Taylor, County Auditor
Tanya Baize, Senior Auditor
Yongwen Huang, Audit Intern**



**JACKSON
COUNTY**
Oregon

MEMO
INTER - OFFICE

Internal Audit

Debbie Taylor, County Auditor
CIA, CGAP, CGFM, CFE

10 S. Oakdale, Room 214
Medford, OR 97501
Phone: 541 774 8021
Fax: 541 774 6705
TaylorDK@jacksoncounty.org

To: Board of Commissioners
From: Debbie Taylor, County Auditor
Subject: 2010-11 Expenditure Testing
Date: June 16, 2011

The attached audit report provides information regarding an audit of County expenditures. The audit was included in the fiscal year 2010-11 Internal Audit Plan as part of the work performed annually in support of the County's external audit and ongoing internal control and risk assessment work.

Audit results have been discussed with Finance Director Shannon Bell, and her response is included at the end of the report. The results were also shared with the County's Audit Committee.

The Internal Audit Office appreciates the cooperation and assistance it received from County staff throughout the audit process.

Cc: Audit Committee
Kenneth Kuhns, & Co. Certified Public Accountants

**Jackson County
Audit of Expenditures
2010-11**

Audit Authority

We conducted the audit in accordance with Codified Ordinance 218 pertaining to the County Auditor. The audit was included in the 2010-11 Internal Audit Plan as part of the work we perform annually in support of the County's external audit and ongoing internal control and risk assessment work.

Audit Background

As of May 5, 2011, Jackson County had expenditures exceeding \$103,116,000 in fiscal year 2010-11 (not including personal services).

Some of the risks associated with expenditures include:

- Purchase of unauthorized items;
 - Overpayment;
 - Improper expense coding;
 - Non compliance with LCRB rules; and
 - Fictitious vendors.
-

Audit Objectives

The objectives of our audit were to:

- Determine if internal controls were reasonably adequate to ensure compliance with the following criteria:
 - Proper authorization;
 - Payment amount agrees with cover sheet documentation;
 - Paid from original invoice;
 - Charged to correct fiscal year;
 - Charged to proper business unit and account;
 - Payee agrees with documentation; and
 - Adherence to Local Contract Review Board Rules.
 - Determine if there is evidence of fictitious vendors in the County's financial system address book.
-

**Audit Scope &
Methodology**

All transaction over \$100,000 with a General Ledger date between July 1, 2010 and November 26, 2010 were reviewed for a total of 45 items. In addition, 25 items with amounts under \$100,000 were judgmentally selected from various

departments for review. We tested transactions totaling \$16,308,349, or 16% of the non-personal services expenditures between July 1, 2010 and May 5, 2011. We also reviewed information for vendor address numbers greater than 160000 as of April 5, 2011 with Post Office box addresses for evidence of fictitious vendors.

Our audit procedures included verifying:

- Required approvals were obtained prior to purchase;
- Dollar amount on the payment request cover sheet agreed with check payment amount;
- Payment made from original invoice;
- Expenditure coded to correct fiscal year;
- Expenditure coded to appropriate business unit and account number;
- Payee agreed with documentation;
- Compliance with Local Contract Review Board Rules; and
- Reviewing vendor information.

Audit Criteria

Criteria represent the laws, regulations, contracts, grant agreements, standards, measures, expected performance, defined business practices and benchmarks against which performance is compared or evaluated. Criteria identify the required or desired state or expectation with respect to the program or operation. Criteria for our audit consisted of County Purchasing Policy 4-03, Local Contract Review Board Rules, and standard, commonly recognized expenditure tests developed by the **County's external auditors**.

Internal Controls

We gained an understanding of the internal control system by reviewing Local Contract Review Board Rules, and the **County's Purchasing Policy 4-03**. We also discussed internal controls with Accounts Payable staff. Internal controls relate to **an organization's system of controls that are designed to provide reasonable assurance of achieving effective and efficient operations, reliable financial and performance reporting, or compliance with applicable laws and regulations.**

Compliance with Government Auditing Standards

We conducted this performance audit in accordance with generally accepted government auditing standards. These 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 our evidence provides a reasonable basis for our findings and conclusions based on our audit objectives.

Privileged and Confidential Information

No information was withheld from this report because it was considered privileged or confidential.

Audit Results

Proper Authorization

All items tested had appropriate approvals; however, 13 out of 70 items tested did not clearly show the appropriate authorization documentation on the payment request cover sheet. Of these, ten were recurring monthly payments for employee

benefits, and three were electronic payments to a contractor. In addition, two payment request cover sheets were signed with initials rather than a full signature.

The County's Purchasing Policy states that payments for goods up to and including \$20,000 can be approved by a Department Director or authorized designee. Payments for goods up to and including \$100,000 must be approved by a Department Director or designee, and the County Administrator or designee. Payments for goods over \$100,000 must be approved by the Department Director or designee, County Administrator or designee, and two County Commissioners.

If an item is purchased on a purchase order, appropriate approvals are obtained electronically before the order is placed, and the approved purchase order can be used as authorization for payment. If the Board of Commissioners has approved a purchase by board order, the signed board order can be used as authorization for payment. A contract signed by the County Administrator can also be used as authorization for payment.

Each department is responsible for entering vouchers, obtaining appropriate department approval, and submitting documentation to the County's Finance Department. Finance does all posting in the accounts payable system, and is responsible for the processing of all payments.

Each department batches vouchers to be paid into groups, and prints out a cover sheet, which shows a supplier name and number, invoice number, gross amount, due date, etc. for each voucher. The E-1 financial system Purchasing & Accounts Payable Process manual states that the board order number, purchase order **number, or "per contract" is to be written next to the** voucher on the cover sheet so that Finance can readily see that the appropriate approvals have been obtained. Vouchers that have not been previously approved by purchase order, board order, or signed contract, must show appropriate approval signatures on the cover sheet. We identified thirteen items that did not show the board order number, purchase order number, **or "per contract"** on the cover sheet, although all items had been appropriately approved:

- Ten recurring, monthly payments for employee benefits did not clearly show proper authorization on the cover sheet. The payments were all for over \$100,000, but the cover sheet was signed by the Payroll Supervisor, who is authorized to sign for payments up to \$20,000. There is a payroll authorization form for each pay period signed by the Finance Director, County Administrator, and two Commissioners authorizing payment of payroll and related benefits. These forms are filed in the Payroll **Supervisor's office.** The Payroll Supervisor recently proposed updating this procedure to allow a single board order to be obtained that would require only one signature on the monthly payroll authorization form. **The County's External Auditor has reviewed and approved this change in** procedures.
- Four electronic payments to Library Systems & Services Inc. (LSSI) were tested. All the payments were for over \$100,000, with the Cover Sheet signed by the Sr. Deputy County Administrator who is authorized to sign for payments up to \$100,000. The cover sheet for one of the transactions had an Electronic Payment Request form attached, which showed the board order authorizing the payment. The payments for September, October, and November 2010 did not show the board order number. A new Library Administration Program Manager was hired in February 2011,

and all payments to LSSI after March 2011 show the board order number on the cover sheet.

- In addition, two cover sheets were noted that were authorized with initials rather than a signature. The Accounts Payable Clerk has contacted the Director in question and requested that he sign cover sheets with a full signature.

Payment Amount Agrees with Cover Sheet

The dollar amount on the cover sheet agreed to the payment amount for all items tested.

The check payment amount should agree with the amount on the cover sheet. This is to ensure that the amount paid was correct. The check payment amount agreed to the cover sheet for all items tested.

Payment Coded to Correct Fiscal Year

All items tested were coded to the correct fiscal year.

The County's Year-End Closing Procedures memo explains that goods or services received prior to July 1, 2010 need to be charged to fiscal year 2009-10. Goods or services received after July 30, 2010 need to be charged to fiscal year 2010-11. Two payments to an engineer that were tested indicated that services were for the period of June 27, 2010 to July 31, 2010 which would have required the payments to be split between fiscal years. However, the invoices were not received until August 2010, which was after the July 30 cut off for charging to the 2009-10 fiscal year. In addition, only 4 of the 35 days in the invoice period were in the prior fiscal year, and prorating would have resulted in \$1,029 and \$834 charged to 2009-10, which is an immaterial amount.

Payment Made from Original Invoice

One of the 70 items tested was paid from a photo copied invoice, as the original had been lost.

The E-1 Purchasing & Accounts Payable Process manual states that original invoices must be attached to the cover sheet for each voucher in the batch. This is to prevent duplicate or fraudulent payments made from copies. One sign that an invoice may be fraudulent is the absence of a crease, indicating that the invoice was not folded to fit into an envelope.

A payment by the Sheriff's Office for ammunition was paid on a photo copied invoice, as the original was lost in the mail. A notation to this effect was written on the invoice. In addition, four invoices for employee benefits were noted that did not have creases; however, the invoices were either received via email, or were mailed in a flat envelope that did not require folding.

None of these payments were found to be duplicates or fraudulent. The Accounts Payable Clerk indicated that it is not very often that she pays from a copy, but when she does, she documents why the original invoice was not available.

Expenditure coded to appropriate business unit and account number

One item tested could have been coded to a more appropriate account number.

All expenses should be coded to an appropriate business unit and account number. This helps management to control expenditures, and aids the department in the budgeting process. A purchase of diesel fuel by Fleet Services was found in the Equipment Parts account that should have been in the Diesel account. Both accounts are under Materials & Services, so the account category is correct. A correction has been processed.

Note: this item was not one of the original 70 selected for review, but was found as a result of expanded testing procedures related to the Compliance with Local Contract Review Board Rules testing step below.

Payee agreed with documentation

The payee agreed to documentation for all items tested.

The payee on the check should agree to the payee on the payment documentation submitted to Finance. This is to ensure the correct entity is paid. The payee for all items tested agreed with the documentation.

Compliance with Local Contract Review Board Rules

The sole source exception from competitive bidding requirements was not properly approved by the Public Contracting Officer for one item tested. In addition, competitive quotes were obtained, but documentation could not be provided for two other transactions tested.

Local Contract Review Board Rules (LCRB) were promulgated to establish a procedure to assure that each contract to which the county is a party has met state and county competitive bidding and other purchasing requirements. The LCRB rules also include exceptions when competitive bidding is not required. One of the exceptions is when there is only one seller of a product of the quality required within a reasonable purchase area. In these sole source situations, the LCRB rules state that the Public Contracting Officer shall determine in writing that the goods or services are available from only one source. The LCRB rules also state that the Public Contracting Officer is the County Administrator and his or her designee.

One of the items tested was the outfitting of an emergency vehicle for the Sheriff's Office. The Sheriff's Office makes the arrangements to have the vehicle outfitted, and Motor Pool pays the bill as part of their rental agreement to provide outfitted vehicles. The vendor in question is the only police vehicle outfitter in Oregon, and the County has been using the vendor as a sole source supplier for several years; however, it does not appear that the County Administrator has approved a sole source exception. Some of the departments may have been under the impression that sole source determinations could be made at the department level, but this is not the case. There is potential for sole source exceptions from competitive bidding to be abused if not properly reviewed and approved.

LCRB Rules also state that contracts which exceed \$5,000 but do not exceed \$150,000 for the purchase of goods or services, do not require competitive bids as long as the department seeks at least three informally solicited competitive price quotes or competitive proposals from prospective contractors (See LCRB Rules

Section 6.a (25)b for additional requirements). The department shall keep a written record of the sources of the quotes or proposals received.

One item tested was the purchase of ammunition **by the Sheriff's Office**. The purchase totaled \$15,600 and should have had competitive quote documentation. The Sergeant making the purchase called two suppliers, and purchased the ammunition from the supplier with the lowest price that also had the items in stock, but did not retain quote documentation. The Sergeant noted he would be sure to retain competitive quote documentation in the future.

Another item tested was the purchase of tires by the Fleet Services Program. The purchase totaled \$5,134.94 and therefore required competitive price quotes. The Fleet Management Superintendent is confident that price quotes were obtained for this purchase, but the documentation is missing. We therefore expanded testing procedures and selected three additional transactions through Fleet Services or Motor Pool that should have had competitive quote documentation. Appropriate documentation was provided for all three transactions.

Vendor Information

No evidence of fictitious vendors was noted in the vendor address book for vendors with numbers greater than 160000 as of April 2011.

Reviews of vendor information can sometimes reveal fraud scams including **fictitious "shell entities" set up by employees or others that may or may not provide goods or services**. In this scheme, an employee creates a false entity – a shell- to become middleman or broker who supplies goods and services to the original **business but includes a healthy price "mark-up" on the invoice**. The fraudster also may use the shell to submit invoices for goods and services that are never delivered or rendered. Often, the shell is nothing more than a fabricated name and a post office box or mail drop.¹

We reviewed the number of payments, and the total value of payments to new vendors (those with an address number of 160000 or higher as of 4/5/2011), between 7/1/2010 and 4/5/2011. Most of the payments were property tax refunds. No evidence of fictitious vendors was noted.

Recommendations

Finance Director

1. To improve compliance with the E-1 Financial System Purchasing & Accounts Payable Process manual, cover sheets for employee benefit payments should note the board order number and include a copy of the signed payroll authorization form.
2. To ensure an adequate system of checks and balances, the Payroll Authorization Form should itemize the payroll and benefits paid, and list the monthly or bi-monthly amount budgeted for each item. The Finance Director should periodically review the signed authorization forms.

¹ From Craig L. Greene article, Audit Those Vendors, The White Paper May/June 2001 (The Association of Certified Fraud Examiner's Journal)

3. To clarify procedures for purchasing an item exempt from competitive bidding under sole source, the Finance Director should annually remind departments that all sole source determinations are to be approved by the County Administrator or his designee.
4. To improve compliance with LCRB Rules, the Finance Director should remind departments to maintain documentation of competitive quotes obtained.

Management Response

Per email on file in the Internal Audit Office, the Finance Director agrees to:

- Note the board order number on employee benefit payment cover sheets, and attach a copy of the signed payroll authorization form.
- Show the breakdown of the benefit payments on the payroll authorization form.
- Annually remind departments that sole source determinations need to be approved by the County Administrator.
- Remind departments to maintain documentation of competitive quotes obtained.

The Finance Director does not feel comparing the monthly or bimonthly payroll benefits paid to budgeted amounts would be beneficial, as seasonal changes would make setting a tolerable variance difficult, and notes that the departments are held accountable for monitoring their personal service budgets.