

**Performance Audit
City Purchasing Card Program**

April 2009

City Auditor's Office

City of Kansas City, Missouri

April 29, 2009

Honorable Mayor and Members of the City Council:

This performance audit of the city purchasing card program was initiated by the city auditor pursuant to Article II, Section 216 of the city charter. We focused on cardholders' compliance with established purchasing card guidelines between May 1, 2006 and November 30, 2007. Additionally, this audit compares the purchasing card program's monitoring and internal control processes with recommended internal controls and practices. During the audit period, city staff made about 16,400 purchasing card transactions totaling a little over \$4 million. In early 2008, the city switched service providers for the purchasing card program.

We found purchasing card transactions that violated the city's purchasing card program guidelines, city code, or city procurement rules. Our examination of transactions revealed split purchases, missing documentation, unqualified or prohibited purchases, purchase amounts that exceeded allowable monetary limits, and one transaction that was potentially a misuse of city funds. Some transactions related to gift cards or award gifts with a monetary value may also have potential tax liabilities for the city or employees.

The city's purchasing card program contains many practices or policies recommended by the Government Finance Officers Association and the Association of Government Accountants. The new program provides the city with better managerial oversight and monitoring capabilities and the Finance Department instituted a monitoring program in August 2007. Even with these improvements, there are still some elements of the control environment such as communication, segregation of duties, and training that could be improved.

The city's purchasing card program relies on the ethics, integrity, and judgment of cardholders and staff who review and approve purchasing card transactions. The tone at the top of the organization has an affect on the control environment, particularly the ethics and integrity of all staff in the organization.

We shared a draft of this report with the city manager and the directors of finance and general services on March 17, 2009. Management's response is appended. We would like to thank staff in the Finance and General Services departments as well as staff in the city departments we visited during the course of this audit. The audit team for this project was Jason Phillips and Douglas Jones.

Gary L. White
City Auditor

City Purchasing Card Program

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City Purchasing Card Program

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Introduction

Objectives

We conducted this audit of the city's purchasing card program under the authority of Article II, Section 216 of the Charter of Kansas City, Missouri, which establishes the Office of the City Auditor and outlines the city auditor's primary duties.

A performance audit provides assurance or conclusions based on an evaluation of sufficient, appropriate evidence against stated criteria. Performance audits provide objective analysis so that management and those charged with governance and oversight can use the information to improve program performance and operations, reduce costs, facilitate decision making, and contribute to public accountability.¹

This report is designed to answer the following questions:

- Are purchasing card transactions and activities in compliance with established city guidelines?
- Are the city's monitoring and internal control processes consistent with recommended internal controls and practices?

Scope and Methodology

Our review focused on cardholders' compliance with established purchasing card guidelines between May 1, 2006 and November 30, 2007. Additionally, this audit compares the purchasing card program's monitoring and internal control processes with recommended internal controls and practices.

Our methods included:

- Reviewing the city's purchasing card guidelines, contracts with UMB and Bank of America, and city code establishing the city's purchasing card program.

¹ Comptroller General of the United States, *Government Auditing Standards* (Washington, DC: U.S. Government Printing Office, 2007), p. 17.

- Reviewing relevant literature to identify recommended internal controls and practices and potential risk areas.
- Interviewing staff in the Finance and General Services departments as well as staff in departments using purchasing cards.
- Reviewing electronic records for approximately 16,400 purchasing card transactions made between May 1, 2006 and November 30, 2007, obtained from the Finance Department's Treasury Division.
- Selecting a judgmental sample of transactions based on potential risk areas or likelihood of violating the city's purchasing card program guidelines. (See Appendix A for our sampling methodology.)
- Examining supporting documentation for the transactions in our judgmental sample.

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.

No information was omitted from this report because it was deemed privileged or confidential other than the following exception: we identified several questionable transactions and provided this information to the city's internal auditor.

Background

Purchasing Card Programs

Purchasing card programs are established to provide an efficient and cost effective method of purchasing and paying for small-dollar as well as high volume, repetitive purchases. Purchasing cards can be used with any vendor that accepts credit cards rather than using a purchase order, check request, or petty cash. While this type of program is meant to be efficient and cost-effective, there can be opportunities for potentially abusive and/or fraudulent activities, as well as opportunities for noncompliance with organization policies and procedures.

The City's Purchasing Card Program

The city's purchasing card program was established in Section 2-1590 of the Code of Ordinances in July 2001. Employees started using purchasing cards in early 2002. The commissioner of purchases and supplies was responsible for developing rules and regulations to implement the program. Finance's Treasury Division and the General Services Department are responsible for overseeing the city's purchasing card program and training employees to use purchasing cards.

Until 2008, UMB was the service provider for the city's purchasing card program. In early 2008, the city changed to a program through Bank of America. The new program uses an online software program to assist cardholders and management in tracking purchases and monitoring use. The bank's software also interfaces with PeopleSoft.

The city issued the KCMO Purchasing Card Program Handbook in 2002 and a revision in 2006. Both manuals outlined procedures and documentation requirements, and noted a number of prohibited or unqualified purchases. (See Exhibit 1.) In 2008, a new manual was prepared for the current program that outlines similar rules and procedures for card use and documentation requirements, and identifies prohibited or unqualified purchases.

Exhibit 1. Prohibited or Unqualified Purchases

Prior Program	Current Program
Alcoholic beverages	Alcoholic beverages
Cash advances	Conversion into cash (e.g. gift cards, money orders, cash advances, etc.)
Construction, renovation, or installation	Construction, renovation, or installation services
Controlled substances	Controlled substances
Hazardous chemicals and materials	Hazardous chemicals and materials
Hospitality or entertainment	Hospitality or entertainment (without prior approval from the director of finance or designee)
Leases	
License agreements/software	
Computer hardware, software or any other related item	Computer hardware, software, or any other related item (without written IT Department approval)
Purchases involving trade-ins	
Telephones	Telephones
Travel, travel-related expenses (hotel, airfare)	Travel, travel-related expenses (hotel, airfare)
Weapons, ammunition	Weapons and ammunition
Personal purchases	Personal purchases
Split transactions	Split transactions
	Tobacco products
	Items available through contracted vendors (with the exception of emergencies and Corporate Express)

Source: KCMO Purchasing Card Program Handbooks (2002, 2006, 2008, and 2009).

City Purchasing Card Program

The purchasing card program administrator in Finance's Treasury Division is the primary contact for communication with cardholders and the purchasing card program service provider. Departments can obtain purchasing cards through the program administrator and are responsible for maintaining transaction documentation and reconciling monthly purchasing card statements. Under the program in effect during the audit period, documentation supporting purchases was reviewed by the department's designated reconciliation accountant; the new program now requires supervisory or managerial review of transactions in addition to the reconciliation accountant's review.

Our audit period covered May 1, 2006 through November 30, 2007. During this period, 159 city staff with purchasing cards made over 16,400 transactions totaling a little over \$4 million. The average amount per transaction was approximately \$244. The limit on an individual transaction was \$1,000 until August 27, 2007, when the limit was increased to \$1,500. The maximum amount that could be charged on a city purchasing card was \$10,000 per month. With the new program, departments can set the monthly maximum between \$1,500 and \$10,000 based on the anticipated needs of the cardholder.

City staff purchased a variety of goods and services from over 2,000 vendors. The following exhibit lists the top ten vendors by total dollar sales during our audit period.

Exhibit 2. Top Ten Vendors for Purchasing Card Use (May 2006 – November 2007)

Vendor	Total	
	Amount	Transactions
Country Kennels & Arrowhead Veterinary Services	\$148,697	195
WW Grainger	95,173	460
Corporate Express ²	75,537	271
Office Max	61,559	450
Wal-Mart	52,132	504
Lowe's	48,780	366
Schmitt Irrigation & Pump	44,393	57
Hertz Equipment Rental	43,627	164
The Home Depot	42,888	340
Best Buy	42,468	154

Source: Purchasing card transactions.

² The city has a contract with this vendor that is used by all city departments for office supply purchases.

Findings and Recommendations

Summary

We found purchasing card transactions that violated the city's purchasing card program guidelines, city code, or city procurement rules in every department or office in our sample. Our examination of transactions revealed split purchases, missing documentation, unqualified or prohibited purchases, purchase amounts that exceeded monetary limits, and one transaction that was potentially a misuse of city funds. Some transactions related to gift cards or award gifts with a monetary value may also have potential tax liabilities for the city or employees.

The prior and current purchasing card programs contain many practices or policies recommended by the Government Finance Officers Association as well as best practices identified by the Association of Government Accountants. The new program provides the city with better managerial oversight and monitoring capabilities and the Finance Department instituted a monitoring program in August 2007. Even with these improvements, there are still some elements of the control environment such as training, segregation of duties, and communication that could be improved.

Transactions and Activities Were Not Always Within Established Guidelines

We identified 591 violations of purchasing card program guidelines, city code, or city procurement rules in our judgmental sample of 381 transactions. Violations included inadequate documentation, split transactions, exceeding purchase limits, and unqualified purchases. Some of these transactions represented multiple violations. Problems with purchasing card transactions were identified in all 17 departments or offices in our sample.

Transactions Were Not Always Adequately Documented

The most frequent issue we found with purchasing card transactions was poor documentation. About 38 percent (146 of 381) of the purchasing card transactions we reviewed had partial or no supporting documentation. (See Exhibit 3.)

Exhibit 3. Documentation Status of Sample Transactions

Documentation Status	Transactions	
	Number	Percent
Full Documentation	235	61.7%
Partial Documentation ³	59	15.5%
No Documentation ⁴	87	22.8%
Total	381	100.0%

Source: CAO review of department purchasing card documentation.

Under the city’s prior purchasing card guidelines, cardholders were required to complete and maintain an activity log of all their purchasing card transactions, as well as retain receipts for all purchases. It also stated that cardholders had the “ultimate responsibility to keep detailed transaction records.” Cardholders forwarded the supporting documentation to the department’s reconciliation accountant for review and reconciliation with the card statement and amount due.

Maintaining complete supporting documentation for purchasing card transactions verifies that purchases were paid, identifies items purchased, identifies where items were purchased, and facilitates the reconciliation process. Complete documentation helps strengthen management’s ability to monitor purchasing card transactions and ensure that purchases are for city purposes. Inadequate documentation for purchasing card transactions increases the risk that cardholders could ignore or circumvent internal controls which could result in improper or fraudulent purchases. Cardholders and management with oversight responsibilities should receive additional or ongoing training to ensure that they are aware of the requirement for obtaining and retaining all supporting documentation in purchasing card files.

Exceptions Were Not Always Recorded

We identified 57 of 16,435 transactions that exceeded the purchasing card program’s single purchase limit.⁵ The value of these transactions ranged from \$1,004 to \$4,500. We also identified seven instances where the monthly limit was exceeded.⁶ The monthly expenditures for these cards ranged from \$10,035 to \$14,100.

³ Partial documentation means that transactions were either recorded on the activity log or the department had a receipt.

⁴ No documentation means that transactions were not recorded on the transaction activity log and had no corresponding receipts.

⁵ The maximum limit for a single purchase was \$1,000, which was changed to \$1,500 on August 27, 2007.

⁶ The maximum amount that could be charged on a city purchasing card was \$10,000 per month.

Cardholders and departments request exceptions related to dollar limits or merchant blocks⁷ through Treasury or General Services. Staff in Treasury or General Services contact the bank to authorize these exceptions. The Treasury Division maintains a log of approved exceptions.

We reviewed Treasury’s exception log to determine whether any of the individual purchases or total monthly card expenditures we identified as exceeding program limits were approved. During the audit period, Treasury documented 18 approvals for exceptions; however, none of these were for transactions that exceeded the dollar limits.

These instances of expenditures exceeding limits without approval could have occurred because the vendor’s processing equipment was off-line at the time of the purchase; an override request was approved by Treasury, but not recorded in the exception log; or the override request was approved by General Services and Treasury was not informed. The recent change in the program’s structure clearly identifies that cardholders should contact the program administrator in Treasury to request exceptions or overrides and that the program administrator is responsible for handling these exceptions. Management should take steps to ensure that all exceptions are properly approved and documented.

Split Purchases Circumvented Transaction Restrictions

We identified 85 split purchases in our judgmental sample of purchasing card transactions. Cardholders in 12 of 17 departments made at least one split purchase transaction. A split purchase transaction occurs when the value of a purchase exceeds the single purchase limit and the transaction is split into two or more transactions

Split transaction on a single card to purchase sporting goods equipment		
Transaction Date	Receipt Time Stamp	Amount
6/1/2006	5:19 PM	\$935.77
6/1/2006	5:23 PM	935.77
6/1/2006	5:26 PM	935.77
6/1/2006	5:29 PM	431.89
6/1/2006	5:38 PM	935.77
6/1/2006	5:42 PM	935.77
6/1/2006	5:44 PM	935.77
6/1/2006	5:58 PM	791.80
6/1/2006	6:03 PM	220.99
Totals	44 minutes	\$7,059.30

Source: Receipts from department files.

The maximum limit for a single purchase at the time was \$1,000.

⁷ The city is able to block purchasing card transactions at certain types of vendors by using merchant classification codes (MCC). When a card is used at a vendor in the blocked MCC, the transaction is denied. These blocks may be released on a case-by-case basis by the city’s purchasing card program administrator in consultation with the city’s Procurement Division.

with values below the single purchase limit. The city’s purchasing card program states that split transactions are not allowed and that this type of transaction is an improper use of the card. The majority (60) of the split transactions we identified were made by individual cardholders.

Split transactions may also involve two or more cardholders working together to make two or more transactions with the same vendor on the same day or following day to circumvent the single purchase limit. The value of individual split purchase transactions we identified ranged from about \$1,300 to \$7,100.

Split transaction using multiple cards to purchase trash bags			
Cardholder	Date	Invoice #	Amount
A	06/15/07	142734	\$ 999.84
B	06/15/07	142735	999.84
C	06/15/07	142736	999.84
D	06/15/07	142738	999.84
Total			\$3,999.36
Source: Receipts from department files.			

Some cardholders told us they were not aware that split purchase transactions were prohibited and one management individual with responsibility for monitoring card use told us they were not too concerned if this activity occurred. Cardholders and management with oversight responsibilities should receive additional or ongoing training to ensure they are aware split transactions violate the city’s purchasing card guidelines. Management staff responsible for monitoring purchasing card use should ensure split purchases are identified, cardholders are discouraged from making these transactions, and that appropriate disciplinary action is taken.

Quotes Should Have Been Solicited for Some Purchases

We found 81 transactions (individual and split transactions) in our sample that required a more thorough procurement process before the purchases could be made using a purchasing card. Amounts for these transactions ranged from about \$1,521 to \$7,100.

In fiscal year 2007, city code⁸ required quotes be solicited for purchasing card transactions between \$1,500 and \$15,000 and between \$1,600 and \$16,000 in fiscal year 2008. City procurement regulations also state that

⁸ Code of Ordinances, Kansas City, Missouri, Sec. 2-1590(c) “Purchases over \$1,000.00 to \$10,000.00. If the cost of a single purchase exceeds \$1,000.00 but does not exceed \$10,000.00, quotations shall be solicited by any method from a reasonable number of qualified sources to ensure the proposed purchase is advantageous to the city, price and other factors considered.” The amounts in Sec. 2-1590 are automatically adjusted at the beginning of each fiscal year by Sec. 2-1602 to eliminate the effects of inflation on purchasing power.

the Procurement Division will handle the solicitation process for purchases above \$1,500. We did not find any documentation with the transactions that exceeded these thresholds to support that quotes or bids had been solicited. Additionally, neither the prior or current purchasing card program guidelines referenced any requirements or limitations outlined in city code or procurement regulations.

Cardholders and management with oversight responsibilities should receive additional or ongoing training to ensure that they are aware of the transaction amount limits in the purchasing card guidelines and that city code and procurement regulations place additional requirements or limitations on the use of purchasing cards. Management staff responsible for monitoring purchasing card use should ensure that cardholders' purchases do not exceed these limits, discourage cardholders from making these types of transactions, and take appropriate disciplinary action. City code and procurement regulations related to requirements or limitations on purchasing card transactions should be included in the city's purchasing card program guidelines.

Purchasing Cards Were Used by Staff Other than the Cardholder

We identified four transactions where purchases were made using the card of an employee who was no longer employed by the city. Staff in the department of the former employee made the purchases and the department's fiscal officer said that these were reasonable purchases for the department. Even with the knowledge and approval of the department fiscal officer, these transactions violated the city's purchasing card rules. We also identified one split transaction, totaling almost \$7,100, in which the signature on five of the nine receipts was not that of the cardholder.

The managerial responsibilities section of the city's purchasing card manual stated "Department managers must immediately cancel a departing employee's card by completing the Cardholder Action Request Form." The manual further directed the department manager to "CUT UP THE CARD and return it to the program administrator." (Emphasis in original.) A basic rule in the employee responsibilities section of the manual stated "The card is issued in your name and may not be used by anyone else."

Beginning in October 2008, the Finance Department began receiving a report on a regular basis that lists employees who have left city employment. According to Finance Department staff, this report is compared to the list of purchasing cardholders. If a cardholder's name appears on the former employee list, the purchasing card program administrator is notified so the card can be deactivated.

Cardholders and management with oversight responsibilities should receive additional or ongoing training to ensure that they are aware of their responsibilities related to using and managing the city's purchasing cards. Department managers should ensure that purchasing cards are cancelled and destroyed when employees leave the city or their department. The Finance Department should continue their monitoring efforts in this area. Cardholders should never give their card or card number to another employee.

Prohibited Computer Software and Hardware Purchases Were Made

The purchasing card program in effect during the audit period prohibited purchases related to computer hardware, software, or any other related items. We found 35 computer-related purchases, such as computer software, projectors, and printers, in the transaction sample we reviewed. This restriction has been modified in the new purchasing card program to allow these types of purchases to be made with approval from the Information Technology Department.

Cardholders and management with oversight responsibilities should receive additional or ongoing training to ensure that they are aware that technology-related purchases cannot be made without prior approval. Cardholders should be reminded and discouraged from making unapproved computer software and hardware purchases. Management staff responsible for monitoring purchasing card use should ensure that all technology-related purchases have documentation showing proper approval and take appropriate disciplinary action when they do not.

Prohibited Hospitality and Entertainment Purchases Were Made

Our transaction sample included 49 purchases for business meals or employee morale/team building events. Food was purchased for luncheons, meetings, or catered events for city employees or individuals doing business with the city. These expenditures totaled about \$22,000 and individual amounts ranged from \$4 to \$4,500. (See Exhibit 4.) These types of purchases are considered hospitality or entertainment, which the city's prior purchasing card program prohibited. The current rules now allow these types of purchases with prior approval from the director of finance or designee.

Exhibit 4. Hospitality and Entertainment Related Purchases

Vendor	Amount	Vendor	Amount
Embassy Suites KC	\$4,500.00	Big Momma's Rolls	\$100.80
Science City at Union Station	3,576.60	Big Momma's Rolls	81.60
Worlds/Oceans of Fun	1,972.15	Price Chopper	81.23
Marriott	1,414.59	LSG Sky Chefs	73.44
Hilton Hotel	1,200.00	La Mar's Donuts	67.20
Embassy Suites KC	1,117.24	Chophouse	66.06
Peachtree Restaurant	1,100.30	Cascone's Grill	56.40
Dean & Deluca	562.62	D'Bronx	54.97
Missouri Restaurant Assoc	550.00	Candy Direct	49.52
Necco Coffee	542.88	Vivace	45.47
Necco Coffee	540.95	Arun Thai Grill	43.80
Gourmet Grocery Catering	520.75	Swagat	29.87
Hotel Phillips	486.42	Subway	24.92
Peachtree Restaurant	472.00	Quiznos Sub	22.89
Fiorella's Catering	402.80	Minsky's Pizza	21.87
Krispy Kreme	394.85	Gates	21.47
Niece's Restaurant	345.00	Cupini's	19.64
Hereford House	276.47	Cupini's	19.59
Stroud's	257.50	Wal-Mart	17.24
Napoleon Bakery	167.65	Judi's Family Bakery	11.00
Topsy's Popcorn	151.80	Peachtree Restaurant	10.93
Panache Chocolatier	149.75	Succotash	6.52
Church's Chicken	139.89	Cupini's	5.95
Peachtree Restaurant	131.93	Wal-Mart	4.16
Napoleon Bakery	120.85		

Source: Purchasing card transactions.

Cardholders and management with oversight responsibilities should receive additional or ongoing training to ensure they are aware that hospitality and entertainment purchases cannot be made using the city's purchasing card without prior approval from the director of finance or designee. Management staff responsible for monitoring purchasing card use should ensure that hospitality or entertainment purchases are identified and have documentation showing management's prior approval. Cardholders should be reminded and discouraged from making unapproved hospitality and entertainment purchases.

While purchases related to hospitality and entertainment are now allowed with prior approval from the director of finance, we were unable to identify any city policies or procedures outlining acceptable expenditures of city funds related to business meals or morale/team building events. In some situations, meals paid for by the city could also represent a potential tax liability for the city and employees. The city manager should develop policies that provide guidance to city management regarding acceptable

use of city funds for hospitality, entertainment, business meals, or employee morale/team building events.

Purchasing Cards Were Used to Pay Travel Expenses

Our transaction sample included 18 instances where either airfare or hotel lodging was purchased by cardholders for employees traveling on city business. The city's purchasing card guidelines in effect during our transaction review period specifically prohibited using the card to pay for travel expenses. Additionally, two policies, Administrative Regulation 3-03 and Manual of Instruction 2-14, outline the city's policies and procedures governing how employee travel expenses should be handled. Neither policy mentions the use of the city's purchasing card as a payment method for travel expenses. However, the new purchasing card program guidelines provide some leeway as cardholders can "request an exception be granted for a purchase outside of the normal parameters by contacting the Program Administrator." These exceptions must be approved by the director of finance. Permanent exemptions for travel-related purchases have already been granted to several cardholders under the current program.

Allowing travel expenses to be paid using purchasing cards increases the potential that the city could pay for the same travel expenses twice because purchasing cards and travel expense reimbursements are reviewed and processed under two different systems. Having a method to pay for travel expenses that differs from the city's normal processes and permanently lifting restrictions from purchasing cards increases the risk of inaccurate, abusive, or fraudulent travel expenses.

The city paid twice for the same travel expense

Our sample of transactions included a room service charge paid by a city purchasing card. The travel expense reimbursement signed by the traveler included reimbursement of the full per diem allowed for that day. As a result, the traveler was reimbursed for a meal charge the city had already paid.

Travel expenses should be processed as outlined in the city's administrative regulations and manual of instructions. Merchant blocks should be put in place to ensure that travel-related purchases cannot be made with city purchasing cards without prior approval. If management decides to allow travel expenses to be paid using purchasing cards in certain situations or for certain individuals or cardholders, the city's travel expense policies and purchasing card program guidelines should be updated to reflect this change and ensure proper accountability of travel expenses.

Sales Taxes Were Inappropriately Paid on Some Transactions

Sales tax was paid on 31 purchasing card transactions in our sample. The city is exempt from paying sales tax. The city's purchasing card guidelines state that if sales tax is inadvertently added to a purchase, "it will be the responsibility of the cardholder to reconcile and/or refund if charged." We found evidence of sales tax refunds for only 2 of 31 transactions in which sales tax had been assessed.

One management individual with responsibility for monitoring card use told us they felt it would cost more for the city to attempt to retrieve the sales taxes paid than to just absorb the costs. While there may be some validity to this argument, the most cost effective manner is to not pay sales taxes when purchasing items for the city using a purchasing card. Cardholders and management with oversight responsibilities should receive additional or ongoing training to ensure they are aware that the city is exempt from paying sales taxes, that they should ensure sales taxes are not assessed on city purchases, and if sales taxes are assessed, they are responsible for obtaining a refund.

Some Purchases May Have Tax Implications

Our transaction sample included 18 purchases for gift cards totaling about \$5,500, with individual gift card values ranging from \$5 to \$50. The departments purchasing the gift cards reported giving them to employees during customer service week, as recognition for a job well done, or for contributing to the city's charity campaign. Some departments did not maintain adequate documentation regarding who received these cards.

Another department had a sick leave incentive program and gave qualifying employees their choice of items such as a watch, digital camera, luggage, etc. ranging in value from about \$130 to \$470. We identified about \$7,800 that was spent on these incentives.

According to federal tax regulations, gift cards of any denomination and prizes or awards given to employees could represent a potential tax liability for employees and/or the city because cash or cash equivalents are always taxable regardless of amount. Additionally, gift cards could be converted to cash or personal use by a purchasing cardholder if gift cards are not adequately monitored and controlled by departments.

The city's new purchasing card program explicitly prohibits the purchase of gift cards. Cardholders and management with oversight responsibilities should receive additional or ongoing training to ensure they are aware that gift cards are now a prohibited purchase.

Management staff responsible for monitoring purchasing card transactions should ensure that this type of transaction is not made by cardholders and take appropriate disciplinary action if this occurs. Department managers should also verify with Finance and/or the Law departments how to ensure that gifts or awards given to employees are properly accounted for regarding their potential tax liability.

City Funds Were Potentially Misused

We identified one purchase that resulted in the potential misuse of city funds. A \$750 expenditure was made for a table at a banquet staged by a local political action committee in 2007. The stated purpose on the banquet reservation form was to “raise funds to support local progressive candidates.” The city’s expenditure was reported by the political action committee to the Missouri Ethics Commission as a contribution. State law prohibits the use of public funds to support any candidate for public office.⁹

Many community organizations conduct fundraising through banquets or educational programs. While these events may provide city staff an opportunity for networking or participating in the work of an organization, special care must be taken when attending these types of events. Whether or not an expenditure of public funds by the city for participation in an event is lawful depends on the specific nature of the event. Contributing to the fundraising events of some organizations may be an unlawful use of public money. It must be determined whether the intent of the public expenditure serves a public purpose or promotes a private purpose. The city manager should develop policies that provide guidance to city management regarding the expenditure of city funds to attend community organization banquets, education programs, or other events.

Lack of Policy Increases Risk of Inappropriate Use of City Funds

This report contains several examples of purchases that could be inappropriate or questionable uses of city funds for non-essential items such as an employee team building/morale event at Oceans of Fun, gift cards to reward employees who contribute to the city’s charity campaign, expensive gifts as part of an employee sick leave incentive program, and a contribution to a political action committee. The city manager should develop policies that provide guidance to city management regarding expenditures for non-essential items to ensure they are an appropriate use of city funds.

⁹ Revised Statutes of Missouri, §115.646.

Purchasing Card Program Incorporates Many Recommended Practices and Controls

The Government Finance Officers Association and the Association of Government Accountants have identified a number of recommended or best practices and policies for purchasing card programs. The city's prior and current purchasing card programs contain most of these recommended practices. Although the city's purchasing card program incorporates many recommended practices, there are some areas such as communication, segregation of duties, and training that could be improved.

Recommended Practices from Government Finance Officers Association and Association of Government Accountants

The Government Finance Officers Association (GFOA) recommends that purchasing card programs in governments maintain appropriate controls, in accordance with their purchasing policy, to ensure the ongoing success of a purchasing card program. The city's purchasing card program incorporates many of the recommended practices. (See Exhibit 5.)

Exhibit 5. Recommended Practices from the Government Finance Officers Association

Recommended Practice	Prior Program	Current Program
Written agreements with banks, which include fee schedules and processing procedures	Yes	Yes
Written policies and procedures for internal staff	Yes	Yes
Instructions on employee responsibility and written acknowledgments signed by the employee	Yes	Yes, but not all cardholders signed the new agreement
Ongoing training of cardholders and supervisors	No	No
Spending and transaction limits for each cardholder both per transaction and on a monthly basis	Yes	Yes
Written requests for higher spending limits	Yes	Yes
Recordkeeping requirements, including review and approval processes	Yes	Yes
Clear guidelines on the appropriate uses of purchasing cards, including approved and unapproved merchant category codes (MCC)	Yes	Yes
Guidelines for making purchases by telephone and fax or over the Internet	Yes	Yes
Periodic audits for card activity and proper documentation	No	Yes
Timely reconciliation by cardholders and supervisors	Yes	Yes
Procedures for handling disputes and unauthorized purchases	Partially, no instructions for unauthorized purchases	Partially, no instructions for unauthorized purchases
Procedures for card issuance and cancellation, lost or stolen cards, and employee termination	Yes	Yes
Segregation of duties for payment approvals, accounting, and reconciliations	Yes, with some exceptions	Yes, with some exceptions
Systems to ensure compliance with IRS 1099 reporting regulations	Yes	Yes

Source: Government Finance Officers Association Recommended Practices.

The Association of Government Accountants (AGA) surveyed state and federal agencies and identified a number of best practices and policies for government purchasing card programs. Although the city's prior program did not incorporate most of these best practices and policies, the current program incorporates all but one. (See Exhibit 6.)

Exhibit 6. Best Practices and Policies Identified by the Association of Government Accountants

Policies and Best Practices	Prior Program	Current Program
Ensure training is completed before cardholder receives card	Yes	Yes
Ensure training is reinforced on periodic basis	No	No
Institute a policy that deals with consequences if the card is used inappropriately	Yes	Yes
Use available data and software tools to monitor credit card purchases	No	Yes
Use of merchant category card blocks	Yes	Yes
Use of exception reports	No	Yes
100 percent review by approving officials	No	Yes
Daily review of transaction data	No	Yes
Third-party periodic or statistical review	No	Yes
Data mining	No	Yes
Appropriate or maximum spending limits for locations	Yes	Yes

Source: Association of Government Accountants State and Federal Purchase Card: Uses, Policies, and Best Practices.

The prior program incorporated 16 of 26 practices recommended by GFOA and AGA, and the current program incorporates 23 of 26 recommended practices from the literature we reviewed. Overall, we found improvements in internal controls over purchasing cards but there are still some areas with room for improvement.

Monitoring Efforts and Managerial Oversight Capabilities Have Improved

In August 2007, the Finance Department began conducting periodic reviews of departments' purchasing card transactions. The new purchasing card program requires managers or supervisors to review and approve transactions. The new program also provides online access to transaction data and reports for review and analysis.

Finance now has a monitoring program in place. In August 2007, the Accounts Division of the Finance Department began conducting internal reviews of the purchasing card program. These ongoing reviews involve examining at least one month of purchasing card transactions on a department by department basis. Periodic evaluation is one of GFOA's recommended practices and should be continued as a way to reduce the risk that improper, abusive, or fraudulent purchasing card transactions occur.

Managerial oversight and monitoring capabilities improved with the new program. The current program requires review and approval of purchasing card transactions by the cardholder's supervisor or manager. In the past, review and approval was assigned to the reconciliation

accountant who may or may not have known whether a purchase was appropriate or needed.

The current program uses an online program that automatically records purchasing card transactions. Cardholders can review their transactions and input additional information about their purchases. The online program also allows reconciliation accountants, managers, and others charged with oversight duties to review purchasing card transactions in real-time as well as prepare a variety of reports for more detailed review and analysis. The prior program used manual activity logs and monthly statements and did not require a cardholder's supervisor to review and approve transactions.

Control Environment Needs Further Improvement

Although the city's purchasing card program includes a number of recommended practices, communicating changes related to purchasing card guidelines; segregating incompatible duties; obtaining signed cardholder agreements; and conducting periodic refresher training for cardholders and management with oversight responsibilities would improve the controls over purchasing card use and monitoring efforts.

Communication should be improved. We noted that program changes were not always adequately communicated to all cardholders. In the 2006 revision to the purchasing card manual, the single purchase transaction limit was increased from \$1,000 to \$1,400. However, this was not communicated to all departments, all cardholders, or the bank processing the city's purchasing card transactions. Additionally, the Finance Department's intranet site still had the 2002 purchasing card manual posted until November 2008. Program changes or information that affects the use of city purchasing cards should be communicated to cardholders, department management, and other interested parties in a timely manner.

Not every cardholder has signed a current agreement. In September 2008, we reviewed Treasury's files for cardholder agreements related to the new purchasing card program and found 117 of 140 purchasing cardholders did not have signed agreements for the current program. We brought this to Treasury's attention and they worked to correct this oversight during the course of this audit. However as of February 2009, Treasury's files did not contain signed agreements for 10 of the 140 purchasing cardholders. According to the current purchasing card guidelines, staff interested in obtaining a purchasing card must attend the city's Procurement Card Training course and then fill out the required application and agreement forms before receiving a purchasing card. The

agreement is the cardholder's acknowledgement that they have received training, read and understand the program guidelines, read and understand the agreement, and accept responsibility for the protection and proper use of the purchasing card assigned to them.

Treasury did not initially have all cardholders sign agreements for the current purchasing card program when they received training and their new purchasing cards. Treasury staff reported that if cardholders had signed an agreement for the prior purchasing card program they did not think it was necessary for them to sign an agreement for the current program. All approved cardholders should have current cardholder agreements on file before they are issued a city purchasing card.

Lack of segregation increases risk of abuse or fraud. We found several situations where segregation of duties was lacking because the reconciliation accountant was also a cardholder. There were 114 such transactions in our sample. In some cases, departments had mitigating controls in place such as having another staff member or manager review transactions and bank statements or approve the individual's purchases in advance. The current purchasing card manual, in reference to the individual performing reconciliations, states "This person cannot be an active Cardholder and ideally should not report to the same supervisor as a Cardholder." The prior purchasing card program also recognized that reconciliation accountants should not be cardholders and stated "Ideally, this person should not be an active cardholder or report to the same supervisor as the cardholder."

Segregation of duties is a critical internal control element which reduces the risk that employees have opportunities to make abusive, improper, or even fraudulent transactions with a purchasing card and cover up these activities. Purchasing cards should not be issued to individuals who are also reconciliation accountants.

Supervisor/Subordinate relationships increase risks. An issue related to segregation of duties is having reconciliation accountants who report to a supervisor, manager, or department director who is a cardholder. This type of situation increases the risk that abusive, improper, or even fraudulent purchases could be covered up or ignored because the subordinate individual performing the review or reconciliation could be intimidated to overlook problems or forced into collusion by the person to whom he or she reports. Reconciliation accountants should not have a direct reporting relationship to a cardholder.

Training should be strengthened. Both purchasing card programs required cardholders to attend an initial purchasing card training session.

The city does not conduct any additional training or refresher courses for current cardholders. Best practices identified by GFOA and AGA included initial training as well as ensuring that training is periodically reinforced for cardholders and supervisors.

While initial training is important for cardholders and management with oversight responsibilities to become aware of the program's policies and procedures, follow-up training sessions are essential to ensure continued cardholder compliance and diligent monitoring by management. The city should conduct annual follow-up training for cardholders and management with oversight responsibilities to reinforce proper use of purchasing cards and the importance of management's review and approval process, and to communicate any changes or ongoing problems that need to be addressed.

Other Issue

During the course of this audit, we became aware of another issue that was related to purchasing card use, but has broader implications for city contracting and purchasing processes and procedures.

The city manager has not consistently notified city staff in a timely manner regarding changes in limits or thresholds associated with the city's contracting or purchasing practices. (See Exhibit 7.) City code¹⁰ requires the city manager to announce adjustments to various contracting or purchasing limits at the beginning of each fiscal year, including those that affect the city's purchasing cards.

¹⁰ Sec. 2-1602. Escalation of dollar limits.

(a) At the beginning of each city fiscal year, the monetary amounts specified in Code sections 2-1582, 2-1584, 2-1586, 2-1587, 2-1590, 2-1599, 2-1600, 2-1753, 38-1 and 38-81 shall automatically be adjusted and shall be announced by the city manager to reflect an increase equal to an increase in the consumer price index (all items/all urban consumers/Kansas City, Missouri-Kansas) published by the United States Department of Labor, Bureau of Labor Statistics Consumer Price Index for all urban consumers to eliminate the effects of inflation on purchasing power. Such monetary amount, as adjusted, shall be rounded upwards to the nearest \$1,000.00.

(b) If the monetary amounts in Code sections 2-1582, 2-1584, 2-1586, 2-1587, 2-1590, 2-1599, 2-1600, 2-1753, 38-1 and 38-81 are \$9,999.00 or below, the adjustment provided for in subsection (a) shall be rounded upwards to the nearest \$100.00.

(Ord. No. 010460, § 1, 7-19-01)

Exhibit 7. Dates Consumer Price Index Increase Memo Was Released

Fiscal Year	Due Date	Memo Date	Calendar Days Late
2007	May 1, 2006	December 1, 2006	210
2008	May 1, 2007	May 3, 2007	2
2009	May 1, 2008	June 2, 2008	31

Source: Memos from City Manager to Department Directors.

Although the city code automatically increases these contracting and purchasing limits or thresholds at the beginning of each fiscal year, these changes should be communicated to city staff at the same time, if not earlier. Without this formal communication from the city manager, city staff may not be aware of changes to limits or thresholds that affect purchasing cards as well as other city contracting or procurement processes.

Recommendations

1. The city manager should develop and implement policies to provide guidance to city management regarding acceptable use of city funds for hospitality, entertainment, business meals, or employee morale/team building events.
2. The city manager should develop and implement policies to provide guidance regarding acceptable use of city funds for community organization banquets, education programs, or other events.
3. The city manager should develop and implement policies that provide guidance regarding expenditures for non-essential items, to ensure they are an appropriate use of city funds.
4. The city manager should ensure monetary gifts or awards given to employees are properly accounted for regarding their potential tax liability.
5. The city manager should require that all city travel expenses be processed as outlined in the city's administrative regulations and manual of instructions.
6. The director of finance should take steps to ensure that all purchasing card exceptions or overrides are properly approved and documented.

City Purchasing Card Program

7. The director of finance should not issue purchasing cards to individuals who are also reconciliation accountants and should ensure that reconciliation accountants do not have a direct reporting relationship to a cardholder.
8. The director of finance should not issue purchasing cards to individuals who have not completed and signed a current cardholder agreement form.
9. The directors of finance and general services should put merchant blocks in place to ensure that travel-related purchases cannot be made with city purchasing cards without prior approval.
10. The directors of finance and general services should conduct periodic follow-up training for cardholders and management with oversight responsibilities to reinforce program guidelines and proper use of purchasing cards; emphasize the importance of management reviews; and communicate information about any ongoing problems that need to be addressed.
11. The directors of finance and general services should communicate any changes in the purchasing card program to all cardholders and management with oversight responsibilities in a timely manner and ensure they have the most current copy of the purchasing card program guidelines.
12. The directors of finance and general services should ensure that requirements or limitations from city code and procurement regulations related to purchasing card transactions are included in the city's purchasing card program guidelines and communicated to city departments and cardholders.

Appendix A

Sampling Methodology

City Purchasing Card Program

Sampling Methodology

One objective of this audit was to determine whether purchasing card transactions and activities were in compliance with established city guidelines.

We obtained electronic records of monthly purchasing card transactions made between May 1, 2006 and November 30, 2007 from the Finance Department's Treasury Division. We used those reports to develop a database of over 16,400 purchasing card transactions totaling a little over \$4 million. These records contained information for each transaction such as the vendor name, transaction amount, transaction date, cardholder name, merchant classification code, and department name.

Our review of the transaction database helped us identify transactions that represented a potential risk for noncompliance with program guidelines such as transaction limits; split transactions; lack of segregation of duties; or unqualified purchases such as hospitality and entertainment, travel, or computer-related items. We looked at the vendors used, merchant classification codes, transaction amounts, and frequency of transactions.

Our initial review of the data identified a number of transactions that were potentially non-compliant. Because of the amount of time needed to physically examine the supporting documentation for all of these potentially non-compliant transactions, we decided to select a smaller, judgmental sample¹¹ to determine whether there were transactions that did not comply with purchasing card program guidelines. Audit staff also added a small number of transactions to our sample that seemed questionable while they were reviewing transaction files.

Overall, our judgmental sample included 381 records that were selected based on their likelihood of representing at least one violation of purchasing card program guidelines. Our sample is not statistically representative of all purchasing card transactions. We selected transactions from departments¹² with purchasing cards and also reviewed at least one transaction for each cardholder in those departments. From each noncompliance area identified within a department's transactions, we selected five to ten transactions, all transactions greater than \$1,000, and a cross-section of vendors. The number of transactions we selected

¹¹ A judgmental sample is a non-probability sampling procedure in which the sample taker uses his/her preferences to choose the sample items. This method was chosen, in part, to create a more manageable sample size while still satisfying the objectives of this audit.

¹² Due to the low frequency of purchasing card transactions or independence issues, we did not include purchasing card transactions and activities in the Human Relations Division, City Clerk's Office, and City Auditor's Office in the sample.

City Purchasing Card Program

and reviewed depended on the number of questionable transactions within each of the noncompliance areas. The Health Department, Police Department, and City Council did not have purchasing cards.

The following table shows sample sizes and monetary amounts by department compared to total transactions and dollar amounts.

Judgmental Sample Compared to Total Transactions (May 2006 – November 2007)

Department	Transactions		Sample of Transactions			
	Number	Amount	Number	Amount	% of Number	% of Amount
Water Services	4,190	\$1,108,778	31	\$ 34,998	0.7%	3.2%
Aviation	3,297	786,475	42	47,100	1.3%	6.0%
General Services	3,184	649,421	20	30,772	0.6%	4.7%
Neighborhood and Community Services	1,624	447,443	34	32,485	2.1%	7.3%
Fire	1,276	327,202	26	31,098	2.0%	9.5%
City Manager	627	141,025	37	34,752	5.9%	24.6%
Parks and Recreation	447	119,001	17	30,352	3.8%	25.5%
Convention and Entertainment Centers	414	94,716	10	7,922	2.4%	8.4%
Information Technology	235	75,740	20	23,673	8.5%	31.3%
Law	175	75,591	37	15,182	21.1%	20.1%
Municipal Court	322	61,370	41	21,368	12.7%	34.8%
Capital Improvements Management Office	278	55,976	13	3,155	4.7%	5.6%
Public Works	92	19,792	10	6,597	10.9%	33.3%
Finance	100	15,739	6	1,776	6.0%	11.3%
Human Resources	84	12,422	3	431	3.6%	3.5%
City Planning	51	10,683	20	8,088	39.2%	75.7%
Mayor's Office ¹³	14	2,038	14	2,038	100.0%	100.0%
City Auditor ¹⁴	18	1,342	0	0	0.0%	0.0%
City Clerk	6	762	0	0	0.0%	0.0%
Human Relations	1	417	0	0	0.0%	0.0%
Totals	16,435	\$4,005,933	381	\$331,788	2.3%	8.3%

Source: Purchasing card transactions.

¹³ Transactions in the Mayor's Office occurred under the current administration. The Mayor's Office no longer uses a purchasing card.

¹⁴ The Finance Department conducted reviews of the City Auditor's Office purchasing card use in January 2008 and March 2009 and found no exceptions.

Appendix B

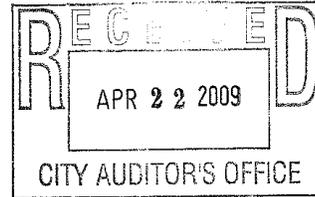
Management's Response

CITY OF FOUNTAINS
HEART OF THE NATION



KANSAS CITY
MISSOURI

Office of the City Manager



DATE: April 20, 2009
TO: Gary L. White, City Auditor
FROM: Wayne A. Cauthen, City Manager
RE: Purchasing Card Audit - May 1, 2006 to November 30, 2007

My staff and I have reviewed the recommendations and I offer the following comments.

The City's current purchasing card program provides a highly efficient, alternative payment method for small dollar purchases. Given that a purchase order or other payment can cost as much as \$70 a transaction, I intend to encourage the continued growth of this important program. The purchasing card program allows for timely pay and reduces the number of labor-intensive transactions. The issues uncovered in this report will be taken into account as we move forward restructuring and proliferation. Based on the review you prepared, the majority of the findings related directly to, or impart, to the internal control framework surrounding the program. This included the deviations from the purchasing card programmatic rules and departmental accountability issues. The programmatic rules represented policy limitations, not legal or contractual.

I believe that the majority of the internal control issues, as the draft report indicates, have been remedied with the advent of a new agreement with Bank of America. Programmatic issues will be addressed through both training and future tailoring of bank card products to better meet the City's needs.

The City's current bank card programs, a narrowly tailored purchasing card program and departmental "card-less" travel accounts; cover only a small range of potential purchases. The Proper alignment of the bank's many flexible card products with the wide range of potential city uses will help reduce misuse – both real and perceived.

Finally, accountability issues listed in the report may also be resolved through the implementation of an administrative regulation requiring a uniform review of program violations with prescriptive disciplinary action. I have directed Jeff Yates, the CFO/Director of Finance to draft an administrative regulation and better define the needed internal controls.

Please see the attached responses to the specific findings.

Recommendation 1: The city manager should develop and implement policies to provide guidance to city management regarding acceptable use of city funds for hospitality, entertainment, business meals, or employee morale/team building events.

Response: Agree. The City Manager will instruct the Director of Finance to assess additional policy requirements providing specific guidance concerning the use of city funds using purchasing cards, as well as review the existing policies and provide additional training at a future directors' meeting

Recommendation 2: The City Manager should develop and implement policies to provide guidance regarding acceptable use of city funds for community organization banquets, education programs, or other events

Response: Agree The City Manager will instruct the Director of Finance to review the current policies and develop any policies needed to address this issue. Training will be provide to staff.

Recommendation 3: The City Manager should develop and implement policies that provide guidance regarding expenditures for non-essential items, to ensure they are an appropriate use of city funds

Response: Agree. The City Manager will direct the Finance Director to assess additional policy requirements providing specific guidance concerning the use of city funds using purchasing cards, as well as review the existing policies and provide additional training at a future directors' meeting.

Recommendation 4: The city manager should ensure monetary gifts or awards given to employees are properly accounted for regarding their potential tax liability.

Response: Agree. The City Manager will direct the Director of Finance to review and provide an updated Manual of Instruction providing specific guidance concerning the proper accounting for monetary gifts.

Recommendation 5: The city manager should require that all city travel expenses be processed as outlined in the city's administrative regulations and manual of instructions.

Response: Agree. The City Manager will see that all travel card users are instructed to follow the city's administrative regulations and manual of instructions

Recommendation 6: The Director of Finance should take steps to ensure that all purchasing card exceptions or overrides are properly approved and documented

Response: Agree The Director of Finance will review, document and approve all purchasing card exceptions or overrides as outlined in the administrative regulations and manual of instructions.

Recommendation 7: The Director of Finance should not issue purchasing cards to individuals who are also reconciliation accountants and should ensure that reconciliation accountants do not have a direct reporting relationship to a cardholder.

Response: Agree The implementation of the new purchasing card program in 2008 corrected most of the situations where a reconciliation accountant was either a cardholder or was the supervisor of a cardholder. In smaller departments, alternative mitigating controls will be implemented to account for the lack of staffing. This challenge is not specific to the purchasing card reconciliation, but exists with all types of payment. These areas will be reviewed for possible consolidation in the future.

Recommendation 8: The Director of Finance should not issue purchasing cards to individuals who have not completed and signed a current cardholder agreement form.

Response: Agree. The cardholders who did not have a cardholder agreement on file at the time of the audit had a signed agreement on file prior to participation in the old program; however, some agreements were not updated at the outset of the new program. Staff is in the process of auditing those agreements and ensuring everyone in the program has a current cardholder agreement. This will be completed by the end of May 2009.

Recommendation 9: The Directors of Finance and General Services should put merchant blocks in place to ensure that travel-related purchases cannot be made with city purchasing cards.

Response: Disagree. Appropriate guidance will be provided through an Administrative Regulation. The goal of the purchasing card program is to facilitate business and reduce transactional costs. The program should rely on the policies and controls in place to facilitate the use of the p-cards, reducing transactional cost as well as generating rebated funds from the p-card program provider.

Recommendation 10: The directors of finance and general services should conduct periodic follow-up training for cardholders and management with oversight responsibilities to reinforce program guidelines and proper use of purchasing cards; emphasize the importance of management reviews; and communicate information about any ongoing problems that need to be addressed.

Response: Agree. Annual training will be required in the Administrative Regulation as well as individualized training and counseling for those who violate the program. The new program with Bank of America provided the opportunity to train all program participants within the last year. Repeated violations of the regulation currently results in the loss of the program privileges. Additionally, ongoing monitoring of transactions and documentation will be conducted to ensure compliance with the regulation.

Recommendation 11: The Directors of Finance and General Services should communicate any changes in the purchasing card program to all cardholders and management with oversight responsibilities in a timely manner and ensure they have the most current copy of the purchasing card program guidelines.

Response: Agree. Both Directors will communicate changes in the purchasing card program to all card holders and management in a timely fashion and ensure they have a current copy of the purchasing card program guide.

Recommendation 12: The Directors of Finance and General Services should ensure that requirements or limitations from city code and procurement regulations related to purchasing card transactions are included in the city's purchasing card program guidelines and communicated to city departments and cardholders.

Response: Agree. The Administrative Regulations, Manuals of Instruction, and training materials will be reviewed by the appropriate staff to ensure compliance with city code and purchasing regulations.