



July 23, 2010

Audit Number 09046

Improvements Could Increase Efficiency of Payment Processing

SUMMARY

The Chief Financial Officer (CFO) is required by Florida Statutes to: "...examine, audit, and settle all accounts, claims, and demands whatsoever, against the state, arising under any law or resolution of the legislature, and issue a warrant directing the payment out of the State Treasury of such amount as he or she allows thereon."

The Division of Accounting and Auditing fulfills the CFO's settlement responsibility. The Division's Bureau of Auditing (Bureau) had in excess of 50 budgeted positions in the 07-08 FY; expenditures totaled \$2.9M.

The majority of the Bureau's expenditures (in excess of \$1.5M) were spent on pre-auditing payment requests from state agencies. The Bureau also performed post-audits, post execution contract reviews, and training for state agencies to reduce the number of discrepancies identified in the payment process. These functions are mostly manual. The current approach will be more difficult to sustain if resources available for manual processes continue to decline.

We believe the Bureau can improve its ability to safeguard public assets and increase the effectiveness and efficiency of its processes in the following ways:

- Gradually transition from the existing reliance on manual pre-audit effort to a more automated process using Continuous Control Auditing (CCA) software to reduce time, increase error identification, and add

new capabilities not currently used and/or maximized by the Bureau (such as automated reviews for duplicative invoices in the pre-audit process). Integrating automation may allow for a redeployment of some resources from pre-audits to post-audits and provide additional assurance of appropriate internal controls at the agency level; compliance with laws, rules and regulations; and review of overpayments due to fraud or error.

- Revise pre-audit procedures to ensure all identified discrepancies are adequately remedied by state agencies.
- Develop a written procedure to review agency payments exempted from the pre-audit process. For example, certain DOT expenditures totaling \$3.61B in FY 07-08 were classified as exempt from review in 2000 and have been reevaluated once in 2005.
- Develop a written quality assurance procedure to validate the pre-audit process is sufficient and only correct invoices have been authorized for payment.
- Update the Reference Guide for State Expenditures, last revised in 2006, to correct conflicting information and decrease the opportunity for errors in agency submissions.

SCOPE

In response to a request from the Chief Financial Officer, we conducted an audit of the effectiveness of the Bureau. This request was made because the Bureau had not been the subject of an internal audit since 2002 and because of a recent change in its methodology to select invoices for its pre-payment review process.

BACKGROUND

The Bureau of Auditing was authorized 54 full-time positions in FY 07-08 and expended \$2.9M. The Bureau performs the following primary functions to provide assurances that accounts are appropriately settled and payments are accurately remitted:

- Pre-payment reviews (pre-audits) of vendor payment requests
- Post execution contract reviews
- Post-audits of state agency payments
- State agency training and trend analysis

Note: Other duties performed by the Bureau include Florida Single Audit Act and procurement card payment administration.

Pre-audits of payment requests

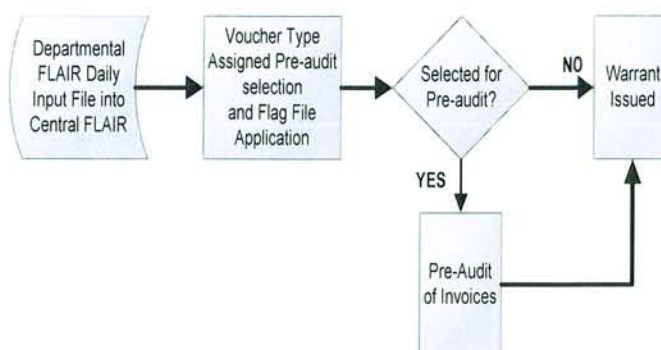
The pre-audit process begins with the submission of a voucher by state agencies (see Exhibit 1). Vouchers are authorizations for payment associated with one or more vendor invoices. Information required to be provided by state agencies on vouchers is designed to allow the Bureau to ensure that each claim is properly recorded and there is sufficient legislatively authorized funding. In addition, authorized employees at each state agency are required to certify transactions identified on the voucher were made in accordance with Florida law and goods and services were received.

The pre-audit process compares information on vouchers, such as invoice amount and vendor name, with information included on associated invoices.¹ This comparison verifies that the

vendor and state agency are in agreement that the stipulated goods and services were provided for an agreed-upon cost. In addition, to verify that the transaction represents a legal obligation, state agencies are required to provide copies of documentation certifying services were provided in accordance with the terms of the contract.

For invoices selected for pre-audit, funds are not authorized for disbursement until completion of the pre-audit process.

Exhibit 1: Current Pre-audit Process



In the 07-08 fiscal year, the Bureau processed approximately 9.8 million pay requests (invoices) totaling \$132B (a payment request may contain multiple payees). Several types of invoices were excluded from the pre-audit process, including but not limited to: state payroll, retirement benefits, public assistance, and unemployment compensation payments.

After excluding the invoice types above, there were 3.6 million remaining invoices subject to audit totaling \$59.6B. This number was further reduced by the Bureau's policy of sampling vendor invoices under \$10,000. With this further reduction, the Bureau actually pre-audited approximately 527,000 invoices in FY 07-08, or 15 percent of invoices subject to pre-audit (527,000/3.6 million). The dollar value of the invoices pre-audited was \$58.3B, or 98 percent of the dollar value of invoices subject to pre-audit (\$58.3B/\$59.6B).

For the quarter ending June 30, 2008, the pre-audit process identified critical discrepancies in

¹In addition to the invoice, depending on the nature of the associated procured good or service, state agencies are also

required to submit additional documentation. For example, Section 216.345, F.S., requires state agencies document that membership dues are essential to its duties and responsibilities.

less than 1% of the total number of invoices that were pre-audited. The value of these critical errors was also less than 1% and totaled \$1.3M.

For each pre-audited invoice with identified discrepancies, the Bureau notifies the agency of the associated discrepancy via a "return form." State agencies are to remedy the identified discrepancy(ies), as a condition of releasing the invoice for payment.

Post-execution contract reviews, Post-audits, and Training and trend analysis

The Bureau conducts assessments of the processes utilized by state agencies to acquire goods and services. The purpose of these assessments is to enhance processing of future payments. The Bureau also provides payment process training to state agencies. Each of these functions is detailed as follows:

Post-execution contract reviews

Effective January 1, 2008, the Bureau began reviewing contractual service and grant agreements and had completed 412 reviews as of December 2008. Upon execution, state agencies are required to submit contractual and grant service agreements valued at \$1M or more.²

For each contract/grant review, the Bureau evaluates whether the agreement sufficiently identifies:

- activities and services to be rendered,
- deliverables and correlation to payment schedule,
- remedies for non-performance, and
- compliance with laws, rules and policies.³

The results of each contract review are annotated on a checklist which is provided to the state agency. This checklist provides a yes or no response to seventeen questions. In addition, the Bureau provides each state

agency a quarterly compilation of contract reviews, which identifies the total number of yes and no answers for each checklist question.

Post-audits of state agency payment processes

These audits include an evaluation of the system of internal controls over payments by state agencies. During FY 07-08, the Bureau completed five of these audits. Most of these audits (four of five), were related to state agency utilization of purchasing and fuel cards, which are not subject to pre-audit review.

For audit of payments not related to the purchasing cards, the Bureau Chief reported that, "The benefit of this type of evaluation is that if the agency's internal controls are effective, we could possibly reduce pre-audit coverage of those types of expenses and shift audit resources to higher risk or problem areas."

Training and trend analysis

The Bureau conducts training to educate state agencies and service providers on the rules, laws and best practices for contract and grant management. Service providers include contractors and recipients of state and federal grant funds disbursed from the State of Florida Treasury.

In FY 07-08, the Bureau conducted 34 classes with a total of 1,030 attendees. In addition, the Bureau conducts training on the Florida Single Audit Act. This training provides an introduction to the Act and its associated compliance requirements. In FY 07-08, the Bureau conducted ten classes with a total of 136 attendees. The training emphasizes elements of the process where accountability issues have been previously identified by the Bureau.

Policies and Procedures

The Chief Financial Officer is authorized to disseminate procedural and documentation standards relating to requests for payments through issuance of administrative rules or through memoranda.⁴

²As specified in [CFO Memorandum No. 1 \(2007-08\)](#), Information Technology consulting agreements with a value of \$500,000 or more are also reviewed.

³Review includes verification that provisions of [Section 287.058, F.S.](#), and [Section 287.0582, F.S.](#), are contained in the agreement.

⁴[Section 17.29, F.S.](#), provides the CFO with general rulemaking authority to implement her duties assigned by statute or the State

Currently, the Division's primary method for issuing procedural and documentation standards relating to requests for payments is through issuance of memoranda. The Division issues two types of memoranda: Chief Financial Officer (CFO) and Agency Addressed. The Bureau reported that CFO Memoranda have the authority of an administrative rule, while Agency Addressed Memoranda are issued only for information purposes.

As of June 17, 2009, the Division had 95 active CFO Memoranda and 188 CFO Memoranda identified as inactive. Some inactive CFO Memoranda were deactivated when the guidance was incorporated into statute, administrative rule, or another policy document. In other instances, CFO Memoranda were deactivated upon issuance of a new CFO memorandum containing superseding guidance.

Payment processing guidance is also provided to state agencies via a Reference Guide for State Expenditures, which was issued via a CFO memorandum in 2003.⁵ The purpose of this reference guide is to provide state agencies guidance regarding specific payment processing requirements.

ISSUES AND RECOMMENDATIONS

Issue 1: Increased automation would increase the Bureau's ability to comprehensively analyze payment requests.

The majority of the Bureau's duties include manually pre-auditing invoices, which takes considerable time and effort. An analysis of

pre-audit results performed by the Bureau for the last quarter in this audit period identified critical discrepancies on less than one percent of selected agency payment requests.⁶ This raises the question of whether some pre-audit resources could be better utilized for additional post-audits, reviews, and training.

Recommendation 1: We recommend the Bureau consider adding CCA analytics to the pre and post payment review process (see Exhibit 2 and 3). If the Division mitigates a portion of existing payment process risk differently by replacing some of the current manual pre-audit effort with automated analytics, additional resources can be devoted to post-audits. Improvements by agencies as a result of post-audits would help ensure that future submissions have been subject to appropriate internal controls at the agency level; are compliant with state law and CFO prescribed standards; and have been reviewed for overpayments due to fraud or error.

Specifically, we envision CCA performing comparisons and producing management exception reports for selected invoices during the pre-audit process and all invoices as a part of the post audit process. These comparisons would include:

- Comparisons of vendor invoices to vendors listed on the DMS and Federal convicted vendors list to ensure compliance with Section 287.133, Florida Statutes.
- Invoice comparisons with the DOS Division of Corporations SunBiz database for active and legitimate vendors.
- Comparing invoice vendor addresses with state employee addresses to identify possible conflicts of interest.
- Invoice comparisons with Tax Lien databases for discovery of outstanding liens.
- Duplicate invoice comparisons, i.e., similar invoice same vendor, same invoice different vendor, similar invoice in defined date range.

Constitution. In addition, [Section 120.52, F.S.](#), exempts the CFO having to utilize administrative rule relating to agency requests for payments. [Section 17.03, F.S.](#), authorizes the CFO to adopt and disseminate procedural and documentation standards for payment requests. [Section 17.14, F.S.](#), authorizes the CFO to prescribe the forms of all papers, vouchers, reports and returns, and the manner of keeping the accounts and papers to be used by the officers of this state or other persons having accounts, claims, or demands against the state or entrusted with the collection of any of the revenue thereof or any demand due the same, which form shall be pursued by such officer or other persons.

⁵ [CFO Memorandum No. 8 \(2002-03\)](#).

⁶ Since our audit period, the Bureau has shown an ability to increase its identification of invoice discrepancies.

- Discovery of invoice splitting to avoid competitive procurement requirements by comparing payments for similar scope invoices in close date proximity.

Other benefits may include:

- Faster payment processing from the Bureau calculated 4-day average for pre-audited invoices.
- Elimination of a percentage of the estimated 9 million pieces of paper submitted annually

by state agencies to support the current pre-audit process.

We recommend that the Department issue a "Request for Information" to provide private sector CCA vendors with an opportunity to share their approach. Some examples of public and private sector entities that have successfully integrated CCA into their payment process are at Appendix A.

Exhibit 2: Proposed Pre-audit

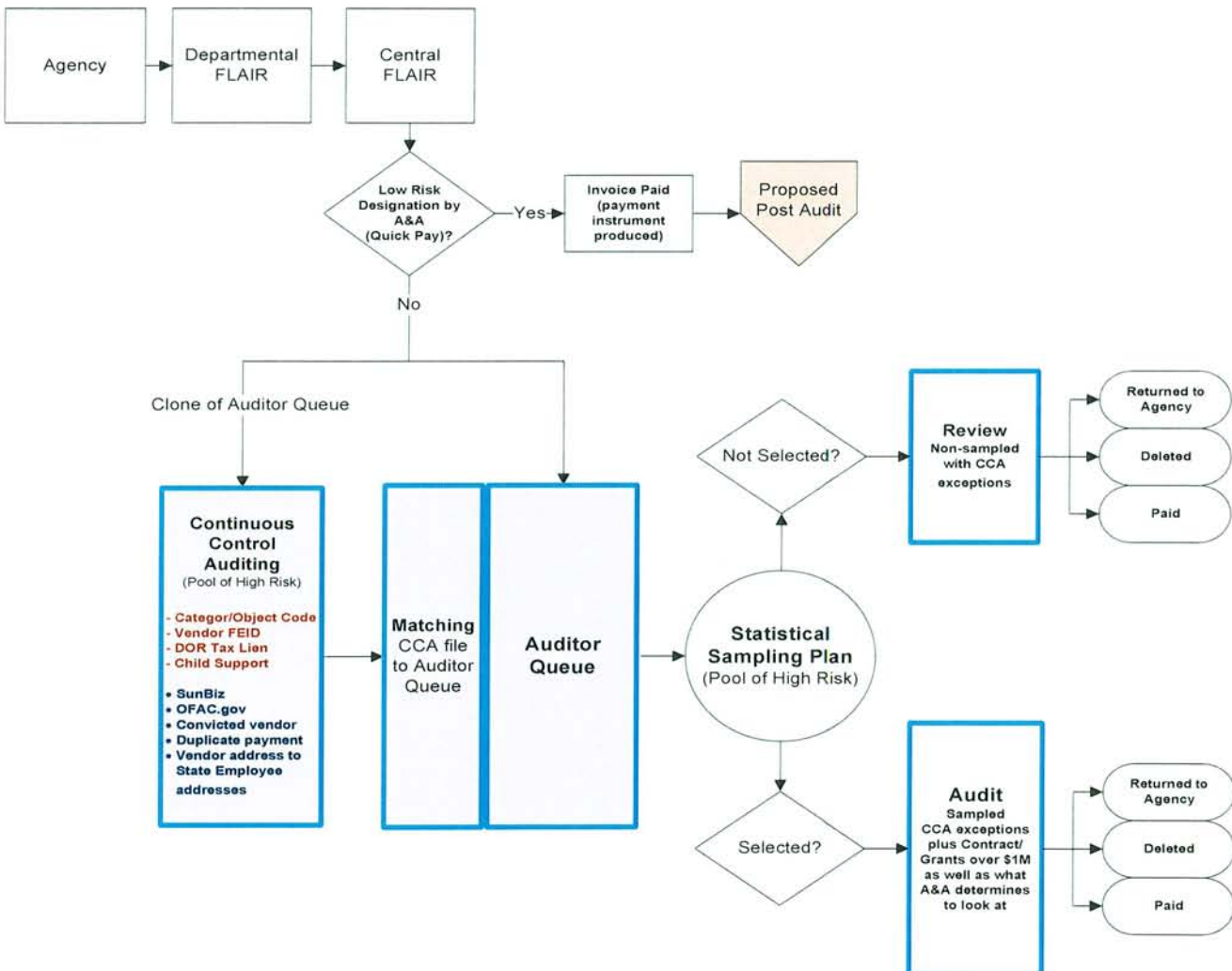
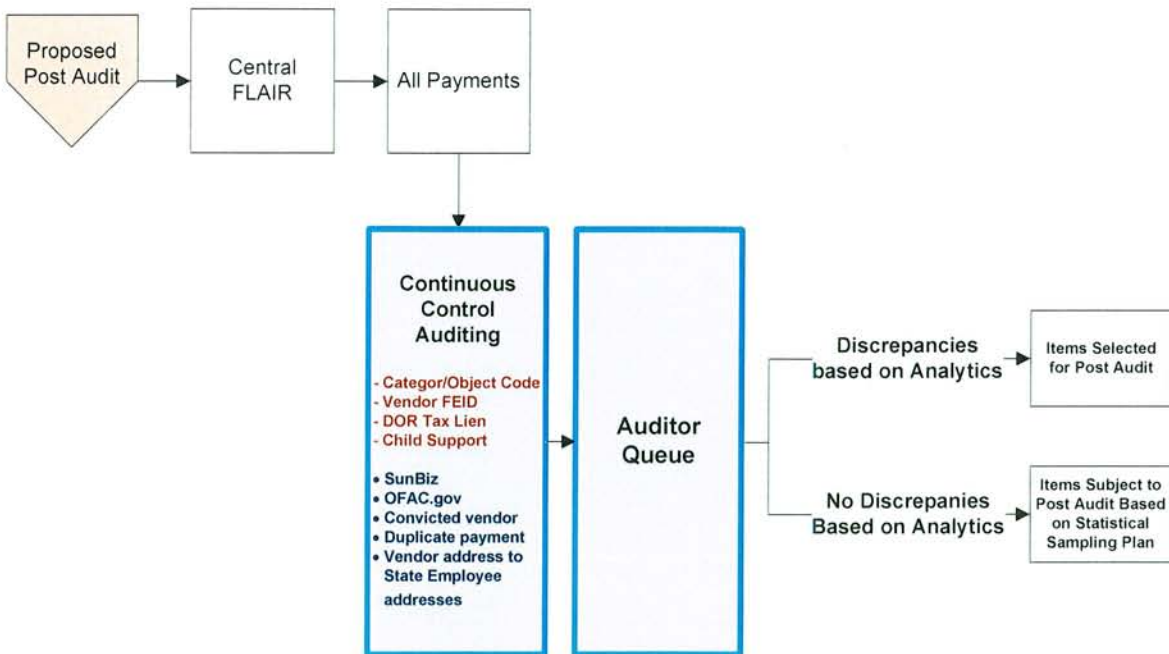


Exhibit 3: Proposed Post Audit



Management Response: We agree with the concept; however, we disagree with some of the explanations and conclusions discussed in the report.

The report refers to automation of the pre-audit process. We agree that automation offers great promise for the future; merely adding a new CCA component to the existing FLAIR system, however, does not represent automation. Automation is a paperless environment where vendor invoices, purchase orders, contracts and receiving reports are data elements within one system. In the current FLAIR environment, an additional CCA component will still involve a manual process of reviewing source documentation driven by management exception reports.

To provide some background, the Florida Accounting Information Resource Subsystem (FLAIR) is the accounting system for the State of Florida. For the purposes of this report, FLAIR comprises two systems. The Departmental Accounting component provides general ledger control at the State agency level, while the Central accounting component drives payment transactions with budgetary control within the Division of Accounting and Auditing. These two FLAIR systems

interchange payment and other data on a daily basis.

FLAIR is a 28-year old source document driven mainframe-based application. FLAIR does not have electronic record capability for invoices, purchase orders, contracts, receiving reports, and other required data to support payments. Regardless as of whatever proposed analytical software might be introduced; there will be limitations within this system because of FLAIR's inherent capabilities.

The audit report provides examples of database comparisons. It provides, however no explanation describing specific analytical routines that would serve to identify overpayments and noncompliance issues based on source documentation. The examples provided in the report either are already being performed in the current FLAIR environment or are not feasible. We offer comments as to each of the report's suggested comparisons, which are set forth in bulleted paragraph.

- Comparisons of vendor invoices to vendors listed on the DMS and Federal

convicted vendors list to ensure compliance with Section 287.133, Florida Statutes.

It would be highly impractical to match millions of FLAIR records against this list. Since there are only approximately 87 vendors listed on the DMS test, it would be easier and more efficient to flag the Vendor ID field to prevent payment. Moreover, upon our review of the list, many of these vendors have been inactive for ten years or more and therefore are no longer subject to the statutory prohibition from doing business with the state. Finally, a noncompliance issue would not conclusively preclude payment to a listed company that is party to a legally binding contract with a state agency.

- Invoice comparisons with the DOS Division of Corporations SunBiz database for active and legitimate vendors.

First, we would be matching the Vendor ID field in FLAIR with Federal Employer Identification Number in SunBiz. This comparison can be easily performed in the current IT environment with desktop software. However, due to the large number of social security numbers and U.S. foreign corporations, there would be a high number of non matches. This analysis performed on a routine basis would be costly to the Bureau due to the number of false negatives.

- Comparing invoice vendor addresses with state employee addresses to identify possible conflicts of interest.

Historically, we have seen very few examples of state employees having direct business relationships with the State of Florida. Because of this, we question the cost vs. benefits of performing a non-productive analysis on a routine basis.

- Invoice comparisons with Tax Lien databases for discover of outstanding liens.

This is already being performed in FLAIR. When matches are identified, all tax lien information is loaded to FLAIR several times per week. Flag files are created for those vendors and no payments to the vendor under lien can be posted.

- Duplicate invoice comparisons, i.e., similar invoice same vendor, same invoice different vendor, similar invoice in defined date range.

This is also being performed in the existing FLAIR process.

The Bureau currently utilizes analytical software but will consider other continuous control applications.

Issue 2: Pre-audit discrepancies identified by the Bureau may not be remedied by state agencies.

The current pre-audit process does not provide adequate assurances that identified discrepancies are remedied by state agencies. When discrepancies are identified during the pre-audit process on a sampled voucher, the Bureau may return the voucher to the agency for correction. However, resubmitted vouchers may not be identified as corrected. If a new voucher is submitted without being identified as previously returned, the Bureau could be unaware that the voucher is a resubmission and should be reviewed for appropriate corrections.

Recommendation 2: We recommend pre-audit procedures be revised to ensure that all identified discrepancies are adequately remedied by state agencies.

Management Response: We agree with the issue. The existing audit process does not have a reconciliation and tracking of control totals for final resolution. However, due to the

high number of return forms and corrected vouchers that are received by the Bureau each month, we do know that a high percentage of these vouchers are being corrected. As part of improving this process, we are looking into ways of tracking these invoices through a bookkeeping indicator in FLAIR. For the report, it should be noted that due to the nature of certain types of errors, some vendor invoices will never reenter the payment process and therefore, we would not have a one to one ratio on every error detected.

Issue 3: Procedures for agencies exempt from initial and continued pre-audit eligibility should be improved.

In FY 07-08, 34,205 payment requests totaling \$3.63B were exempted from the pre-audit process. These exemptions were based on prior determinations by the Bureau that the associated payment process utilized by the state agency ensured compliance with all requirements. Nearly all of these exempted payment requests (\$3.61B) were attributable to certain goods and services procured by the Department of Transportation (DOT). Exemption from pre-audits for these payments was based on the Bureau's participation in a DOT project to revise its consultant invoice submission process in 2000. The Bureau conducted one review of DOT's CITS payment process and associated internal controls in 2005. The Bureau Chief reported these types of payments are also frequently reviewed by federal and state external auditors.

Recommendation 3: To help ensure that the process used by the Bureau to exempt state agency payment processes from pre-audit eligibility achieves intended objectives, we recommend that the Bureau develop a system to demonstrate whether the state agency internal controls over the payment process adequately mitigate each identified risk. In addition, procedures should stipulate when an agency will be reevaluated to determine if the agency's internal controls remain adequate. If the Bureau relies on external audits for a portion of their assurances, any material findings in these reviews may suggest a need

to remove the agency exemption from the pre-audit process.

Management Response: We agree that there are no written procedures explaining this process. Each year during the month of May, the Bureau conducts an annual risk assessment of major disbursements of the State for the upcoming fiscal year audit plan. The purpose of this plan is to identify and prioritize potential audits/reviews for the upcoming fiscal year. In developing our plan, the Bureau takes into account audit work being performed by the State of Florida Auditor General and other auditors in order to avoid duplicating audit efforts. The top five major program disbursements for the State are Medicaid, Florida Education Finance Program, Highway Planning and Construction, Food Stamps, and Unemployment Insurance. Excepting the Florida Education Finance Program, all programs have Federal Participation and are therefore subject to vigorous federal audit standards. All of these major programs have financial information and payments captured on independent stand alone financial systems and are audited by the State of Florida Auditor General for the State of Florida Comprehensive Annual Financial Report and Federal Awards audits. As part of the annual risk assessment process, the Bureau reviews Florida CAFR and the Federal Awards Audits to determine whether there are issues related to payment processing. Additionally, there are discussions with agency staff relating to these programs. The Bureau will document in the annual risk assessment information analyzed or planned reviews of exempt payments.

Issue 4: Documented quality assurance reviews of the pre-audit process would benefit the Bureau by identifying whether pre-audited and approved invoices are sufficient and compliant.

Pre-audit staff perform at least two functions. First, they audit invoices for sufficiency and compliance, and second, they perform the operational role of finalizing payment. After finalizing payment, if no errors on the invoice

are identified, no documentation (including the invoice) is retained to validate the sufficiency of the review.

Although quality assurance reviews are informally conducted, the Bureau would benefit from developing a written quality assurance procedure to validate the pre-audit process is adequate and only correct invoices have been authorized. Management reported a documented quality assurance review process is being implemented.

Recommendation 4: We recommend the Bureau continue its efforts to establish a documented quality assurance review of pre-audited invoices.

Management Response: We agree and have developed written procedures to explain this process. We are in the process of formalizing the procedures and performing internal reviews and training of our staff.

Issue 5: Updated payment processing guidance would help improve agency payment compliance.

Our review of administrative rules, active CFO Memoranda and the Reference Guide for State Expenditures identified several instances in which updating these documents would eliminate inconsistencies among documents and clarify procedures for agencies to follow. Examples in which updating procedures and documentation standards would benefit agencies include where:

- Administrative rules, CFO memoranda, and the Reference Guide for State Expenditures are in conflict regarding utilization of the FLAIR Central Contract System.⁷

- Administrative rules are not accurately referenced in the Reference Guide for State Expenditures.
- CFO memorandum indicating a prior CFO memorandum is inactive, while the Division's website indicates the memorandum is active.⁸

Our review also disclosed limited guidance relating to establishment of safeguards against waste, fraud and abuse by state agencies. Without promulgation of recommended procedures, the Bureau is relying on state agencies to unilaterally develop procedures that ensure payments are accurately submitted and safeguarded without any state-level guidance.

Recommendation 5: We recommend the Bureau perform a comprehensive review of all applicable rules and memoranda, as well as the Reference Guide for State Expenditures. In addition to ensuring compliance with statutory requirements relating to administrative rules, a comprehensive review of all applicable procedural and documentation standards would help ensure clear and uniform guidance is being provided to state agencies.

Management Response: We agree. We are in the process of updating and formalizing the State Expenditure Guide and reviewing old CFO memoranda for changes.

⁷Rule 691-40.040, *F.A.C. Contracts and Grants*, references requirements associated with payments processed through the contract system. [CFO Memorandum No. 02 \(2003-04\)](#) states that contract will no longer be tracked in the FLAIR Central Contract System. The [Reference Guide for State Expenditures](#), Contract Review Process, states that payments on contracts/purchase order contracts for contractual services for which the contract/purchase order amount is greater than \$75,000 will be processed through the Central Contract System

with the use of an agency-assigned Statewide Contract number. ⁸[CFO Memorandum No. 02 \(2003-04\)](#) states that [CFO Memorandum No. 11 \(2001-2002\)](#) is inactivated, but the Division website identified it to be active. Subsequently, this citing was updated.

APPENDIX A

Government and Private Sector CCA Examples:

The Department of Defense, Finance and Accounting Services group (DOD) recently implemented analytics/monitoring software to evaluate enormous multi-year operational budget spending. This software has allowed the DOD to quickly review and analyze more than 3 million U.S. Air Force records from the most recent six budgets. Included in the review were records associated with travel expense management, contract oversight and payroll. According to officials overseeing the implementation of this project, more than \$2B in unused budget and reduced financial waste have been identified.

An example of a government that has transitioned from a manual prepayment review process to an automated process is British Columbia's Ministry of Finance. British Columbia no longer pre-audits invoices, but has implemented a post-audit process based on a statistically valid sample that selects invoices to audit after the vendor has been paid. The emphasis on post-audits has resulted in savings from both redeployment of personnel and identification and recovery of vendor overpayments.

Another example of an entity that has moved from manually pre-auditing invoices to an automated post-audit process, using statistical sampling, is a Florida-based healthcare business. This business has not quantified its savings from going to an automated post-audit process, but indicated that the process is much more efficient than before.

A Florida Trend Top 10 company uses automated continuous control audit software to monitor their general ledger accounts. The company reported that since implementation of the software they are able to run analytics routinely prior to issuing a payment. This automated analytical software replaced their former manual review process. Since implementation, the company reported software and script development has more than paid for itself.

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This report is distributed, with all exhibits and attachments, to:

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Tammy Teston, Chief of Staff
Kimberly McMurray, Director, Division of Accounting and Auditing
Mark Merry, Chief, Bureau of Auditing

File:

The original of the complete report has been placed in the Audit File.

The Department of Financial Services' mission is to safeguard the people of Florida and the State's assets through financial accountability, education and advocacy, fire safety, and enforcement.

The Department's vision is to be known as the most ethical, professional and proactive state agency in Florida.

The mission of the Office of Inspector General is to promote integrity, accountability and process improvement in the Department.

The Office of Inspector General's vision is to provide objective fact-based perspectives to the Department team; championed by our customers, benchmarked by our counterparts, and dedicated to quality in our products and services.

This audit was conducted pursuant to Section 20.055, Florida Statutes, in accordance with applicable Principles and Standards for Offices of Inspectors General as published by the Association of Inspectors General and the International Standards for the Professional Practice of Internal Auditing as published by Institute of Internal Auditors, Inc. This audit was conducted by Patricia Lee and Sally Moniz under the supervision of Alan Sands, Audit Director, CPA. Please address inquiries regarding this report to the DFS Office of Inspector General at (850) 413-3112.