



April 9, 2014

To: Finance and Administration Committee

From: Darrell Johnson, Chief Executive Officer

Janet Sutter, Executive Director
Internal Audit Department

A handwritten signature in black ink, appearing to read "Janet Sutter for", is written over the typed name of Janet Sutter. The signature is fluid and cursive.

Subject: Review of Purchase Order Issuance and Oversight

Overview

The Internal Audit Department has completed a review of purchase order issuance and oversight. Based on the review, purchase orders were generally procured in accordance with Orange County Transportation Authority policies and procedures; however, two recommendations were made to strengthen invoice review controls and to update written policies and procedures.

Recommendation

Direct staff to implement two recommendations offered in the Review of Purchase Order Issuance and Oversight, Internal Audit Report No. 14-509.

Background

Purchase orders (PO) are used to purchase supplies, equipment, hardware components and software maintenance, training materials, facilities equipment, and straight-forward services. The departments that use the most PO's are the Maintenance Department, the Information Systems Department, and the General Services Department.

The requesting departments initiate PO's by entering requisitions into the Ellipse system. Project managers, or their delegates, contact vendors and request specific quantities and services. Project managers are responsible for reviewing and authorizing invoices for payment. Accounts Payable reviews the invoices for proper signing authority and remits payment.

Discussion

The Internal Audit Department (Internal Audit) reviewed a sample of 25 PO's for compliance with policies and procedures, and reviewed a sample of invoices paid for contract compliance and evidence of invoice review controls.

Internal Audit identified several instances in which orders were placed against PO's that had not yet become effective. In addition, several instances were noted where vendors invoiced for items, brands, and/or services not listed on PO pricing sheets or at rates that differed from the PO pricing sheets. Internal Audit also identified PO's requiring parts to be billed at cost, or at cost plus a stated mark-up; however, the PO's did not consistently require the vendor to provide proof of cost.

Internal Audit recommended that invoices be reviewed for compliance with PO terms. For the PO's that include multiple parts/goods, the PO's should require that items not identified in the PO pricing summary be billed at cost plus a set mark-up percent. The PO's should also consistently include a requirement that the Orange County Transportation Authority be provided with adequate supporting cost documentation to allow validation of mark-ups as needed. Management agreed to implement these recommendations.

Internal Audit also recommended updates to the Procurement Policies and Procedures Manual to address sole source PO's exceeding \$50,000, that do not require price review by Internal Audit and to document procedures for services marketed by brokers. Management agreed to develop these procedures.

Summary

Based on the procedures performed, PO's were generally procured in accordance with policies and procedures; however, recommendations were made to strengthen invoice review controls and to update policies and procedures.

Attachment

- A. Review of Purchase Order Issuance and Oversight, Internal Audit Report No. 14-509

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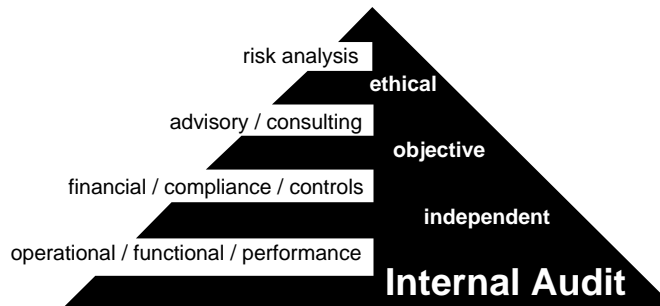
ORANGE COUNTY TRANSPORTATION AUTHORITY INTERNAL AUDIT DEPARTMENT



Review of Purchase Order Issuance and Oversight

Internal Audit Report No. 14-509

March 26, 2014



Internal Audit Team: Janet Sutter, CIA, Executive Director
Serena Ng, CPA, Principal Internal Auditor

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Conclusion

The Internal Audit Department (Internal Audit) has completed a review of purchase order (PO) issuance and oversight. Based on the review, PO's are generally procured in accordance with Orange County Transportation Authority (OCTA) policies and procedures; however, Internal Audit has made recommendations to strengthen invoice review controls and to update written policies and procedures.

Background

General Information

PO's are used to purchase supplies, equipment, hardware components and software maintenance, training materials, facilities equipment, and straight-forward services. The departments that use the most PO's are the Maintenance Department (Maintenance), the Information Systems Department (IS), and the General Services Department (General Services).

The requesting departments initiate PO's by entering requisitions into the Ellipse system. Project managers (PM), or their delegates, contact vendors and request specific quantities and services. PM's are responsible for reviewing and authorizing invoices for payment. Accounts Payable reviews the invoices for proper signing authority and remits payment.

Requesting Department's Procedures over PO's

Maintenance Department:

The senior business unit analyst uses a Microsoft Access database to track all the vendors in Maintenance and Facilities, with information about the PO number, maximum value, and balance.

Requisitions are entered into Ellipse by the senior business unit analyst. For one-time PO's, the PM prepares the scope of work and independent cost estimate (ICE). For recurring PO's, the senior business unit analyst enters the requisitions for a new PO six months before the expiration date of the existing PO for the same goods or services. If the senior business unit analyst notes that a PO balance is approaching the PO maximum quicker than it should, she enters a requisition to increase the PO maximum value. Requisitions are approved by the Maintenance manager.

For most services, the base Maintenance employees fill out and sign verification of work forms and send them to the senior business unit analyst. For goods, the base Maintenance employees sign the packing slips and send them to the senior business unit analyst. When the senior business unit analyst receives the invoices, she compares

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the verification of work forms and packing slips to the invoices to ensure that services were performed and goods were received. If there is a missing packing slip and the base Maintenance employees can't find it, then the base Maintenance supervisor is required to sign the invoice and send the signed invoice to the senior business unit analyst with confirmation that the goods were received.

IS Department:

Each section manager monitors PO's for their area. Most of the PO's are recurring PO's to renew software maintenance and pay hosting application fees.

The section manager or the office specialist will enter requisitions into Ellipse. The section manager will then prepare the ICE by updating the prior ICE's and/or obtaining on-line pricing and quotes, rates for past services, and vendor estimates for unique projects. The IS manager approves all the requisitions, and the requisitions then go to the Contracts Administration and Materials Management Department (CAMM). IS management meets with CAMM on a bi-weekly basis to go over requisitions.

Upon receipt of invoices, the section manager compares the invoice to the PO's and signs for approval. If the invoice includes professional services requested by others, the section manager will request that person to sign the invoice before approving the invoice. For PO's with multiple invoices, the section manager will track payments against the maximum obligation using a spreadsheet.

General Services Department:

The senior office specialist maintains a list of purchase orders for General Services. At the request of the PM, the senior office specialist enters all the requisitions into Ellipse. The manager of General Services approves all requisitions. The PM prepares the scope of work and ICE.

The direct reports to the manager of General Services review invoices to check if charges are consistent with the information in the purchase order listing and then initial the invoices. The manager of General Services signs the invoices.

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Objectives, Scope and Methodology

The objectives were to determine whether PO's are procured in accordance with OCTA procurement policies and procedures, and to assess the adequacy of monitoring and invoice review controls.

The methodology consisted of review of procurement policies and procedures, individual department practices over PO issuance, amendments, tracking, and payment, review of a sample of PO's for compliance with policies and procedures, and review of a sample of invoices paid on selected PO's for contract compliance and evidence of invoice review controls.

The scope is limited to compliance with OCTA's procurement policies and procedures, contract compliance of the selected PO's, and internal controls over amendments and payments. The scope included a judgmental sample of recent invoices paid against selected PO's.

This review was conducted 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 the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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Audit Comments, Recommendations and Management Responses

Noteworthy Accomplishments

In the Maintenance Department, the senior business unit analyst reviews invoices against verification of work forms and/or packing slips prior to approving invoices for payment. If the verification of work form or packing slip has not been provided, the senior business unit analyst requires base Maintenance employees to review and sign the invoice as confirmation that billed services or parts were received.

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Compliance with PO Terms

Internal Audit identified four instances in which Maintenance placed orders against PO's that had not yet become effective. In addition, several instances were noted in which vendors invoiced for items not listed on PO pricing sheets. Finally, four Maintenance PO's require parts be billed at cost, or at cost plus a stated mark-up; however, only one of the four PO's requires the vendor to provide proof of cost. Without a requirement to provide proof of cost, management has no means of determining if invoiced prices comply with the PO terms.

Likewise, Internal Audit identified discrepancies between invoices and PO's issued by General Services. One PO included a pricing sheet listing specific items and their unit prices, and a second PO included a pricing sheet listing set discounts for certain brands. Internal Audit noted invoices against these PO's that included items, brands, and/or services not listed in the PO pricing sheet or billed at rates that differed from the PO pricing sheet.

Recommendation 1:

Internal Audit recommends that Maintenance review invoices for compliance with PO terms. For the PO's that include multiple parts/goods, the PO's should require that items not identified in the PO pricing summary be billed at cost plus a set mark-up percent. The PO's should also consistently include a requirement that OCTA be provided with adequate supporting cost documentation to allow validation of mark-ups as-needed.

Internal Audit recommends that General Services review invoiced pricing for compliance with PO pricing terms. PO's should be amended to include all required items and their negotiated prices.

Management Response (Maintenance):

Maintenance management concurs with Internal Audit's recommendation. Goods on PO's are ordered by individuals at three different operating bases. The senior business unit analyst tracks expenditures based on invoices being paid. During the final months of the PO, this has the potential of goods being ordered in excess of the remaining balance of the PO. As a result, those invoices are paid against the new PO. To avoid this in the future, the senior business unit analyst will more closely track the remaining balances of each PO. Once 75 percent of the not-to-exceed amount has been expended, the senior business unit analyst will notify staff at all three bases that orders must be coordinated through her. The senior business unit analyst will take appropriate action to avoid encumbering invoices in excess of the PO.

Maintenance management recently recognized that POs for goods are inconsistent with respect to individual items not listed on the PO. All future procurements will include a

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more complete list of goods to be ordered during the term of the PO, provide an option to purchase unlisted items at cost plus markup, and require that proof of cost be provided with the invoice to be paid.

Management Response (General Services):

Management agrees with the recommendations regarding the General Services department and will add language to PO's to cover items that were not included in the original scope of work.

Updates to the Procurement Policies and Procedures Manual

The Procurement Policies and Procedures Manual requires that CAMM request a price review by Internal Audit for sole source purchases greater than \$50,000. However, sole source software and hardware licensing, maintenance, and emergency support PO's, while authorized by the Board of Directors through the budget process, are not subject to price review by Internal Audit.

Internal Audit also identified services marketed by brokers, but the Procurement Policies and Procedures Manual does not address these types of procurements.

Recommendation 2:

Internal Audit recommends that the Procurement Policies and Procedures Manual be updated to address sole source PO's exceeding \$50,000 that do not require price review by Internal Audit and develop and document procedures for services marketed by brokers.

Management Response (CAMM):

Management has reviewed the recommendations and agrees to develop procedures that address sole source POs that do not require a price review by Internal Audit. Each year a list of sole source procurements, the majority of which are software maintenance agreements, are included in the budget documents for the Board of Directors to review. These procurements are approved by the Board of Directors when they take action on approving the annual OCTA budget.

Management also agrees to develop and document procedures for services that are marketed by brokers, such as property insurance policies and health insurance policies.