

INTERNAL AUDIT REPORT

2019-03

Purchase Orders Under \$5,000

Purchasing Department

April 11, 2019

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Municipality of Anchorage

Ethan Berkowitz, Mayor

Internal Audit Department

April 11, 2019

Honorable Mayor and Members of the Assembly:

I am pleased to present for your review **Internal Audit Report 2019-03, Purchase Orders Under \$5,000, Purchasing Department**. A brief summary of the report is presented below.

In accordance with the 2018 Audit Plan, we have completed an audit of Purchase Orders Under \$5,000. The objective of this audit was to determine whether there were sufficient internal controls in place for purchases under \$5,000 made with SAP-automated purchase orders. To accomplish our objective, our audit included a review of automated purchase orders processed by various departments in 2018. Specifically, we judgmentally selected transactions to ensure purchases were properly authorized, supported, and physically present for inspection, if goods were procured. In addition, we determined if SAP had adequate segregation of duties for purchases under \$5,000.

Our audit revealed that internal controls for purchases under \$5,000 made with SAP-automated purchase orders could be improved. Specifically, our review of selected purchases revealed 12 purchases totaling \$107,582 that appeared to be split into two or more smaller transactions to circumvent the \$5,000 single purchase order limit. Furthermore, there was a lack of segregation of duties regarding controls over automated purchase orders under \$5,000. Finally, our review found that there was no written policy and procedure for using the SAP-automated purchase order function for purchases under \$5,000.

There were three findings in connection with this audit. Management was responsive to the findings and recommendations.

Michael Chadwick, CIA, CICA
Director, Internal Audit



Municipality of Anchorage

Ethan Berkowitz, Mayor

Internal Audit Department

April 11, 2019

Internal Audit Report 2019-03 Purchase Orders Under \$5,000 Purchasing Department

Introduction. The Municipality of Anchorage's (Municipality) Purchasing Department (Purchasing) is responsible for the acquisition of supplies, services, and construction. In October 2017, the Municipality implemented a new financial system, SAP, which replaced PeopleSoft. With the implementation of SAP, the procurement process changed for purchases under \$5,000. These purchases no longer involve Purchasing staff. Instead, municipal employees make these purchases by generating automated SAP purchase orders (POs). In 2018, municipal employees processed 3,508 automated POs totaling almost \$5.9 million as shown in the table below.

2018 Automated POs Under \$5,000

<u>Department</u>	<u>Amount</u>	<u>Number of POs</u>	<u>Percent of POs</u>
Municipal Light & Power	\$1,713,076	1,051	30%
Public Works	1,433,916	1,021	29%
Anchorage Water & Wastewater Utility	1,198,770	654	19%
Anchorage Fire Department	560,747	263	7%
Economic & Community Development	263,398	135	4%
Anchorage Health Department	245,663	150	4%
General Government ¹	165,406	82	2%
Anchorage Police Department	125,831	73	2%
Solid Waste Services	75,775	42	1%
Public Transportation	66,197	25	<1%
Port of Alaska	21,708	8	<1%
Merrill Field	5,716	4	<1%
Totals	\$5,876,203	3,508	100%

¹General Government includes Finance, Risk Management, Municipal Manager, Mayor's Office, and the Office of Management & Budget.

Source: Auditor's analysis of SAP query provided by the Purchasing Department

Objective and Scope. The objective of this audit was to determine whether there were sufficient internal controls in place for purchases under \$5,000 made with SAP-automated POs. Our audit included a review of automated POs processed by various departments in 2018. Specifically, we judgmentally selected transactions to ensure purchases were properly authorized, supported, and physically present for inspection, if goods were procured. In addition, we determined if SAP had adequate segregation of duties for purchases under \$5,000.

We conducted this performance audit in accordance with generally accepted government auditing standards, except for the requirement of an external quality control review. 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. The audit was performed during the period of January through February 2019. The audit was requested by the Administration.

Overall Evaluation. Internal controls for purchases under \$5,000 made with SAP-automated POs could be improved. Specifically, our review of selected purchases revealed 12 purchases totaling \$107,582 that appeared to be split into two or more smaller transactions to circumvent the \$5,000 single PO limit. Furthermore, there was a lack of segregation of duties regarding controls over automated POs under \$5,000. Finally, our review found that there was no written policy and procedure (P&P) for using the SAP-automated PO function for purchases under \$5,000.

Management Overall Comments. Management stated, "It should be noted this audit was at the request of the Purchasing Department due to concerns that departments might "game" the system in order to bypass the competitive process."

FINDINGS AND RECOMMENDATIONS

1. Transactions Split to Circumvent Dollar Limit.

- a. **Finding.** Our review of selected purchases revealed 12 purchases totaling \$107,582 that appeared to be split into two or more smaller transactions to circumvent the \$5,000 single PO limit. Eight of these purchases belonged to Municipal Light & Power (ML&P), and the remaining four purchases belonged to Anchorage Water and Wastewater Utility (AWWU). For example, two POs totaling \$9,633 were issued for \$4,816.50 each for the same item ordered a day apart from the same vendor. In another case, a \$6,300 payment for rain jackets was split into two charges of \$3,150 each, on the same day to the same vendor. Furthermore, a \$6,496.20 payment for transformers was split into two charges of \$3,248.10 each, on the same day to the same vendor. Staff made a specific request to the vendor to provide a separate quote under \$5,000 for each purchase to circumvent the single purchase limit for the automated PO. Employees at ML&P and AWWU stated that the purchases were separated to expedite the automated SAP purchase process since the procurement process through Purchasing takes longer. According to Purchasing management, any purchase, from any vendor with the same, similar, or different items on the same day or within days, separated with an intent to remain below the single purchase threshold is considered a split purchase.
- b. **Recommendation.** The Purchasing Officer should ensure a definition and prohibition of split purchases are included in the draft P&P for POs under \$5,000.
- c. **Management Comments.** Management stated, "Purchasing concurs with the finding and recommendation. We have started drafting the recommended P&P and will coordinate drafts with Internal Audit."

- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

2. **Lack of Segregation of Duties.**

- a. **Finding.** There was a lack of segregation of duties regarding controls over automated POs under \$5,000. Specifically, we found instances where one individual had authority to initiate the purchase, receive the ordered goods, and receive the invoice for payment. We identified this condition at six agencies: Public Transportation Department, Public Works Department, Anchorage Police Department (APD), Planning Department, Solid Wastes Services (SWS), and the Parks and Recreation Department. In other instances, one individual had authority to receive the ordered goods and receive the invoice for payment. We identified this condition at four agencies: APD, SWS, Parks and Recreation Department, and Risk Management. According to guidance from the United States General Accountability Office, "Management divides or segregates key duties and responsibilities among different people to reduce the risk of error, misuse, or fraud. This includes separating the responsibilities for authorizing transactions, processing and recording them, reviewing the transactions, and handling any related assets so that no one individual controls all key aspects of a transaction or event."
- b. **Recommendation.** The Purchasing Officer should review SAP position-specific role-mapping with the Employee Relations and Information Technology Departments to ensure the accuracy of role assignments for positions that initiate the purchase, receive the ordered goods, and receive the invoice for payment.
- c. **Management Comments.** Management stated, "Purchasing concurs with the finding. This issue was identified and discussed during the implementation of SAP for small departments. With the exception of one identified department, the departments

identified in the audit were not small departments, therefore, the issue will be revisited and when possible, changes will be made.”

- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

3. **Lack of Written Policy and Procedures for Purchases Under \$5,000.**

- a. **Finding.** Our review found that there were no written P&Ps for using the SAP-automated PO function for purchases under \$5,000. The problems identified in this report could have been mitigated with written P&Ps that provide clear guidance in using SAP’s automated POs for purchases under \$5,000. According to Purchasing management, P&Ps are still being developed.
- b. **Recommendation.** The Purchasing Officer should ensure that P&Ps for POs under \$5,000 are implemented and followed.
- c. **Management Comments.** Management stated, “Purchasing concurs with the finding. See response to Finding 1, the P&P is being drafted with an estimated completion date of July 1, 2019.”
- d. **Evaluation of Management Comments.** Management comments were responsive to the audit finding and recommendation.

Discussion With Responsible Officials. The results of this audit were discussed with appropriate Municipal officials on March 4, 2019.

Audit Staff:
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