



MIAMIBEACH

BUDGET AND PERFORMANCE IMPROVEMENT
Internal Audit Division

INTERNAL AUDIT REPORT

TO: Jorge M. Gonzalez, City Manager
VIA: Kathie G. Brooks, Budget and Performance Improvement Director
FROM: James J. Sutter, Internal Auditor

DATE: September 13, 2010
AUDIT: Public Works Department Warehouse Purchasing Audit
PERIOD: October 1, 2008 - August 31, 2009

This report is the result of a regularly scheduled audit to review the documentation maintained and internal controls implemented to help ensure that selected purchases made by the City's Public Works Department's warehouse are in compliance to the City's policies and procedures. The report addresses opportunities to improve related processes and procedures in Warehouse Operations, the Finance Department and the Procurement Division.

INTRODUCTION

The Public Works Department warehouse located at 451 Dade Boulevard is responsible for 115 purchase and change orders with 80 different vendors to provide services and materials totaling \$1,942,010.23 for the 2008/09 fiscal year. Examples of approved vendors include Aaron Industrial Safety, Condo Electric Motor Repair, Mercedes Electric Supply Inc., Sensus Metering Systems and Universal Signs & Accessories.

Beside purchase orders, payments can also be made through the processing of Request for Direct Payments. The Procurement Division's operating policy and procedure state "The Request for Direct Payment (D.P.) is to be used by Departments when one time payments are required for the procurement of products or services that are exempt from the City's Purchasing Procedures." There is a circulated list of allowable categories which include travel reimbursements, meal allowances, refunds to customers, etc. In a simplistic overview, a standardized D.P. form is completed by the originating department, approved by the applicable parties based on the payment amount and submitted to the Finance Department's Accounts Payable Division for final review and the issuance of a City check. At least three quotes should be obtained for these purchases whenever possible, especially above the \$5,000 threshold.

Purchase cards or p-cards are typically assigned to City personnel to expedite delivery and payment of needed goods that otherwise would be processed by a Request for Direct Payment or through a purchase order. In return, the City receives monies back (\$87,933 during the 2008 calendar year) from all applicable purchases.

Parts are ordered as needed primarily by either the Warehouse Supervisor or the Storekeeper III with few purchases originating from higher departmental management. Computerized quote requests should be sent to vendors requesting prices on desired goods. The quotes received should then be analyzed with the vendor offering the lowest price selected to fill the order. A requisition form printed from Cityworks listing such details of the transaction as the items, quantities, pricing, purchase order numbers, etc. is sent to the vendor confirming the agreed upon terms.

Delivered parts are accepted by warehouse staff and compared to the packing slip or other similar

documentation for completeness. In addition, the charged prices are checked against those quoted to confirm their agreement. Once approved, the inventory is accepted, entered into the Cityworks system and ultimately paid through normal procurement channels.

The City Commission through the adoption of Resolution No. 2005-25924 authorized the execution of a professional services agreement covering the installation, configuration, start-up and training of a (Cityworks) computerized maintenance management system which includes infrastructure asset management, work order management and service request management. The Public Works Department warehouse began using this system on April 1, 2006 as it replaced the outdated PWK system.

OVERALL OPINION

The Public Works Department's warehouse purchases a multitude of goods and services each year through purchase orders, purchase credit cards and Requests for Direct Payment. In doing so, it is crucial that Procurement rules are strictly followed to help ensure that the City obtains the most competitive price for the desired items. Furthermore, implemented internal controls need to be followed and sufficient documentation maintained to provide reasonable assurance that tested vendors provided the reviewed products and were properly paid. Internal Audit's testing showed the following incidents noted below which point to the necessity for improvements:

Public Works

- An unauthorized \$158,634 purchase was made from a vendor approximately 6 ½ months before the corresponding purchase order was secured. The Procurement Division informed Internal Audit of two other fiscal year 2008/09 instances whereby similar unauthorized non-warehouse purchases occurred by the Public Works Department. A separate citywide review by the Finance Department of all expenses over \$25,000 for the past two fiscal years confirmed these items and corrective action has been taken to enhance departmental compliance with procurement policies and procedures.
- Tested purchase card transactions found that vendor quotes were not always obtained and one apparently legitimate purchase was split between two transactions.
- Goods were ordered from vendors at least two months before the corresponding purchase orders were finalized for two of the nine (22%) fiscal year end purchases reviewed.
- Public Works purchase and change orders took an average of 34 days to complete as most purchase orders were not created until mid-December thereby possibly delaying the ordering and payment of needed goods.
- The lack of uniformity in the accounting for purchase card transactions in comparison to purchase order and Direct Payment purchases becomes difficult when the warehouse has to store and safeguard these items to avoid the division/area charging out the item from being invoiced twice.
- One instance was noted of the fifty tested or 2% whereby the actual price invoiced by the vendor was \$28.84 higher than the previously agreed upon quoted price and no documentation was presented to show that the difference was questioned or its cause.

Public Works, Finance and Procurement

- The Public Works Department and Procurement Division have not updated their policies and procedures to better detail newly instituted practices.

PURPOSE

The purpose of this audit is to determine whether items were purchased in accordance with Procurement rules; whether transactions are economically and efficiently processed, accurately and promptly recorded, reported, and followed up; whether key forms, records, files and systems are properly safeguarded and controlled, and access thereto is restricted in accordance with management's criteria; whether the amounts paid to confirmed vendors agrees to quoted prices; and whether all transactions were correctly and timely recorded in the City's Financial System.

SCOPE

1. Confirm that documented operating policies and procedures exist, are complete and are properly adhered to.
2. Confirm that well organized, complete and sufficient documentation is maintained to support tested transactions.
3. Confirm that a proper segregation of duties and sound internal controls exist.
4. Confirm that sampled vendors are legitimate based on review of the internet, phone calls, address verifications, etc. and that their contact information entered into the Eden System is complete.
5. Confirm that tested purchases comply with City Procurement rules as to competitive bidding, required approvals, etc.
6. Confirm that purchase order funds are made available timely and compute the average number of days spent in each step of the approval queue looking for repetitive delays.
7. Confirm that quantities, prices and terms on vendors' invoices agree to those quoted and listed on the purchase requisitions.
8. Confirm that payments are made timely to vendors so that the City can take advantage of any offered discounts and avoid late fees.
9. Confirm that proper cut-offs are made so that fiscal year end purchases were paid with the correct fiscal year's monies.
10. Confirm that all tested transactions were properly entered in the City's Financial System.

FINDINGS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

Public Works

1. Finding – *Unauthorized Purchases*
The Public Works Department's Capital Projects Coordinator accepted the terms listed in ITT Water & Wastewater Florida, LLC's proposal on 12/04/08 authorizing the purchase of six submersible pumps for the City's sewer pump station upgrade for \$158,634. The pumps

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were sent on 04/07/09 and an invoice was mailed shortly thereafter. Therefore, the vendor was notified to proceed although the funds had not yet been secured as the corresponding purchase order numbered 011639 was not initiated until 06/29/09.

The City's Procurement Division became aware of this purchase and researched it further summarizing their findings in a 08/10/09 memorandum. The Public Works Assistant Director responded that this was an emergency purchase and that the Division was attempting to standardize sewage services throughout the City with Flygt pumps as ITT Water & Wastewater Florida, LLC is the sole manufacturer that provides these pumps under the Miami-Dade County contract.

The Procurement Division concluded that this \$158,634 purchase did not comply with the provisions listed in City Code Section 2-393(b) for emergency purchases. Therefore, this unauthorized purchase needed the approval of the City Manager for payment to be made, which was received on 08/19/09. As a result, purchase order number 011639 was created on 08/21/09 and its funds were used to issue City check number 286239 on 08/25/09 to pay the vendor in full.

Although not part of the scope of this warehouse purchasing audit, the audit division was made aware by inquiries with the Procurement Division that on two other occasions during fiscal year 2008/09 the Public Works staff made unauthorized purchases for items not warehouse related as vendors were given the notice to proceed before purchase orders have been created. The Department has already taken action on correcting the deficiencies by reassigning personnel and retraining staff on the existing policies and procedures.

In addition, a separate inquiry from a Commissioner regarding the policies and procedures and internal controls on citywide purchases over the \$25,000 threshold established by the City Code, the Finance Department along with Procurement Division reviewed more than 32,000 citywide transactions for fiscal year 2007/08 and 29,000 transactions for fiscal year 2008/09. They concluded that from the 2,600 citywide transactions reviewed that exceeded \$25,000 during the two year period that ten instances citywide were noted where established polices were not followed. An additional fifteen instances citywide were identified that previously practices were no longer appropriate and new procedures were implemented.

Recommendation(s):

Recent inquiries with the Procurement Division Director found that the two unauthorized non-warehouse related purchases above were included in the ten citywide purchases identified in the City Manager's 12/08/09 memo to the Commissioner based on testing of 29,000 Fiscal Year 2008/09 citywide transactions. Internal Audit is reasonably assured that the steps outlined in this memo of Procurement Division Director's review of all Request for Direct Payment purchases, additional departmental training, lowered purchase credit card limits, review and approval of independent contractor agreements and the threat of employee discipline should help reduce the possibility of future occurrences.

Management Response:

Public Works Department:

- 1) Assistant Director was unaware of such memorandum by the Procurement Division and does recall responding to Procurement's question by phone with his response being that the Flygt purchase was an Operations emergency purchase. The Operations Division was under the impression that an ITT Flygt purchase order was

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still in-place and since it was an emergency for the sewer pump stations, increasing the purchase order would not be a problem. It was subsequently determined that the purchase order was closed by Procurement as Operations had not rolled over the funds to a new fiscal year. In the future, Public Works staff will communicate with Procurement Department for emergency purchase authorization. Public Works Operations will strengthen Warehouse policies and procedures for emergency purchases approval.

- 2) Public Works staff will be trained by Procurement on an annual basis on the proper steps to follow in order to correct this issue.
- 3) The Assistant Director was counseled and re-assigned to a new position in the Public Works yard as the Infrastructure Division Director

Procurement Division:

The JOC cost proposal approval form has been revised to ensure that contractors understand that the purchase order is the official document they must receive prior to performing any work. Additionally, a training session was provided to Public Works staff so that employees have a clear understanding of their role and authority in the procurement process.

2. Finding – Purchasing Cards (P-cards)

Ten different purchases (approximately 20%) ranging from \$419.88 to \$18,000.00 made by Public Works Department employees using their City issued p-cards were reviewed and the following deficiencies were noted:

- Supporting documentation was only provided for one tested transaction, a \$1,263.64 purchase of 1 ½ and 2 inch meters from Badger Meter, in which price quotes were received from other vendors prior to authorizing the purchase. Therefore, Internal Audit is unable to determine if the remaining nine tested purchases were made at the least inexpensive price, was the vendor the sole provider, etc.
- Transformers were purchased via p-card from South Dade Electrical in November 2008 although the applicable purchase order was not created until 12/03/08.
- An \$18,000 purchase of sod from Action Sod to restore the City's Par 3 golf course to its original condition was made by two \$9,000 p-card transactions dated the same day. Although the purchase appears legitimate and does not exceed the cardholder's pre-approved limit, the splitting of purchases raises questions as to possible negative reasons why it may have been done (to avoid closer scrutiny by approvers, to stay below the p-card owner's approval limit, etc.).

Recommendation(s):

Public Works staff should obtain and document the quotes received from at least three different vendors for p-card purchases in accordance with Procurement rules. Also, purchases should not be made until the funding source is secured. Finally, purchases should not be split as it could lead to the circumvention of established internal controls.

Management Response:

Public Works Department:

- 1) Sensus Meters were not available at the time of placing an order of water meters. Sensus delivery was 8 weeks. Due to low stock of meters and out of one inch meters, quotes were received from three vendors. Two of the vendors offered two

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- weeks delivery, while the third vendor, Badger Meters Company, offered next day delivery. Given the urgency of the out-of-stock situation, Badger Meters Company was the choice due to their ability to provide next day delivery.
- 2) The camera was purchased for Operation Inspector to document flooding. The South Dade Electric transformers were an emergency purchase for the use of city-wide Wi-Fi nodes. No purchase orders in-place due to new fiscal year which takes weeks, or months, to obtain due to Eden System approvals. In the future, Operations staff will communicate with Procurement Division for emergency purchases and included in Warehouse policies and procedures.
 - 3) The \$18,000.00 sod purchased from Action Sod was recommended by the City-Parks Department for Par 3 Golf Course restoration. The two purchases were made three weeks apart. The first purchase was for the Par 3 north side area and the second purchase for the south side.

During the first few months of a new fiscal year, the Budget Department does not load the approved budget until late November onto the Eden System. Then, it takes a week or two for Operations staff to load requisitions onto the Eden System. Procurement Division receives the requisition and by that time, Procurement is overloaded with other Departments requisitions. In the meantime, Public Works – Operations uses the P-card to purchase items from vendors that have done business in the past, or other vendors as necessary until finally, a purchase order is issued to vendors by the Procurement Division.

3. Finding – Fiscal Year End Purchases

Pre-numbered requisition forms are printed from the Cityworks System listing the ordered parts, quantities, prices, etc. and are sent to the vendor to confirm the terms of the sale. Therefore, the amount due should never exceed the quoted price but lower amounts due may be accepted by the City if offered by the vendor.

These requisitions are currently stored in random numerical order inside folders by the month that the completed order was received thereby making it time consuming to locate desired forms as some items may be back ordered for an extended time. Also, the requisition forms are not cross referenced or attached to the vendor's corresponding invoice to facilitate reconciling to subsequent payments.

Internal Audit selected nine requisition forms found in Public Works files occurring at or near 09/30/08 and noted the following two instances (2/9 or 22%) whereby the goods were ordered and received before the purchase order was created:

- Requisition form number 520 ordered a 30 amp 120 volt contactor from Raybro/Consolidated Electric on 09/12/08. The complete order totaling \$650.00 was received by the Public Works Department warehouse on 10/06/08. However, funds from purchase order number 009060 which was approved on 12/11/08 were used to pay the invoice through City check number 274860 dated 12/23/08.
- \$4,423.59 in tape, towels, pumps, cartridges, respirators, etc. were ordered from Grainger on 09/30/08. Requisition form number 541 states that the complete order was received on 10/06/08. The vendor was ultimately paid by City check number 276234 dated 01/27/09 after purchase order number 010906 was approved on 12/22/08.

Recommendation(s):

The Warehouse Supervisor has instructed their staff to begin attaching the completed requisition form to the vendor invoice going forward to help ensure agreement before payment is made and to centralize the storage of documents. Finally, Public Works Department personnel should not order goods until the funding source has been approved by all authority levels including Procurement and the monies are available.

Management Response:

Public Works Department:

There are times when Public Works Operations requires emergency and/or non-emergency purchases. In this case, the new fiscal year budget was not loaded in the Eden System. The Procurement Division experiences an overload of new requisitions by citywide departments which take Procurement weeks to issue purchase orders. Existing Warehouse policies and procedures are being revised to ensure that the recommendations made are properly addressed.

4. Finding – Purchase Order Creation

Testing found that almost all of Public Works Department's 115 current active open purchase and change orders were created in mid-December 2008, which may be later than desired as projects and repairs could be adversely impacted by the delay. Consequently, Internal Audit reviewed the Eden System's automated approval queue to calculate the number of days that it took for each person to approve each transaction to try and determine where the process was being bottlenecked.

The purchase orders reviewed did not enter the approval queue until late October at the earliest with most waiting until mid November. Further analysis showed that it took an average of thirty-four days from the date that the tested purchase and change orders first entered the queue until the date that they were created and the corresponding funds were made available. Most of the queue time was spent inside the Procurement Division with an average of twenty-one days consisting of seventeen days by the employee assigned to that department, two days by the Procurement Division Director and two days to finalize the purchase/change orders.

Thirty-four days represents a seven day or 26% increase over the number of days that it took the Procurement Division to create sampled purchase orders during the 2002/03 fiscal year as identified in the internal audit report issued on 09/27/03. External factors (i.e. the purchase order was incomplete or prepared incorrectly, the supporting invoice(s) were not attached, etc.) which lengthen the process could not be properly evaluated and measured. However, the overall average processing time may be too long as the purchase orders are frequently created due to the initiating departments/divisions' immediate needs.

Recommendation(s):

The Public Works Department should try and make a more concerted effort to start the approval queue process earlier, as close to October 1st as possible. Meanwhile, the Procurement Division should brainstorm to try and determine what steps can be taken to expedite and streamline the process so that needed monies could be made available earlier, especially at the beginning of the fiscal year.

Management Response:

Procurement Division:

The number of days to process a requisition into a purchase order compared only one city department. We are continuously tracking the number of days to convert purchase requisitions into purchase orders as part of our Active Strategy reporting, and re-assign projects as necessary to ensure the best possible lead time. There are many variables that determine whether the issuance of a purchase order was completed in a timely manner: the total dollar amount; information provided by the requesting department; the purchasing authority (is in place or must one be obtained); and the priority of other projects that Procurement staff is working on.

It is important to note that the first three (3) months of the fiscal year account for more than 70% of our annual purchase requisitions received. In past years, temporary labor would be brought on to help with the processing of high volume of requests, or free-up Procurement staff from performing ministerial functions so that there was a greater focus on processing purchase requests. However, in an attempt to reduce costs due to constrained resources over the past several years, the department has elected to not to budget dollars for professional services or temporary labor.

Also it is important to note is that past practices of exercising the renewal options on contracts when the vendor was performing in accordance with their contract is no longer the standard practice. The standard practice is now to rebid contracts although renewal options may exist. Thus many contracts that would have been renewed administratively in a very simple and streamlined process are now formally bid, which takes procurement staff time away from processing requisitions.

New fiscal year budget needs to be loaded during the first week of the fiscal year so as not to impact operations.

5. Finding – P-card Accounting

Eden, the City's Financial System, currently accounts for inventory under the periodic system whereby a purchase account is used and the inventory balance remains unchanged until the year end physical count. Meanwhile, the Public Works Department's warehouse internally uses the Cityworks System to record inventory which does not interface well with the Eden System. This Cityworks System uses a perpetual inventory system so that inventory balances are continually revised as items are purchased and disbursed. As a result, in theory the ending Cityworks inventory balance should equal the items on hand (excluding shrinkage, poor recordkeeping, etc.).

Any Public Works warehouse purchases paid by City check (purchase orders and Direct Payments) are initially charged to MX Stock (bond monies) purchases and pooled cash accounts as they do not necessarily know which division/area will ultimately use the parts. When they are subsequently charged out, Public Works warehouse staff will then enter the disbursement into the Cityworks system along with the applicable general ledger account number. The Cityworks run report called Warehouse Issue Report Summary which totals all disbursements for each general ledger account during the month specified is then forwarded to the Finance Department. From here, it is reviewed and the reclassification entries are made into the Eden System through monthly journal entry number 005. The problem with this approach is that until the goods are charged out (if ever), the MX Stock purchases account may be overstated and the incorrect pooled cash account is used to fund the purchase.

However, p-card purchases are treated differently because the items are bought for a particular division/area so the appropriate Eden System entries can be made at the time of purchase thereby eliminating the need for reclassifying entries. Although this is the preferred and less time consuming approach, the problem occurs when excess items are purchased or the items are not to be used immediately and are returned to the warehouse for safekeeping. At this time, these goods need to be separated from other items purchased by Direct Payment or purchase order and closely monitored. They cannot be entered into the Cityworks System because then the division/area charging out the parts will be billed twice (once at the time of purchase and once when disbursed through journal entry 005).

Recommendation(s):

Given the above facts, Internal Audit believes in the need for uniformity in the accounting for Public Works warehouse purchases in the Eden System. Although archaic and time consuming, we opine that p-card purchases should be treated the same as purchase order and Request for Direct Payment transactions to avoid the possibility that inventory balances will be overstated if the inventory is inadvertently comingled. Public Works and Finance Department personnel should meet to try to determine if a more efficient solution can be reached going forward.

Management Response:

P-card purchases occur mostly during the start of a new fiscal year, before funds are loaded and purchase orders can be issued. Since P-card purchases are also utilized by other departments, it would be appropriate to schedule a joint meeting to also include other operations, such as Parks / Property Management, Sanitation, to discuss optimum methods. The Public Works Department will be addressing software interface issues between Cityworks and the Eden system; however, the Cityworks software is being updated in 2011. At that point, the Public Works Department will work with the Finance Department and the Procurement Division to address the interface issues. Public Works and Finance personnel will meet to discuss further and to determine the optimum method of accounting for these transactions.

6. Finding – Pricing Differences

Internal Audit arbitrarily chose fifty different current fiscal year purchase order transactions for testing. One of the tests performed included confirming that the actual prices charged by the vendor did not exceed the quoted requisition form prices. In doing so, one of the fifty purchase order transactions (2% of those reviewed) had an invoice price of \$314.44 paid that exceeded the quoted price of \$285.60 for the purchase of liquid bleach from Rex Chemical.

Recommendation(s):

Although not a material amount, Rex Chemical should only have been paid \$285.60 based on their acceptance of requisition number 584. Meanwhile, Public Works warehouse staff should going forward closer scrutinize all vendor invoices to help ensure that they do not exceed the quoted price to prevent the vendor from receiving more monies than previously agreed upon and documented.

Management Response:

Past practices have been for the Warehouse Supervisor to periodically review random invoices. Management will formalize the process so that in addition to the Warehouse

Supervisor, the Operations Superintendent will conduct / review random invoices on a bi-weekly basis and report findings to the Operations Division Director. In addition, the Operations Division Director will also conduct random reviews of invoices with the Superintendent and the Warehouse Supervisor. Warehouse policies and procedures are being revised to reflect these modifications.

Public Works, Finance and Procurement

7. Finding – Policies and Procedures

Although descriptive and covering a wide array of topics, the Public Works Department's policies and procedures were last revised (effective 10/01/02) and did not fully address warehouse operations. Furthermore, the Procurement Division's policies and procedures were last revised on 10/14/03. Some of the previous procedures have changed with the implementation of p-cards, new computer systems like Eden and Cityworks, etc.

Additionally, Section 2-339 of the City of Miami Beach Code states that the Procurement Director shall "*Prescribe and maintain a manual of purchasing procedures and provide same for all using agencies.*" The Procurement Division does not have an up-to-date purchasing manual serving as a basic guide to the City's purchasing operations and reflecting the current provisions of the Purchasing Ordinance. Consequently, Procurement Division personnel may receive numerous inquiries from other departments/divisions on various items that can hinder their ability to perform other more important tasks.

Recommendation(s):

Operating policies and procedures should be updated as soon as possible and should more descriptively outline current operations. Policies and procedures serve both as a benchmark to measure individuals' performance and as an instruction manual in the event employees' change.

Finally, the Procurement Division Director should maintain an updated purchasing manual on-line that is available to all City departments/divisions. Refresher training should be provided annually or bi-annually to City staff, as well as to new management team members as a component of their required supervisory training.

Management Response:

Public Works Department:

Warehouse policies and procedures are being updated to reflect these modifications.

Finance Department:

In an effort to improve our P-card process, the Finance Department has been reviewing p-card charges and analyzing expenditures trends. Upon doing so, it was discovered that most departments typically use their p-cards for the same vendors. As a result, we have created vendor cards for those frequently used vendors. These p-cards are restricted only to the specific vendor, (i.e. Office Depot and Home Depot). Additionally, we are currently in the process of reviewing and updating our p-card policies and procedures.

Procurement Division:

There are many policies that need minor revisions (i.e., changing the reference from MSAF to Eden), and others that will require policy decisions (i.e., de-centralized purchasing authority). And new policies and procedures will also be created.

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EXIT CONFERENCE

An exit conference was held in the Office of Budget & Performance Improvement. Participants included Michael Alvarez (Assistant Public Works Director), Gus Lopez, Procurement Division Director, Georgina Echert (Assistant Finance Director), Ramon Suarez (Finance Manager), James Sutter (Internal Auditor) and Mark Coolidge (Senior Auditor). All parties were in agreement as to the contents of this report. Management responses were solicited and included in our report.

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Audit performed by Mark Coolidge (Senior Auditor)

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cc: Jorge Gomez, Assistant City Manager
Fred Beckmann, Public Works Director
Patricia Walker, Chief Financial Officer
Gus Lopez, Procurement Division Director