City of Edmonton
Office of the City Auditor

Evaluated Receipt Settlement Audit

June 16, 2020

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Report Highlights

Objectives

To determine whether key controls over evaluated receipt settlement processes and transactions are adequately designed and operating effectively.

Scope

This audit assessed Evaluated Receipt Settlement data from May 1, 2018 until February 29, 2020. We focused our sampling procedures on Integrated Infrastructure Services Department and Edmonton Transit Service transactions due to the dollar value and volume of transactions.

We excluded External Agencies, Boards and Commissions such as the Edmonton Public Library and Edmonton Police Service from our scope because those organizations do not report to the City Manager.

Statement of Professional Practice

This project was conducted in accordance with the International Standards for the Professional Practice of Internal Auditing.

Executive Summary

What is Evaluated Receipt Settlement?

Evaluated receipt settlement (ERS) is a process to match goods or services received to details from an approved purchase order, and authorize payment for those goods or services at the same time. This differs from the traditional accounts payable process because an invoice is not required in the ERS process. The City processed over $680 million worth of ERS transactions in 2019, which accounted for 24% of payments made in the year.

A key risk associated with using ERS is that invoices are not tracked within the payment system. This means that there is an increased risk of duplicate payments and overpayments.

What did we do?

The objective of this audit was to determine whether key controls over ERS processes and transactions are adequately designed and operating effectively.

To do this we interviewed staff from two business areas that use ERS and obtained an understanding of the processing and payment process. We then reviewed a representative sample of ERS transactions in these two areas.

We reviewed processes to prevent and detect duplicate payments and tested whether the City had made any duplicate payments. We also examined the system access roles that City employees have to determine whether anyone had conflicting roles (the ability to create a purchase order and also receive goods or services against the same order), and then reviewed the procedures to address these conflicts.

What did we find?

During the audit we found that a large percentage of transactions did not have documented approvals in one of the two business areas examined. However, the amounts paid to vendors were accurate and supported. We did not find a documented corporate-wide policy that outlines what types of transactions are eligible for ERS and the use of this processing stream, or what related controls should be in place.

Corporate-wide duplicate payment testing revealed a small number of duplicate payments, and led to the conclusion that the City can improve controls to prevent or detect duplicate payments for ERS. We also found staff with incompatible system roles that were not properly monitored.

Recommendations

Recommendation 1

Design and implement an ERS Administrative Directive

We recommend that the Branch Manager of Financial Services works with business areas to develop and implement a documented Evaluated Receipt Settlement administrative directive to:

- Determine which types of transactions should be processed in Evaluated Receipt Settlement.
- Determine what types of payments need approval.
- Ensure controls are in place to prevent and detect duplicate payments.

Recommendation 2

Perform regularly scheduled operational processes in support of monitoring controls

We recommend that the Branch Manager of Open City and Technology ensures that operational processes are performed, to periodically review user roles; and to update user roles in support of Evaluated Receipt Settlement and segregation of duty monitoring controls that are performed by the business areas.

Background

What is Evaluated Receipt Settlement?

Evaluated receipt settlement (ERS) is the process of approving payments for goods without receiving an invoice.

This process is designed so the information on a purchase order is matched with the information from the corresponding goods receipt or service receipt (two-way match). This is different from traditional accounts payable transactions where purchase orders, goods receipt, and an invoice are all matched (three-way match).

ERS Process

Accounts Payable Process

How are they used in the City?

Two of the most frequent users of ERS in the City are
- Integrated Infrastructure Services Department (IIS)
- Edmonton Transit Services Branch (Transit) in the City Operations Department

IIS and Transit transactions account for approximately 92% of the total value ERS transactions processed by the City.

IIS and Transit ERS Process

IIS is responsible for the design and delivery of facilities, transportation, LRT, neighbourhoods, and open spaces infrastructure, including projects that are for the benefit of other City of Edmonton business areas.

Transit is the City's public transportation system that provides over 80 million rides each year. Transit plays an important role in City-building and provides connection within Edmonton and surrounding areas.

IIS and Transit mainly use ERS to process transactions related to capital projects, transit maintenance, leases, and construction-related payments. In both areas, staff members receive a physical invoice and compare it to the purchase order, with the invoice taking the place of a goods receipt document in traditional ERS processing.

Although IIS and Transit use invoices as the document to start processing payment for capital projects, the nature of ERS is such that other areas may process based on a progress estimate, packing slip, or other goods receipt document, without having received an invoice which is how ERS is traditionally used.

Use of Evaluated Receipt Settlement

What did we find?

We found that the City uses ERS in non-traditional ways.

ERS is most often used for the purchase of direct materials where there are high volumes of goods at fixed prices.

These types of transactions use outline agreements or contracts to set the price for the goods. Payments are made based on a two-way match: PO details are matched to the goods receipt, which is then used to start the payment process. This eliminates the need for an invoice to be received.

The City use of ERS is non-traditional.

The City uses ERS to process transactions such as long-term construction contracts and other services. ERS was not originally designed to be used for construction contracts as these types of transactions are more complex than receiving direct materials. The City uses ERS because different phases of construction work can overlap and construction invoices will not match to the PO.

The City does not have standardized requirements for how business areas should use ERS.

We did not find documented city-wide guidance on the use of ERS. Although one of the two business areas we reviewed does have a formalized process in place, without corporate guidance individual areas will likely process ERS transactions differently. This can lead to a lack of controls designed to prevent and/or detect processing errors or duplicate payments. There is an opportunity for the City to perform a best practice review. **(Recommendation 1)**

Authorization and Accuracy of Payments

In 2017, the City implemented the Expenditure Accountability Framework (Framework). The purpose of this is to determine who can approve payments of City money. Financial Services maintains a list of City employees who are authorized to approve payments, and the Framework requires that an employee on the list approve any payments leaving the City.

What did we do?

We examined the processes to review and approve ERS transactions within IIS and Transit, to determine whether the business area paid the correct amounts and had properly documented approvals consistent with the Framework. Business areas are responsible for verifying the accuracy of documents and approving the transaction. After they complete this, Accounts Payable administers the payment.

Accounts Payable does not provide oversight of the overall process as they do not receive the documents associated with ERS transactions.

Business Areas
- Processing
- Verification
- Approval

Accounts Payable
- Paying the vendor
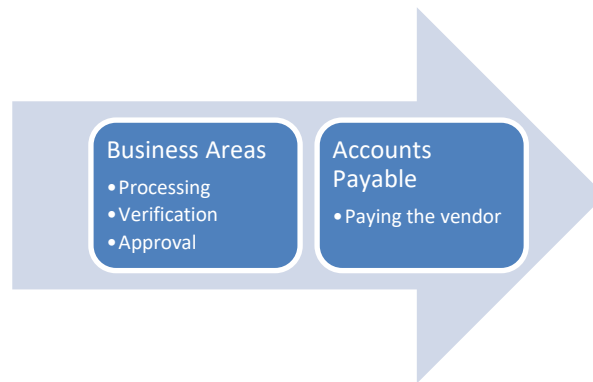
We conducted representative sampling procedures to determine whether payments had properly documented approvals and were accurate (see the report Appendix). We selected IIS and Transit as they had the highest dollar value and volume of ERS transactions.

What did we find?

In Transit, 79% of payments did not have properly documented approval.

In IIS, 17% of payments did not have properly documented approval.

In Transit we found:

- 79% (70/89) of payments were made without properly documented approval. 51 of these are related to one vendor. The individual that processed these transactions was not familiar with the Framework, and did not know that the payment needed to be approved prior to payment.

- 4% (4/89) of payments are approved by employees not on the approved lists.

- All payments are accurately paid.

In IIS we found:

- 17% (16/95) of payments were made without properly documented approval. All of these related to one vendor, for transactions prior to October 2019. We discussed this with IIS management and they informed us that they changed the process in October 2019 to ensure that payments now have documented approval for this specific vendor. We tested 5 newer transactions with this vendor and found all of them have documented approvals in place.

- All payments are accurately paid.

In both areas we found they were making payments without properly documented approvals. Not having properly documented approvals for payments can lead to the City paying vendors prior to them completing the agreed upon work. The City should only process approved payments. (**Recommendation 1**)

Duplicate Payments

What did we do?

We performed corporate-wide testing (including areas outside of IIS and Transit) to identify duplicate payments, and we reviewed the City's processes to prevent and identify duplicate payments relating to ERS.

What did we find?

Individual business areas are responsible for controls related to processing ERS transactions. Accounts Payable is responsible for administering the payment but does not have any controls in place to determine whether it already made a specific payment. When payments are processed through Accounts Payable's three-way match there is a system control that recognizes potential duplicate payments, stops the processing of this transaction and notifies Accounts Payable staff that a review is required. This system control does not exist in ERS.

88 corrected duplicate payments totaling **$377,000**.

We found that business area controls do not prevent all duplicate payments. Between May 1, 2018 and October 31 2019, we found a total of 151 duplicate payments of the 61,000 ERS transactions made. Of these duplicates, the business areas became aware of 85, either through the vendor notifying them or project managers identifying the duplication. These payments were reversed, as well as 3 more that the audit identified.

Of the 63 remaining outstanding duplicate payments we found:

63 outstanding duplicate payments totaling **$108,000**.

- 62 were made twice through the ERS process, and
- 1 was made through both the ERS process and Accounts Payable

The City does not have a specific process to identify duplicate payments relating to ERS. They also do not have documented detective controls in place to check for duplicate payments after they have been made.

Recommendation 1

Design and implement an ERS Administrative Directive

Recommendation

We recommend that the Branch Manager of Financial Services works with business areas to develop and implement a documented Evaluated Receipt Settlement Administrative Directive to:

- Determine which types of transactions should be processed in ERS.
- Determine what types of payments need approval.
- Ensure controls are in place to prevent and detect duplicate payments.

Responsible party:

Branch Manager, Financial Services

Accepted by Management

Management Response

In conjunction with the implementation of ARIBA, the Branch has been examining the ways the City pays vendors. The Branch is drafting corporate wide guidance for transactions including the nature and type of transactions that should be processed in ERS. The Branch is also in the process of drafting ERS Operating Procedures and Governance.

The City's Expenditure Accountability Framework defined what transactions require approval and the level of approval required. All Senior Expenditure Officers, Expenditure Officers, and Proxies including all credit card statement approvers have been trained in accordance with the City's Expenditure Authority Framework guidance. It is anticipated that adjustments to the framework will be made in conjunction with the Enterprise Commons project but we anticipate those changes to result in the standardization of the expenditure officer framework with roles across the corporation rather than changes to the design of the underlying controls.

The Branch is working with the Analytics Centre of Excellence to develop a fraud detection tool to flag potential fraudulent and erroneous duplicate payments to external vendors.

Implementation:

March 31, 2021

Incompatible Roles

What are incompatible roles?

In the context of ERS an incompatible role is when an employee can create a PO and has the ability to receive goods or services. When this occurs there is a potential risk of fraud (paying for goods not received) unless additional monitoring is in place.

In some cases employees will have incompatible roles due to resourcing constraints, coverage for vacation and sick days.

The City's incompatible roles control

The City maintains a list of employees with the ability to create a PO and receive goods and services. The City's Open City and Technology (OCT) Branch identifies these employees and updates the report semi-annually to capture role or personnel changes in the organization. Business areas with employees that have incompatible roles are notified and it is their responsibility to either resolve the incompatible role by reassigning responsibilities or ensuring a reviewer has been assigned to each employee on this list.

The reviewer receives a report each month showing all the transactions where the employee creates a PO and receives the goods or services. The reviewer is responsible for reviewing these transactions to ensure they are for business purposes.

What did we do?

We performed the following procedures:

1. Reviewed controls to update the monitoring lists.
2. Identified employees in all City departments with the ability to create POs and received goods or services that were not monitored by an assigned reviewer.
3. Determined whether the assigned reviewers were still City employees.
4. Identified unmonitored transactions and quantified the related dollar values paid out.

What did we find?

We found that the OCT Branch has not updated the list of employees with the ability to create a PO and receive goods and services since April 2018. Management communicated that this is due to resource constraints and shifting priorities within the organization.

The risk of not updating the lists is that it is possible that

OCT has not updated the list of employees with incompatible roles and their reviewers since April 2018

15 current employees with incompatible roles do not have an assigned reviewer.

An additional 9 employees with incompatible roles have an assigned reviewer that no longer works for the City.

transactions made by employees with incompatible roles are not being properly reviewed. Employees with incompatible roles may not have an assigned reviewer or the person assigned to review the transactions of an employee with incompatible roles may no longer work for the City and is therefore not completing the reviews.

We created an up-to-date list of employees with incompatible roles and found that there were 15 employees that can create POs and receive goods or services, who were not included on the monitoring list.

We reviewed the most recent list, from April 2018, and found there were 4 reviewers who no longer work for the City. These 4 reviewers were responsible for reviewing the transactions of 9 employees, which means that the transactions of these 9 employees were not being reviewed.

The dollar value of the transactions processed by the 9 employees we identified without valid reviewers was only $21,000, and management confirmed that the transactions were all for business purposes.

However, by not performing the controls in place the City has put itself at risk of a potential fraud.

Recommendation 2

Perform regularly scheduled operational processes in support of monitoring controls

Recommendation

Ensure that operational processes are performed to periodically review user roles; and to update user roles in support of Evaluated Receipt Settlement and the segregation of duty monitoring controls that are performed by the business areas.

Responsible Party:

Branch Manager of Open City and Technology

Accepted by Management

Management Response

The Open City and Technology Branch will assess current processes related to Evaluated Receipt Settlement and segregation of duties to ensure they are efficient and effective, and will make updates as required; will increase awareness with impacted staff to ensure knowledge of processes is current; and will maintain documentation and facilitate the performance of segregation of duty monitoring controls.

Implementation:

March 31, 2021

Appendix: Audit Methodology

Methodology

We used the following methods to conduct this audit:

- Performed interviews with management and staff from Financial Services, IIS, Transit, and OCT.
- Reviewed IIS's and Transit's processes to process ERS transactions.
- Performed representative sampling procedures to verify whether payments were properly authorized and accurately paid in IIS and Transit.
  - Representative sampling: This sampling method involves the use of random selection. Each transaction has an equal chance of being selected for review regardless of the value of the transaction. This method allows the results of the sample testing to be expanded to the entire population. We used a confidence level of 90% with a 10% margin of error.
- Analyzed corporate-wide data related to duplicate payments.
- Identified conflicting roles related to ERS and reviewing the controls to monitor these conflicts.