

AUDITOR GENERAL'S REPORT

**City Accounts Payable
Payment Controls and Monitoring Require
Improvement**

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EXECUTIVE SUMMARY

***Review of City
Accounts Payable
included in 2012
Work Plan***

The Auditor General's 2012 Work Plan included a review of the management and administration of City accounts payable. The objective of our review was to assess controls over the creation of vendor accounts, vendor payments and other related processes within the City Accounting Services Division and Purchasing and Materials Management Division.

***Review focused on
controls over
approximately
\$3.2 billion in
accounts payable***

In 2011, the City processed over 500,000 invoices amounting to \$3.2 billion. Over the past number of years external consultants have been retained by the City to review the processes relating to the administration of sales taxes on a contingency fee basis. In conjunction with these reviews, the consultants were retained to review the City's vendor payment process with an emphasis on identifying any duplicate vendor payments. The review indicated that the controls relating to the vendor payment process were adequate as no material duplicate payments were identified.

Our review focused on assessing controls over the administration and maintenance of vendor accounts. We reviewed controls used to ensure vendor payments are made accurately, efficiently and in a timely manner.

***Previous Auditor
General reports
related to City-wide
purchases***

Although our objective was focused on reviewing accounts payable, issues identified in this report relate to potential cost savings available through consolidating City-wide purchases and other similar purchasing related recommendations. Consolidation of City-wide purchases has also been reported in the following previous Auditor General Reports.

“Employee Benefits Review”

In the Auditor General's 2007 report entitled “Employee Benefits Review”, we included the following recommendation:

“The Director, Pension, Payroll and Employee Benefits, in consultation with senior management representatives of the City's Agencies, Boards and Commissions, review and consider the cost-effectiveness of expanding the current City of Toronto benefits umbrella to include other City of Toronto Agencies, Boards and Commissions.”

In May 2011, City staff reported that the City partnered with the Toronto Police Services Board and the Toronto Transit Commission for the first time in the issuance of a joint RFP for employee benefit plan administration and underwriting services.

Consolidated purchase of Employee Benefits resulted in savings of \$54.1 million over five years

In the new five-year contract (2012-2016) with Manulife Financial, the City, Police Services Board, and Toronto Transit Commission will realize an estimated combined savings of \$54.1 million over five years, averaging \$10.8 million savings per year.

“Toronto Community Housing Corporation - Procurement Policies and Procedures Are Not Being Followed”

Consolidated purchasing in TCHC projected to save \$10 million annually

In our 2010 audit entitled *“Toronto Community Housing Corporation - Procurement Policies and Procedures Are Not Being Followed”* the audit report included similar purchasing related recommendations. Savings from the implementation of these recommendations is estimated to be approximately \$10 million annually.

“Toronto Water Division – Review of City Wastewater Treatment Program”

Consolidated purchasing in Toronto Water resulted in annual recurring savings of \$550,000

In our 2007 report entitled *“Toronto Water – Review of City Wastewater Treatment Program”* we recommended Toronto Water and the Purchasing and Materials Management Division consolidate the purchase of common goods and expand the use of blanket contracts.

Implementation of this recommendation has since resulted in \$550,000 in actual annual recurring savings.

We believe significant cost savings are still possible through consolidation of purchases City-wide.

Key Issues

This report identifies areas where the management and administration of accounts payable, vendor account maintenance and purchasing policies and practices can be strengthened.

(1) Vendor Payments and Account Administration

Loss of Vendor Payment Discounts

Delays in processing vendor invoices resulted in approximately \$450,000 in lost vendor discounts during 2011 and 2012

Vendors provide discounts if payments for goods and services are made within 30 days. The total value of discounts taken by the City is over \$900,000 a year.

However, if payments are not processed within 30 days, discount amounts are lost. In the two year period between 2011 and 2012, delays in processing payments resulted in approximately \$450,000 in lost vendor discounts.

Delays were a result of a lack of timely divisional responses to invoices being “parked” for authorization or problem resolution. Our report provides recommendations for strengthening controls to minimize losses due to delays in payments.

Vendor Credits Require Timely Adjustments

Credits in the amount of \$620,000 were not adjusted timely and remain outstanding

Credits offered by vendors of approximately \$620,000 were not adjusted on a timely basis. Approximately \$500,000 in vendor credits had the potential of not being realized at the time of our review. According to management, these credits are currently under review and it is expected that the majority of the credits will be realized.

Vendor Set-up and Maintenance

Vendor accounts created with incomplete information

The process of establishing new vendor accounts needs improvement. Vendor accounts are created with incomplete information. Information such as address and contact information and vendor HST registration numbers are sometimes left incomplete when establishing new vendor accounts. Incomplete vendor account information can result in invoice processing delays and loss of City HST refund claims.

Payment Controls and Monitoring Reports

Reports have been developed to review and control overpayment to vendors. The exception criteria for some of these reports should be revised to make them more useful.

(2) Purchasing Policies and Procedures

Cost Savings by Consolidating Purchase Contracts

City divisions made \$50 million worth of purchases through individual divisional purchase orders in 2011. While there were a number of divisional purchases made to unique vendors across commodity groups, we noted some separate purchases made by divisions using the same vendor and same commodity group. Potential savings through consolidating divisional purchases could be realized through competitive pricing and volume discounts.

Savings could be realized by consolidating individual purchases

We understand that the Purchasing and Materials Management Division has been working with City divisions to increase the use of consolidated purchases. Some City divisions and agencies and corporations have experienced savings of 15 per cent when consolidating purchases. A 15 per cent volume discount on 50 per cent of total purchases could potentially result in savings of \$3.7 million.

Significant additional savings can be realized through consolidating purchases City-wide including City Agencies and Corporations.

Policies and Procedures require PO or CRO prior to ordering goods and services

Non-Compliance with Purchasing Policies and Procedures

Purchasing policies and procedures require that a purchase order (PO) or a contract release order (CRO) be issued before ordering a product or service.

The issuance of a divisional purchase order or contract release order before ordering goods and services assists in controlling the product quality, quantity and services delivered as well as vendor payments.

Goods and Services are ordered before issuing a PO or CRO

Our review of related purchasing reports indicates that a significant number of purchases do not comply with City purchasing policies and procedures related to timely submission of purchase orders and contract release orders. We noted many instances where goods and services are ordered by divisions before issuing a purchase order or contract release order.

Lack of Conflict of Interest Declaration in Sole Source Contracts

A conflict of interest declaration requires a supplier to declare any conflict of interest when entering into a City contract.

Examples of potential conflicts of interest may include relationships with City representatives, employees or family relationships that have the potential to impair the independence and objectivity of an “arms length” relationship between the vendor and the City. The conflict of interest declaration is an important control in purchasing practices.

Sole source contracts were issued without a Conflict of Interest Declaration

All sole source contracts we reviewed were issued without a conflict of interest declaration.

As of September 2012, there were a total of 96 active City sole source contracts with total value of over \$19 million.

Implementation of the 12 recommendations contained in this report will improve controls over the administration and management of City vendor payments, recordkeeping and ensure compliance with City Purchasing Policies and Procedures.

In addition, the Auditor General has also issued a separate letter to management detailing other less significant issues that came to our attention during the audit. These issues are related to reducing cheque processing costs, improving vendor account maintenance and updating certain policies and procedures.

BACKGROUND

City processes over \$3.2 billion in vendor payments annually

The City has over 70,000 active vendors in the SAP vendor master database. In 2011, the Accounts Payable Unit processed over 500,000 invoices valued at approximately \$3.2 billion.

The Accounts Payable Unit of the Accounting Services Division is responsible for processing payments initiated by City divisions accurately and on time ensuring compliance with related purchasing and financial by-laws. The Unit is also responsible for developing, implementing and managing corporate accounts payable policies and procedures.

The City uses SAP as its primary financial system and all vendor payments are processed through this system.

AUDIT OBJECTIVES, SCOPE AND METHODOLOGY

Why we conducted this review

The Auditor General's 2012 Audit Work Plan included a review of vendor payments and related processes.

This review was selected due to the significant amount of funds involved and the importance of timely and accurate processing of vendor payments.

Audit objectives and scope

The objective of our review was to assess controls over the administration and management of vendor accounts, vendor payments and related processes.

The audit covered the period from January 2011 to September 2012.

***Audit
Methodology***

Our audit methodology included:

- Review of vendor creation and maintenance processes
- Review of vendor invoice payments and related processes
- Review of related purchasing practices and procedures
- Interviews with Accounting Services Division and Purchasing and Materials Management Division staff
- Review of vendor invoices and related documents and records
- Review of vendor set-up forms and approvals
- Review of SAP access controls in selected divisions
- Review of the results of recent external and internal audits performed in accounts payable
- Other procedures as deemed appropriate.

***Audit conducted in
accordance with
generally accepted
government
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.

AUDIT RESULTS

This review focused on internal controls related to vendor account maintenance, payments and related processes. In addition, we also reviewed certain related purchasing policies and practices. Findings and recommendations noted during our review are described below.

A. VENDOR PAYMENTS AND ACCOUNTS

A.1. Vendor Invoice Discount Losses Can Be Minimized

The City loses over \$200,000 annually by not taking advantage of vendor discounts. In most cases vendors provide discounts if payments for goods and services are made within 30 days.

In 2011 the City was unable to take advantage of \$220,000 and based on nine months in 2012 the City will lose approximately \$231,000 due to delays in processing vendor payments.

Delays in processing vendor invoices resulted in approximately \$450,000 in lost discounts during 2011 and 2012

The cause of these payment delays is a lack of timely resolution of outstanding queries by City divisions.

Outstanding payments requiring divisional follow-up or clarification are assigned a “parked” status. After “parked” queries are resolved by respective divisions these invoices are cleared for payment. Payment delays ranged from 30 days to over 180 days.

50% of payment delays relate to Facilities Management Division

Approximately 50 per cent of the discounts missed are related to queries directed to the Facilities Management Division. A delay in the resolution of “parked” documents results in delayed payments leading to lost discounts.

Discount Missed Report provided to management after the discount period expires

The Accounts Payable Unit provides a quarterly Discount Missed Report to financial leads and division heads.

Reports should be provided prior to the expiration of the discount period and include the amount of potential discount losses for those invoices “parked”. Reporting should be more proactive and directed to a senior management official accountable for timely follow-up on pending invoices prior to the discount expiry date.

Recommendations:

- 1. City Council request the Director, Accounting Services to evaluate the feasibility of providing a report to divisions identifying potential discount losses due to a lack of timely resolution of outstanding divisional queries prior to discount expiry dates.**

In addition, Accounting Services should provide accumulated discount lost reports by division to senior management staff on a periodic basis for follow-up action.

- 2. City Council request the City Manager to issue instructions to City division heads for timely resolution of outstanding accounts payable queries.**
- 3. City Council request the Chief Corporate Officer to develop a process to ensure outstanding accounts payable queries are promptly resolved in order to obtain vendor discounts.**

A. 2 Outstanding Vendor Credits Require Timely Adjustments

Occasionally vendors agree to provide credits to the City from the total value of goods and services purchased or contracted. These situations usually involve a return or adjustment on unused goods and services.

The maximum benefit is obtained from these credits when they are reviewed and processed in a timely manner. If reviewed in a timely manner adjustments can be made to vendor payments.

Credit balances totaling \$620,000 were not adjusted in a timely manner

Our review indicates that credit balances totaling \$620,000 were not adjusted in a timely manner. In some instances credits are up to two years old.

The Accounting Services Division should review vendor credits with City divisions on a timely basis. Delays in claiming vendor credits could result in losing credits due to a change in vendor status or dissolution.

Approximately \$500,000 in vendor credits had the potential of not being realized at the time of our review. According to management, these credits are currently under review and it is expected that the majority of credits will be realized.

Recommendation:

- 4. City Council request the Director, Accounting Services to ensure vendor credits are reviewed in a timely manner and follow-up action results in actual credit adjustments.**

A. 3. Vendor Set-up and Maintenance Process Requires Strengthening

The Financial Accounting Systems and Policy Unit is responsible for the administration of vendor accounts in the SAP system. Vendor accounts are created based on requests from City divisions.

Vendor payments are processed by Accounts Payable based on information captured in the SAP vendor master database. We noted the following issues related to the administration and maintenance of the SAP vendor master database.

Lack of HST numbers potentially result in delays or loss of HST refund claims

Lack of HST Information

In many instances vendor accounts did not include HST registration numbers. Missing HST numbers could result in delays or loss of City HST refund claims.

Many vendor accounts do not have complete contact information in the vendor database

Incomplete Vendor Set-up Forms

Our review identified incomplete vendor address information in the vendor master database. Many vendors included in the database do not have complete contact information in the vendor database.

Examples include vendor account information with no telephone, fax and address information. Incomplete contact information could potentially result in communication issues with the vendor.

Vendor set-up forms should be adequately reviewed before finalizing in SAP

Vendor account set-up information should receive adequate review before finalizing a vendor account in the master database and respective divisions should be contacted when account information is missing.

Recommendations:

- 5. City Council request the Director, Accounting Services to ensure that vendor set-up forms are adequately reviewed and missing information is obtained from respective divisions before finalizing in SAP.**
- 6. City Council request the Director, Accounting Services to evaluate the feasibility of completing a review of the SAP vendor master database to identify and complete missing vendor information in SAP for active vendors.**

A. 4 Monitoring Reports Need to Be Improved

Monitoring reports can be improved

Monitoring reports can be further improved to enhance operational efficiency and effectiveness. Details of suggested improvements are provided below.

- **Duplicate Vendor List Reports**

Three different reports are generated to review duplicate vendors. These reports are long and require additional sorting in order to generate value. These on-screen reports can contain anywhere from 5,000 to 30,000 entries and can be difficult to visually scan. The current exception criteria create the potential for a real anomaly or exception to not be easily identifiable in the report.

Duplicate vendor names may not be identified due to the extraordinary number of exceptions

For example, duplicate vendor names may not be identified due to the extraordinary number of exceptions identified in the report.

In order to be useful, the exception criteria used to report anomalies should be reevaluated. Fine tuning the exception criteria will improve the value of these reports to the user and create improved efficiencies and effectiveness.

The existing report criteria have the potential to omit exceptions

- **Duplicate Invoice List Report**

The Duplicate Invoice List Report identifies duplicate invoices based on vendor name, date and amount. The existing report criteria have the potential to omit exceptions for duplicates that may appear under a different invoice number or a vendor number for the same vendor.

While this report is useful, reports with additional criteria would provide improved monitoring of duplicate invoices. The following are examples of two such reports that would improve monitoring and control over duplicate invoices:

- Report on the same vendor number, invoice date and amount but different invoice number
- Report on the same vendor name, invoice date, and amount but different vendor number

Our discussions with external auditors and review of best practices identified that such reports using additional criteria, if utilized, will improve controls.

Recommendation:

7. **City Council request the Director, Accounting Services to evaluate existing vendor accounts and payment monitoring reports with regard to improving reporting efficiency and effectiveness.**

B. IMPROVEMENTS TO PURCHASING POLICIES AND PROCEDURES

B.1. Potential Cost Savings by Consolidating Individual Purchase Contracts

Opportunities to further consolidate City-wide purchases exist

The City has made some effort to consolidate purchases of similar commodity groups to obtain competitive pricing and volume discounts with vendors. There has been a reduction in the number of divisional purchase orders from approximately 56,000 in 2008 to 19,000 in 2011. However, opportunities to further consolidate City-wide purchases made through individual purchase orders by various divisions exist.

Divisional purchase activity reports for 2011 indicate that approximately \$50 million worth of purchases were made by separate divisional purchase orders using the same vendor and same commodity group. Even a partial consolidation of divisional purchases can result in significant savings.

A 15 per cent volume discount on 50 per cent of total purchases of \$50 million could result in \$3.7 million

Based on past experience, where divisions have consolidated purchases, savings of up to 15 per cent were realized. A 15 per cent volume discount on 50 per cent of total purchases of \$50 million, if consolidated, could potentially result in savings of \$3.7 million.

Previous Auditor General Report recommendations have resulted in significant cost savings through consolidation of City-wide purchases

Consolidation of City-wide purchases has also been reported in previous Auditor General reports. Implementation of recommendations from these reports has resulted in significant savings to the City and its Agencies and Corporations.

In the Auditor General's 2007 report entitled "Employee Benefits Review" we included the following recommendation:

"The Director, Pension, Payroll and Employee Benefits, in consultation with senior management representatives of the City's Agencies, Boards and Commissions, review and consider the cost-effectiveness of expanding the current City of Toronto benefits umbrella to include other City of Toronto Agencies, Boards and Commissions."

Consolidated purchase of Employee Benefits resulted in savings of \$54.1 million over five years

In the new five-year contract (2012-2016) with Manulife Financial, the City, Toronto Police Services Board, and Toronto Transit Commission will realize an estimated combined savings of \$54.1 million over five years, averaging \$10.8 million savings per year.

Consolidated purchasing in TCHC projected to save \$10 million annually

Toronto Community Housing Corporation estimates annual recurring savings of \$10 million through the consolidation of certain purchases with the City, more competitive procurement processes and the use of blanket purchase orders.

In a 2010 Auditor General report entitled "*Toronto Community Housing Corporation - Procurement Policies and Procedures Are Not Being Followed*" we recommended improved consolidation of purchases and better coordination between the City and its Agencies and Corporations.

Consolidated purchasing in Toronto Water resulted in annual recurring savings of \$550,000

In our 2007 report entitled “*Toronto Water Division – Review of City Wastewater Treatment Program*” we recommended Toronto Water and the City Purchasing and Materials Management Division coordinate and centralize purchasing of common goods and expand the use of blanket contracts. As a result of consolidating purchases and using blanket purchase orders annual recurring savings of \$550,000 were achieved.

We believe significant additional savings can be realized through consolidated City-wide purchasing including City Agencies and Corporations.

Recommendations:

- 8. City Council request the Director, Purchasing and Materials Management to further enhance divisional purchasing coordination through improved reporting and feedback with City divisions in order to facilitate consolidating purchases.**
- 9. City Council request the Director, Purchasing and Materials Management, in consultation with the management of City Agencies and Corporations, review and consider the benefits of consolidating purchases with City Agencies and Corporations.**

B.2. Lack of Compliance with Purchasing Policies and Procedures

Procedures require that a PO or CRO be issued before ordering a product or service

Purchasing policies and procedures require that a purchase order (PO) or contract release order (CRO) be issued before ordering goods and services.

A contract release order is required when the City has entered into a blanket contract arrangement with the vendor for high volume purchases.

If issued before ordering goods and services, purchase orders and contract release orders are useful in managing overall quantities purchased and vendor payments.

In 25 per cent of purchases a PO or CRO was not completed prior to ordering goods and services

Purchasing compliance reports indicate City divisions do not always comply with purchasing policies and procedures with respect to issuing purchase orders and contract release orders. In our review of two months purchasing activity, an average of 25 per cent of goods and services were ordered by divisions before issuing purchase orders and contract release orders.

Our review also indicates that purchasing compliance reports are not distributed to City divisions on a consistent basis. When provided, reports are distributed by the Accounting Services Division to City divisions for information only.

Accounting Services should provide compliance reports to City divisions and follow-up with divisions that deviate from purchasing policies.

Recommendation:

- 10. City Council request the Director, Accounting Services to ensure purchasing compliance reports are provided to respective divisions on a periodic basis and followed-up with non-compliant divisions.**

B.3. Lack of Conflict of Interest Declaration in Sole Source Contracts

Sole Source Contract Conflict of Interest Declaration

Conflict of interest declaration requires a supplier or contractor to declare conflict of interest when entering into a City contract

A conflict of interest declaration requires a vendor, supplier or contractor to declare any conflict of interest when contracting to provide the City with goods and services.

Examples of potential conflicts of interest may include relationships with City representatives, City employees or family relationships that have the potential to impair the independence and objectivity of an “arms length” relationship between the vendor and the City. The “Conflict of Interest Declaration” is an important control in purchasing practices.

As of September 2012, there were a total of 96 active sole source contracts with a total value of over \$19 million.

Conflict of interest declaration was not included in all sole source contracts

The City does not include a conflict of interest declaration in all sole source contracts.

No Conflict of Interest Review Conducted

No process exists to perform periodic review of staff and vendor address data for a potential conflict of interest

Currently there is no process in place to perform a periodic review or comparison of staff and vendor address data. A comparison of staff and vendor address data could result in indications that active City employees or family members are also providing goods and services to the City resulting in a potential conflict of interest between the employee and the vendor.

The conflict of interest declaration is an important control in preventing this risk.

In our limited review comparing employee and vendor addresses we identified instances where conflict of interest was an issue. Management had taken corrective action to resolve the conflicts identified in our review.

We were unable to perform a comprehensive comparison due to a lack of complete and uniform address information.

Recommendations:

11. City Council request the Director, Purchasing and Materials Management, in consultation with the City Solicitor, to ensure that a conflict of interest declaration is included in the sole source process including all future sole source contracts.

Further, that the Director, Purchasing and Materials Management, in consultation with City division heads and the City Solicitor, as necessary, evaluate whether existing sole source vendors should be contacted to provide a conflict of interest declaration.

12. City Council request the City Manager to evaluate the feasibility of developing a process for periodically comparing staff and vendor address data to identify potential conflicts of interest.

CONCLUSION

This report includes 12 recommendations. The majority of recommendations relate to strengthening controls over vendor account management and payments. We have also made recommendations to improve purchasing practices and controls.

The recommendations are intended to improve reporting, minimize discount losses, provide timely adjustment of vendor credits and realize savings through consolidation of purchases. The recommendations are also intended to improve controls in purchasing practices and compliance.

When fully implemented, we expect savings of approximately \$4 million related to vendor discounts applied through timely payments, prompt processing of vendor credits, and consolidation of divisional purchases.