

Office of Inspector General

City of New Orleans

Inspection of the Vendor Payment Process of the City of New Orleans

**E. R. Quatrevaux
Inspector General**

Final Report

October 18, 2012

OFFICE OF INSPECTOR GENERAL
CITY OF NEW ORLEANS



ED QUATREVAUX
INSPECTOR GENERAL

October 18, 2012

Re: **Inspection of the Vendor Payment Process of the City of New Orleans**

I certify that the inspector general personnel assigned to this project are free of personal or other external impairments to independence.

A handwritten signature in blue ink, appearing to read 'E.R. Quatrevaux', is positioned above the printed name.

E.R. Quatrevaux
Inspector General

Inspection of Vendor Payment Process of the City of New Orleans

OIG-I&E 12-001

Executive Summary	3
I. Objectives, Scope, and Methodology	5
II. Introduction	6
III. Findings	11
Finding 1. THE CITY PAID A TOTAL OF \$1,030,343 TO VENDORS OVER A THREE-MONTH PERIOD WITHOUT PURCHASE ORDERS AS REQUIRED BY THE CODE OF THE CITY OF NEW ORLEANS.	11
Finding 2. A TOTAL OF \$4,497,493 IN PAYMENTS TO TWO SEPARATE COLLECTION AGENCIES WAS NOT INCLUDED IN THE CITY’S BUDGET.	14
IV. Conclusion and Recommendations	17
A. Conclusion.....	17
B. Recommendations.....	17
Recommendation 1. THE CITY SHOULD REQUIRE PURCHASE ORDERS BEFORE ISSUING PAYMENTS TO CITY VENDORS IN ORDER TO ENSURE ADEQUATE FINANCIAL CONTROLS AND TO COMPLY WITH THE CODE OF THE CITY OF NEW ORLEANS	17
Recommendation 2. THE CITY SHOULD INCLUDE PAYMENTS MADE TO COLLECTION CONTRACTORS FOR DELINQUENT PROPERTY TAXES AND SANITATION FEES IN ITS BUDGET	18
V. Official Comments from City of New Orleans	19

LIST OF FIGURES

Figure A. Purchasing and Disbursement Process with Purchase Orders.....	7
Figure B. Purchasing and Disbursement Process with Payment Voucher.....	9

EXECUTIVE SUMMARY

The Office of Inspector General of the City of New Orleans (OIG) conducted an inspection of the City of New Orleans (City) vendor payment practices. The objective of this inspection was to determine if the City made payments to vendors in accordance with State and City laws and City policies.

The City has two methods to make payments from its operating fund: purchase orders made through BuySpeed and Payment Vouchers. Although City law requires personnel to follow a process that includes purchase orders when requesting a good or service, the City approves the use of Payment Vouchers for some specific payments.

The City's only method for issuing purchase orders from operating funds is BuySpeed. BuySpeed's ability to interface with budget allocations and account balances guarantees that purchase orders will only be issued if sufficient funds are available to pay for purchases. In addition, the required approvals for purchase orders ensure segregation of duties and provide six layers of oversight to monitor for errors or fraud. BuySpeed also documents the process, thereby providing an audit trail. When the City makes payments to vendors using Payment Vouchers, there are fewer levels of approval and fewer checks for errors or fraud. Payment Vouchers do not document approval from the Budget Office, Finance, and Purchasing.

Inspectors examined 3,319 payments issued by the City from March 1, 2011 through May 31, 2011 to determine if the City followed the City Code by requiring purchase orders from BuySpeed prior to issuing vendor payments. For the three-month period examined, our inspection produced the following findings.

- During the review period, the City made 26 payments totaling \$1,030,343 to vendors without purchase orders. The City issued these payments in violation of City Code Sections 70-420 and 421, which require a purchase order before making payments to vendors.
- A total of \$4,497,493 in payments to two separate collection agencies was not included in the City's budget.

Based on these findings, we made the following recommendations to bring the City into compliance with the City Code.

- The City should require purchase orders before issuing payments to City vendors in order to ensure adequate financial controls and to comply with the Code of the City of New Orleans.
- The City should include payments made to collection contractors for delinquent property taxes and sanitation fees in its budget.

A draft of this report was provided to the Chief Administrative Office and the Department of Finance for review and comment prior to publication. The City's Response is included in Section V: Official Comments from the City of New Orleans.

I. OBJECTIVES, SCOPE, AND METHODOLOGY

The Office of Inspector General of the City of New Orleans (OIG) conducted an inspection of the City of New Orleans (City) vendor payment practices. The objective of this inspection was to determine if the City made payments to vendors in accordance with State and City laws and City policies.

In order to inspect payments for compliance with applicable laws and policies, inspectors generated two lists of City payments between March 1, 2011 and May 31, 2011: (1) a list of purchase orders from BuySpeed, the City's program for issuing purchase orders from operating funds; and (2) a list of payments from Great Plains, the City's general ledger system.¹ Inspectors reconciled the two lists and identified instances when the City issued payments that did not follow the established protocol.

Inspectors requested back-up documentation, such as payment vouchers and invoices, related to payments not appearing in BuySpeed from the Accounts Payable department. All documentation was requested pursuant to City Code Sec. 2-1120 and La. R.S. 33:9613.

After reviewing the documentation, we conducted interviews with City staff members who requested payments to vendors without an approved purchase order. Inspectors interviewed personnel from:

- The Finance Department;
- The Bureau of Purchasing;
- The Office of Cultural Economy; and
- The Parks and Parkways Department.

This inspection was conducted in accordance with the Principles and Standards for Offices of Inspector General for Inspections, Evaluations, and Reviews.² This report includes findings and recommendations intended to bring payment processes into compliance with State laws and City laws and policies.

¹ The City also makes payments through Advantage Human Resource System (AHRS) to process payroll and Advantage Financial Information System (AFIN) for capital projects and grants. Inspectors did not examine payments made through AHRS or AFIN, which are outside the scope of this analysis. We excluded AHRS because the City does not pay vendors through payroll; we excluded payments through AFIN because the OIG has already addressed shortcomings in AFIN. See Office of Inspector General, City of New Orleans. *City of New Orleans Purchasing & Accounts Payable Internal Control Audit*. May 12, 2011.

² Quality Standards for Inspections, Evaluations, and Reviews by Offices of Inspector General, *Principles and Standards for Offices of Inspector General* (Association of Inspectors General, 2004).

II. INTRODUCTION

The City has two methods to make payments from its operating fund: purchase orders and Payment Vouchers (PVs). Although City law requires personnel to follow a process that includes purchase orders when requesting a good or service, the City approves the use of PVs for some specific payments.

PURCHASE ORDERS

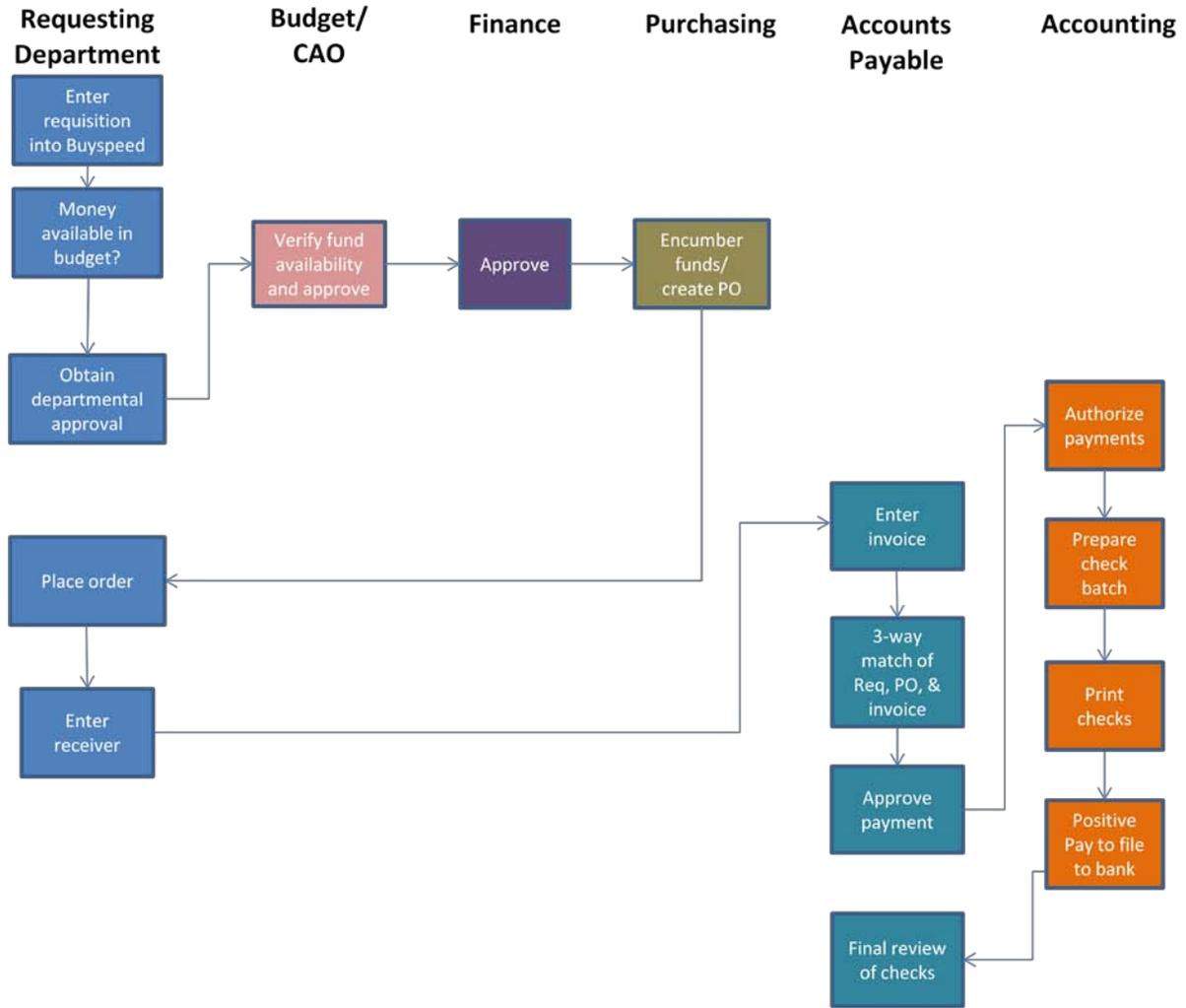
A purchase order is the City's commitment to procure goods or services. The process of obtaining a purchase order and the subsequent procurement and payment process includes six levels of approval. The City issues purchase orders through BuySpeed, a software product that implements controls and automates the purchasing process.

Typically, when a City department decides to purchase goods or services, personnel responsible for procurement within the department first check their own accounting to determine if there are funds available in the budget. The department then submits a requisition (request for a good or service) for the good or service to the Budget Office. The Budget Office checks that the department has budgetary approval to make the expenditure and sends the request to the Finance Department. The Finance Department verifies that the requesting department has a fund balance available and sends the request to the Bureau of Purchasing (Purchasing). Purchasing assists with the vendor selection process (if necessary),³ encumbers the funds (commits funds to a specific purchase), and issues a purchase order to the requesting department.

After receiving the purchase order, the requesting department contacts the vendor and requests the contracted goods or service. Upon receipt, the requesting department acknowledges that it received the goods or service and submits the vendor's invoice to Accounts Payable. Accounts Payable performs a three-way check to ensure that the information on the invoice, the purchase order, and the requisition all match and then approves the payment. The payment is then authorized and prepared in Accounting. This process, including the six layers of approval, is illustrated in Figure A: Purchasing and Disbursement Process with Purchase Orders.

³ Purchasing conducts a formal and public procurement process for purchases above \$20,000 for goods and non-professional services and above \$15,000 for professional services. Departments conduct an informal selection process for purchases under these thresholds. Purchasing requires documentation of the informal selection process.

Figure A: Purchasing and Disbursement Process with Purchase Orders



The purchase order is the method by which the City commits funds to be spent on a specific item.⁴ City Code prohibits vendors from selling to the City without a purchase order; it also prohibits the City from issuing a payment made to a vendor without a purchase order.⁵

BuySpeed, the City’s web-based purchasing software, is the City’s only method for issuing a purchase order. BuySpeed implements the internal controls outlined above through its automated process of issuing requisitions and approvals among requesting departments and the various departments associated with approvals and generating payments. BuySpeed does not allow payment requests to proceed to the next level without authorized approval. For each payment made through BuySpeed, the program automatically checks account balances in the general ledger before approving purchases. Thus, BuySpeed ensures that purchases are only made if a department has sufficient funds available in its budget.

⁴ CAO Policy Memorandum No. 24(R), Section 3, paragraph L.

⁵ City Code Sections 70-420 and 421.

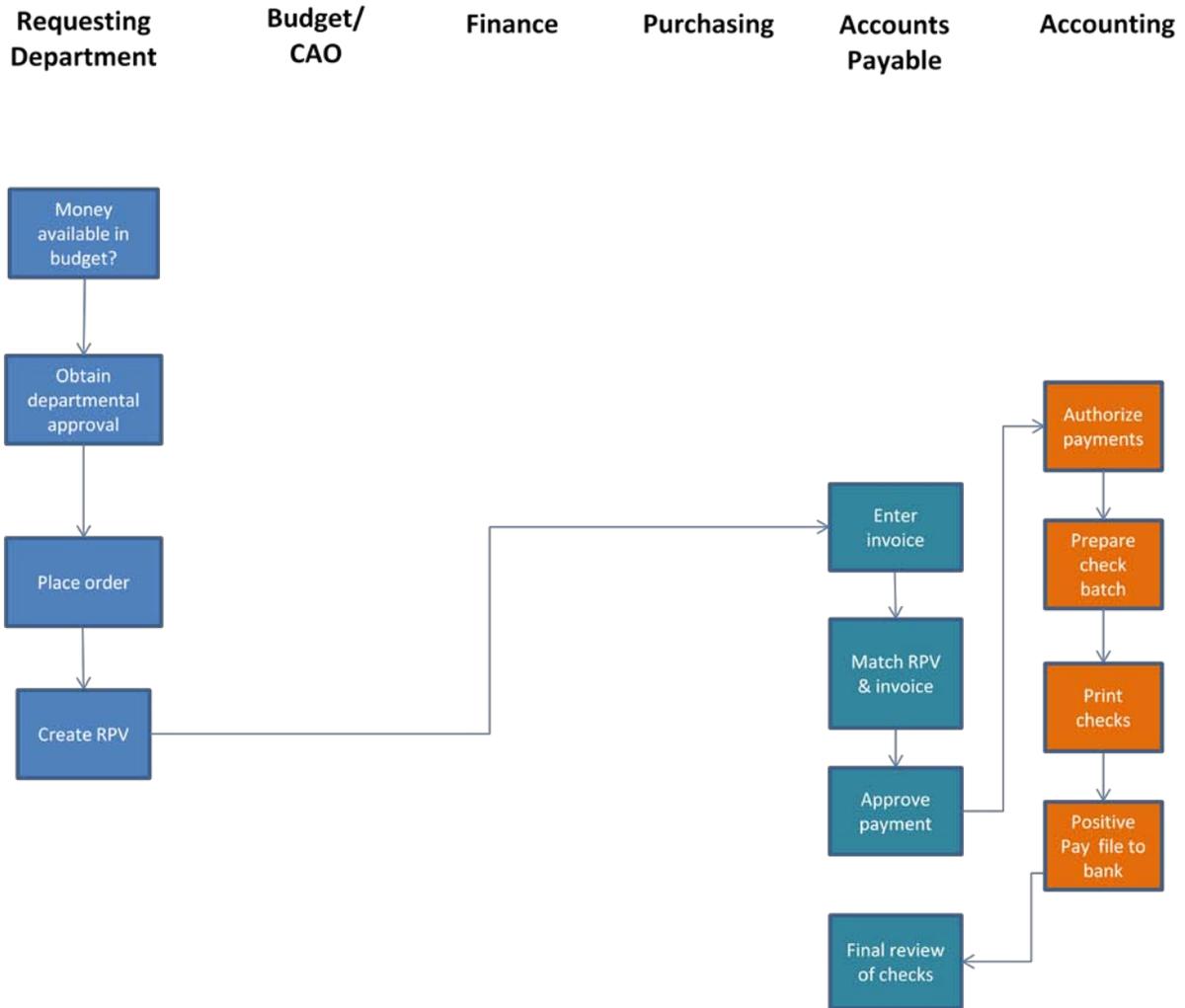
Effective internal financial control procedures should include segregation of duties, proper authorization, and adequate records of transactions. BuySpeed fulfills all these requirements. Purchase orders processed through BuySpeed create an audit trail that provides a chronological record of each purchasing transaction, documenting the sequence of activities the City undertakes to ensure that each purchase is appropriate and within the requesting department's allocated budget. Staff members in six different departments are tasked with exercising rigorous internal controls by separately authorizing each step of the process and monitoring the expense of public funds. The City's approved purchase order process provides verifiable financial oversight by the Finance Department in order to ensure transparency and accountability and enable the City to safeguard assets against errors or unauthorized use.

PAYMENT VOUCHER (PV)

The alternate method for issuing payments is the Payment Voucher (PV) process. When departments make requests using PVs, the process is manual, does not include purchase orders, and includes fewer levels of approval. Compared to the six levels of approval required by a purchase order, PVs have only three levels of approval: Requesting Department, Accounts Payable, and Accounting. Rather than entering requisitions into BuySpeed and following the established protocol, staff members bypass the levels of approval provided by BuySpeed and manually submit hard copy PVs directly to Accounts Payable. After reconciling PVs to invoices, Accounts Payable sends payment requests to Accounting based solely on the approval of the requesting department. Accounting generates the payment upon receiving PVs from Accounts Payable.

No oversight of PVs is provided by the Budget Office, the Finance Department, or Purchasing. As Figure B illustrates, the audit process proceeds in a linear fashion; PVs pass straight from Purchasing to Accounts Payable to Accounting, which authorizes the payments. No department other than the originating department is required to approve funds for the purchase; with only a PV and invoice, a purchase can be approved. Further, because there are no purchase orders, Accounts Payable has nothing against which it can compare invoices. Additionally, Accounts Payable cannot check account balances. Without these additional procedural checks, the process is more vulnerable to error or abuse.

Figure B: Purchasing and Disbursement Process with Payment Voucher



City Code requires purchase orders for payments to vendors, but CAO Policy Memorandum 24(R) (Memo 24(R)) outlines some exceptions. Memo 24(R) authorizes payments made using PVs in limited situations. Section 7 of Memo 24(R) allows payments for the following to be made without a purchase order.

- Claims
- Refunds
- Travel
- Petty Cash
- Reimbursements
- Advertisements
- Interagency Transfers
- Newspaper Advertisements
- Licenses and Permits
- Dues and Subscriptions
- Radio and Television Announcements
- Postage
- Court Costs
- Utilities

The exceptions listed above include payments associated with set costs or routine expenses, such as postage and subscriptions, court filing fees, or advertisements in the journal of record

that are required by law. Exceptions also include payments that have been authorized in another manner, such as travel reimbursements that have been approved in a travel authorization form and utilities that are specifically authorized in the City's Home Rule Charter.⁶

Although not required to do so by law, the City processes most of the excepted payments through BuySpeed, increasing the City's financial control over the purchasing process. However, it still regularly processes some of the exceptions through PVs. These excepted payments are either permitted by Memo 24(R) or are not subject to vendor payments' legal requirements. For example, transfers to other governmental agencies (e.g. disbursement of sales and property taxes) and refunds (mostly due to property tax overpayments, tax title redemption payments, and employee refunds for premium overpayments) are permitted according to Memo 24(R).⁷

The City also uses PVs to process payments associated with payroll, including payroll taxes, wage garnishments, and employee deductions for optional benefit products. These are not explicitly allowed in Memo 24(R) but do not qualify as vendor payments, because the City deducts payments for these funds from employee paychecks and not from City operating funds. For this report, we inspected only vendor payments that were required by City law to have purchase orders.

⁶ Though utility payments could be considered vendor payments, they are specifically exempted in City Charter Sec. 6-308(2).

⁷ City law does not require purchase orders for these transactions. City Code Sections 70-420 and 421.

III. FINDINGS

FINDING 1. THE CITY PAID A TOTAL OF \$1,030,343 TO VENDORS OVER A THREE-MONTH PERIOD WITHOUT PURCHASE ORDERS AS REQUIRED BY THE CODE OF THE CITY OF NEW ORLEANS.

Inspectors examined 3,319 payments issued by the City from March 1, 2011 through May 31, 2011 to determine if the City followed the City Code by requiring purchase orders from BuySpeed prior to issuing vendor payments. During the period, inspectors identified 26 payments totaling \$1,030,343 to vendors without purchase orders. The City issued these payments in violation of City Code Sections 70-420 and 421, which require a purchase order before making payments to vendors.

We obtained PVs, invoices, and checks from Accounting and interviewed staff responsible for making payments to determine why these payments were not processed through BuySpeed. In each observed payment, the City was not able to use BuySpeed to issue purchase orders, because the City did not make the payments from a traditionally budgeted fund. In order to use BuySpeed, the program must have a fund balance to check. None of the payments we identified was associated with funds that had a balance. Instead, payments were drawn directly from the City's total account balance. We found payments to vendors associated with three programs that did not have a balance: group life insurance payments, payments to vendors providing services to the Office of Cultural Economy, and payments to collection agencies.

Group Life Insurance

City personnel did not obtain a purchase order prior to paying for group life insurance. The OIG previously addressed payments made to the group life insurance vendor in its February 2012 *Evaluation of Group Life Insurance Benefits*.⁸ The City's response to that report was (in relevant part):

In some cases an alternative method to purchase orders is used, that has appropriation, budget, and procurement controls. The Law Department personnel followed the payment processing instructions provided by the Finance Department for these life insurance premiums. Life insurance premiums are transferred from each department's approved personnel budget each pay period to an agency fund.⁹ The agency fund is then used to pay the city's premium to the insurance company. Agency funds do not require an additional budget in the city's Great Plains/BuySpeed system and thus payments are processed using the Request for Payment Voucher (RPV) method.

⁸ Office of Inspector General, City of New Orleans. *Evaluation of City Employee Life Insurance Benefits*. February 7, 2012, available at www.nolaoig.org.

⁹ The term "agency fund" refers to a clearing account that the City uses to make group life insurance payments. The clearing account does not carry a balance.

In its response to the OIG City Employee Life Insurance report, the City referred to CAO Policy Memorandum 24(R) to explain why Group Life fell outside the BuySpeed payment protocol. The City stated that it would:

review CAO Policy Memo 24(R) to ensure that all payment processes that use the RPV method, such as refunds, travel reimbursements, and payments to agency funds are clearly identified and that appropriate oversight and controls are in place for them.

Although the OIG acknowledges the City's intention to clarify which payments may be processed through PVs, the City's response did not explain why payments from agency funds are an exception to the requirement for a purchase order. Group life insurance payments are categorically different from the exceptions listed in the memo. The City has not explained the standards it would use to exempt group life insurance payments from the protocols and controls established in Memo 24 (R).

During interviews associated with this inspection, the City clarified why it was not able to use BuySpeed for this fund. City personnel used PVs to make these payments, because BuySpeed can only access funds that have a balance in Great Plains, the City's general ledger. Unlike most departmental vendor payments, group life vendor payments were not allocated to the administering department's budgeted fund (in this case, the Law Department's budget). Instead, the City's general fund operating budget included all personnel costs (salary, taxes, and benefits costs per employee multiplied by the number of employees) in each department's budget.

City staff told us that if group life payments were processed using BuySpeed, the budget would count the expenditures twice: once when they were withdrawn from each department's personnel budgets and a second time when they were withdrawn from the Law Department's operating expenses. Although the City's use of the agency fund solved the issue of counting expenditures twice, it did not address the concern about insufficient financial oversight raised by the lack of a purchase order. BuySpeed is the City's only method for obtaining purchase orders, but it cannot currently access an agency fund.

Special Revenue Funds

Staff in the Office of Cultural Economy (OCE) made vendor payments through PVs rather than requesting purchase orders. The OCE administers two special revenue funds created by City ordinance: the New Orleans Film Commission Fund and the Music and Entertainment Commission of New Orleans Fund.

Unlike most operating funds, the City authorizes spending from these special revenue funds through their establishing ordinances rather than through the City's annual budget process.¹⁰ Funded by mechanisms other than budgeted departmental appropriations, these special revenue funds do not carry an allocated balance; without allocated balances that appear in the City's ledger system, the City cannot pay vendors from these funds using purchase orders processed through BuySpeed.

Although the governing boards or commissions listed in the funds' ordinances may approve spending from these funds, City Code grants administrative authority over the funds and fund payments to the Director of Finance.¹¹ The Director of Finance has the authority—and the responsibility—to ensure that appropriate spending oversight procedures are used. This oversight function is critical, because monies for these special revenue funds are deposited in the City's bank account. When the City makes a payment using PVs from one of these funds, there is no barrier between the monies associated with these special revenue funds and all other City monies. If staff authorized a PV payment from one of these special revenue funds in excess of the fund's current balance, the payment would have to be made using money that was set aside for another purpose.

When other departments make requisitions using a purchase order, the request must be approved by the Budget Office and the Finance Department. However, the OCE appeared to operate more informally. When OCE staff requested goods or services from vendors, they were not required to obtain approvals from the Budget Office or Finance Department, and purchasing never created a purchase order to commit City funds to payments. Instead, the head of the OCE asked one of his staff members to check the account balance in the City's general ledger and made a mental note to commit funds. In one instance, OCE procured professional services in the amount of \$3,000 via e-mail between OCE staff and the vendor rather than relying on a formal contract.

Staff in the OCE initially told us that, because the funds operated outside of the City's general fund operating budget, they could not make payments through BuySpeed. Nonetheless, we found instances in which other City departments made payments from special revenue funds through BuySpeed. For example, Parks and Parkways administrators used BuySpeed for most payments from the Plant-A-Tree Fund. The Plant-A-Tree Fund is a special revenue fund, like the OCE funds cited above, from which Parks and Parkways is authorized to make expenditures.¹²

Though personnel from Parks and Parkways generally used BuySpeed to make vendor payments, inspectors observed one instance in which the department used a PV to make a payment. In this instance, a PV was used specifically, because BuySpeed denied a purchase order when the Plant-A-Tree Fund did not have sufficient funds available to cover the expenditure. According to personnel interviewed by inspectors, Parks and Parkways needed to

¹⁰ City Code Sec. 70-415.21 and 70-256.

¹¹ Id.

¹² City Code Sec. 70-281.

make the purchase quickly in order to comply with the requirements of a donor. The Finance Department instructed personnel from Parks and Parkways to expedite the payment by submitting a PV to Accounts Payable rather than through BuySpeed. Staff in Accounting issued the PV payment directly against the City's total account balance without regard to the amount available in the specific Plant-A-Tree fund.

In this case, the City may have permitted the payment before a donation was credited to an account, because staff in the Accounting Department knew the situation was temporary and additional revenue would become available. Nonetheless, this instance illustrates the potential for misuse of funds inherent in PVs; the PV was a readily available shortcut, used specifically to allow staff to process a payment for which there were no funds.

In an ideal process with sufficiently robust financial oversight, each step is handled by a different person, usually responsible for double checking earlier steps in the process. No one person should be able to override the system of checks established to guard against the incorrect use of funds. At minimum, using PVs as standard practice increases the potential for misuse of funds by reducing effective controls over expenditures. Exceptions, such as the Parks and Parkways example noted here, illustrate a higher level of risk and should involve a separate approval process that documents the justification for deviating from established protocols.

FINDING 2. A TOTAL OF \$4,497,493 IN PAYMENTS TO TWO SEPARATE COLLECTION AGENCIES WAS NOT INCLUDED IN THE CITY'S BUDGET.

Inspectors found that staff in the Treasury Administration used PVs for payments to collection agencies that contracted with the City to collect delinquent sanitation fees and property taxes. Finance Department personnel told inspectors that the payments could not be preceded by a purchase order, because the City did not budget for these payments.

The Finance Department explained that these vendor payments were not in the budget, because Finance defined the payments as deductions on revenue accounts and not purchases. For the collection companies that handle delinquent payments for property taxes and sanitation fees, the process is as follows:

- The City contracts with collection agencies, which are compensated by an additional collection fee charged to the delinquent taxpayer. The collection fee is a percentage of the taxes or fees owed.
- The collection company contacts delinquent payers to solicit payment of past due taxes and/or fees.
- The delinquent payer pays the City the tax or fee amount due plus the collection fee. The City deposits both the payment and collection fee in its bank account.

- The collection company submits an invoice to the City for the amount of the collection fees, and the City issues payment to the collection company.

The rationale the City uses for excluding collection fee payments from the budget is not sound. Payments to collection agencies were not simple deductions on revenue: rather, delinquent payers issued payments to the City Treasury, and the City made payments, based on invoices, to the collection agencies. In addition, the City had formal contracts with the collection companies that outlined how the City would compensate them for their services. The collection fees were revenue to the City, and the payments to the collection company were expenses. State law requires all revenues and expenses to be included in the budget.¹³

State law also requires the City Council to adopt the budget in an open meeting through a transparent process designed to ensure that elected officials are accountable for the decisions they make on behalf of the public. In compliance with this legal requirement, the City Council holds hearings every fall and approves a budget for every City department for the following year. The process is outlined in the Louisiana Local Government Budget Act (“Budget Act”). According to the Budget Act, the budget shall include:

A statement for the general fund and each special revenue fund showing the estimated fund balances at the beginning of the year; estimates of all receipts and revenues to be received; revenues itemized by source; recommended expenditures itemized by agency, department, function, and character; other financing sources and uses by source and use; and the estimated fund balance at the end of the fiscal year.¹⁴

Additionally, the Budget Act stipulates that:

Political subdivisions ... shall afford the public an opportunity to participate in the budgetary process prior to the adoption of the budget.¹⁵

Processing the payments to collections agencies as deductions on revenue fails to comply with state law on two counts: the revenues and expenditures associated with delinquent collections are not included in the budget, and the transactions are not made visible to the public in an open process.

City staff stated two additional reasons why they did not include the collection revenues and expenses in the budget. First, staff stated that the collection expenses inaccurately represented the size of the department’s budget. In their view, the expenses were balanced by the revenue and the program appeared revenue neutral. However, if included in the budget, the revenues would be recorded as general fund revenue not attributed to Treasury, whereas the expenses

¹³ La. R.S. 39:1305(C)(2)(a).

¹⁴ Id.

¹⁵ La. R.S. 39:1307(A).

would be associated with Treasury, increasing Treasury's line item for operating expenses significantly.¹⁶

Second, staff noted that including the transactions in the original Treasury Administration budget was less convenient than PVs. If the City received payments in excess of the budgeted amount, the Chief Administrator's Office would have to request an ordinance to amend the City's budget.¹⁷

Upon further questioning, the Finance Department staff explained that, although they did not include revenues and expenditures for the collection contracts in the original published budget, they included the transactions in the budget later in the year, when staff could more closely estimate actual budget numbers. As established practice, City staff added certain revenues and expenditures to the budget at the end of the year so that independent auditors could audit the funds as required by state and City laws.¹⁸ In addition to collection company fees, Police and Fire Supplemental pay are also added to the budget in this way.

Neither of the above reasons is a legitimate rationale for excluding tax collection fee revenues and expenditures from the published budget. These transactions are legitimate revenues and expenditures, and state law requires that they be included in the published budget, making the process transparent and available for public scrutiny. Although more time-consuming and perhaps cumbersome, the adoption of a City ordinance amending the budget by the City Council during an open meeting is an equally important part of the transparent budget process. Disclosing these revenues and expenditures in open processes permits the public to have an accurate and complete picture of the Treasury Administration budget.

Finally, if the funds had been budgeted prior to payments, Purchasing could have issued a purchase order creating an audit trail and greater operational controls over the funds. Instead, Treasury had to use PVs to request payments to the collection vendors, reducing financial oversight and controls, as well as taking the process out of public view.

¹⁶ In the published 2011 Annual Operating Budget, the City Council granted the Treasury Administration a budget of \$1,969,747, which included line-item personnel and operating expenses for treasury (\$1,560,854), cashiers (\$242,296), ad valorem taxes (\$166,597), and Brake Tag/Sanitation (\$44,309). The sum of these expenses totaled \$2,014,056. The collection contract expenses of \$4,497,493 were not listed in the public document as an operating expense. If the costs of the collection contract were included in the Annual Operating Budget, they would increase the Treasury budget threefold, from \$2,014,056 to \$6,511,549

¹⁷ Although it did not budget for property tax and sanitation fee collection agencies, the City budgeted for Emergency Medical Services collections payments.

¹⁸ La. R.S. 24:513 and City Charter Sec. 6-108.

IV. CONCLUSION AND RECOMMENDATIONS

CONCLUSION

The City improperly used Payment Vouchers (PVs), a mechanism that was designed for limited types of payments in specified circumstances, for the vendor payments described in this inspection. In the case of group life insurance payments, the City overcame an accounting problem with a solution that provided less oversight. For special revenue funds, the City did not track a fund balance, which would allow it to use purchase orders for purchases made from the funds. For collection fees, the City used PVs for payments rather than take the necessary steps to include the revenues and expenses in the annual published budget and make it possible to use purchase orders. In all three cases the City resolved accounting issues by choosing a more expedient process that reduced financial oversight and increased the risk of errors or misuse of funds.

The City uses BuySpeed to ensure financial oversight for operating expenditures. BuySpeed's ability to interface with budget allocations and account balances guarantees that purchase orders will only be issued if sufficient funds are available to pay for purchases. According to City law, all payments made to vendors should be preceded by a purchase order. The City's only method for issuing purchase orders for the kind of payments discussed in this report is BuySpeed. The requirement that departments obtain a purchase order through BuySpeed before the City issues vendor payments ensures that funds are available within the department's budget. The required approvals for purchase orders ensure segregation of duties and enforce six layers of oversight to monitor for errors or fraud. BuySpeed also documents the process, thereby providing an audit trail. When the City makes payments to vendors using PVs, there are fewer levels of approval and fewer checks for errors or fraud. PVs do not document approval from the Budget Office, Finance, and Purchasing.

RECOMMENDATIONS

The City should bring the vendor payments discussed in this report into compliance with City policy by incorporating all vendor payments (including those from payroll clearing funds, special revenue funds, or revenue funds like the ones used for collection agency payments) into BuySpeed and issuing purchase orders prior to the procurement of goods and services.

RECOMMENDATION 1: THE CITY SHOULD REQUIRE PURCHASE ORDERS BEFORE ISSUING PAYMENTS TO VENDORS IN ORDER TO ENSURE ADEQUATE FINANCIAL CONTROLS AND TO COMPLY WITH THE CODE OF THE CITY OF NEW ORLEANS.

Rather than allowing departments to use PVs to bypass the internal controls associated with BuySpeed, we recommend that the City create fund balances for group life insurance payments, payments from special revenue funds, and collection agency payments. The City

should then use BuySpeed for these types of payments. To ensure that these financial controls are in place for all vendor payments:

- The City should create a fund for group life insurance so that it can use BuySpeed for payments or, if this is not possible, institute another payment process that includes the same six levels of oversight included in the purchase order process. For instance, instead of PVs the City could process hard copy purchase orders that are subject to the same financial oversight process provided by BuySpeed.
- The City should create account balances for special revenue funds and require all fund administrators to use BuySpeed. Fund balances should be updated in a timely manner.
- The City should make payments to collections agencies using purchase orders processed through BuySpeed, after including them in the budget as addressed in Recommendation 2.

RECOMMENDATION 2: THE CITY SHOULD INCLUDE PAYMENTS MADE TO COLLECTION CONTRACTORS FOR DELINQUENT AD VALOREM TAXES AND SANITATION FEES IN ITS BUDGET.¹⁹

We recommend that the City end the practice of excluding collection costs from the initial budget process. Instead, the City should include vendor payments for collection of delinquent ad valorem taxes and sanitation fees in the budget process before the City makes payments. State law mandates that all revenues and expenditures are included in the budget.²⁰

When the City does not include collection company fees as revenue and expenses, it misrepresents the size of the budget in the published budget document. These revenues and expenses are not visible, thus violating the principles of transparency and accountability inherent in the Budget Act. The City should include in the annual published budget the fees it collects for delinquent payments as revenue and the corresponding payments to collection companies as expenses.

¹⁹ The legality of the City's assessment of a 10% penalty paid to the City and a 9.5% collection fee paid to the collection contractor is the subject of pending litigation. Our recommendation that these fees be included in the budget applies solely to the City's current practices, without comment on the legality of those practices.

²⁰ La. R.S. Section 39:1305(C)(2)(a).

V. OFFICIAL COMMENTS FROM CITY OF NEW ORLEANS

City Ordinance section 2-1120(8)(b) provides that a person or entity who is the subject of an OIG report shall have 30 working days to submit a written explanation or rebuttal of the findings before the report is finalized, and that such timely submitted written explanation or rebuttal shall be attached to the finalized report. On August 22, 2012, we provided the City with an Internal Review Copy of this report, giving city officials the opportunity to comment on the report prior to public release of this Final Report. A letter received from the Chief Administrative Office of the City of New Orleans follows our view of the City's substantive comments below.

In its comments, the City states that the OIG is not questioning whether legal spending authority was in place during the audit of vendor payments. We disagree; as stated in Section I of the report, "The objective of this inspection was to determine if the City made payments to vendors in accordance with State and City laws and City policies," and inspectors determined that \$1,030,343 was paid to vendors over a three-month period without purchase orders as required by law (Finding 1).

The City next purports that the group life insurance vendor payments are drawn from an internal service fund, and according to Government Accounting Standards Board (GASB) standards, these funds do not require encumbrance accounting. However, GASB standards permit purchase orders, and City Code requires purchase orders for payments to vendors.

The City also asserts that payments to ad valorem tax collection vendors are held in a fiduciary fund, and GASB standards do not require encumbrance accounting for fiduciary funds. GASB states that "Fiduciary funds should be used to report assets held in a trustee or agency capacity for others and therefore cannot be used to support the government's own programs."²¹ However, the City made a choice to contract with a vendor to implement a delinquent tax collection program; this is not a fiduciary responsibility, and vendor payments are not a fiduciary transaction. Therefore, the funds for these payments are subject to the Louisiana Local Government Budget Act, City Code Sections 70-420 and 421, and GASB standards for government funds.

²¹ Governmental Accounting Standards Statement No. 34 – Basis Financial Statements –and Management's Discussion and Analysis – For State and Local Governments. June 1999, paragraphs 69 through 73. Published by the Governmental Accounting Standards Board.

CHIEF ADMINISTRATIVE OFFICE
CITY OF NEW ORLEANS

MITCHELL J. LANDRIEU
MAYOR

ANDREW D. KOPPLIN
FIRST DEPUTY MAYOR & CAO

October 17, 2012

Mr. Edouard Quatrevaux
Inspector General
City of New Orleans
525 St. Charles Avenue
New Orleans, LA 70130

Dear Mr. Quatrevaux:

Re: OIG Report on Inspection of the Vendor Payment Process

The city has reviewed the Office of Inspector General's "Report on Inspection of the Vendor Payment Process of the City of New Orleans." The OIG's report addressed the City's vendor payment process and it identified two common methods of processing payments: the use of purchase orders and payment vouchers. As we discussed with your team in our exit conference on September 24, 2012, we agree with some of your recommendations and will implement them yet disagree on others where we believe Government Accounting Standards Board (GASB) support the management practices we currently utilize and where, on balance, our current practices best meet the city's obligations.

We believe it is important to note that the OIG report does not question whether spending authority had been authorized and was in place for the vendor payments reviewed your office, but rather offers comments on the specific processes used to make these approved payments to certain of the city's vendors.

As always, the City welcomes these recommendations to help improve internal controls and processes. Below are our responses to the Report on Inspection of the Vendor Payment Process of the City of New Orleans.

RESPONSE TO FINDINGS

The report's findings are focused on the City's use of Request for Payment Authorizations (RPAs) and Payment Vouchers (PVs) for making payments to certain vendors, rather than using purchase orders. The finding further described three cases where purchase orders were not used to make certain payments, to:

1300 PERDIDO STREET | SUITE 9E06 | NEW ORLEANS, LOUISIANA | 70112
PHONE 504.658.8600 | FAX 504.658.8648

1



- Group Life Insurance company,
- vendors providing services to the Office of Cultural Economy, and
- Collection Agencies.

The first payment mechanism was also reviewed in the OIG's February 2012 "Evaluation of Group Life Insurance Benefits," as noted in the current report. At that time, the City responded that in some cases an alternative method to purchase orders is used to make payment from an internal service fund or an agency fund. In the current report on "Inspection of the Vendor Payment Process," the report noted that the City did not fully explain why payments from agency funds are an exception to the requirement for a purchase order, i.e. budgetary controls.

Responding to this query requires a fuller discussion of the use of budgetary controls in governmental accounting, and in particular, the role of budgetary controls in operating funds versus other kinds of governmental accounting funds.

Background

The Government Accounting Standards Board (GASB) is the standard setting organization for Governmental Accounting. As reported in the Governmental Accounting, Auditing, and Financial Reporting (GAAFR) book, GASB lists three categories of funds: government funds, proprietary funds, and fiduciary funds.

- Government Funds are those typically used to support the governmental activities. Types of governmental funds are: the general fund, special revenue funds, debt service funds, and capital project funds. *Governmental funds must have legally adopted budgets and use encumbrances to track commitments.*
- Proprietary Funds are used to account for a government's business-type activities. Proprietary funds are classified as enterprise funds and internal service funds. Internal service funds are used to centralize costs or services. *Proprietary Funds do not require adopted budgets or the use of encumbrances.*
- Fiduciary Funds are used to account for resources that are held by the government as a trustee or agent for parties outside the government and that cannot be used to support the government's own programs. Types of fiduciary funds are pension funds, investment trust funds, and agency funds. Agency funds are used to account for taxes collected by one government on behalf of other governments, receipts which are purely custodial, and remittance of fiduciary resources. *Fiduciary Funds do not require adopted budgets or the use of encumbrances.*

For the purposes of this inspection, the typical budgeting and encumbering of spending takes place for Government Funds, the most important of which is the City's General Fund.

However, the city has a large range of activities that fall under the Proprietary or Fiduciary/Agency Fund definitions. For example, in 2011, the City had collections of agency funds of over \$414,000,000 for taxes, interest, and fees which were held as a fiduciary liability. The council authorizes the collection of ad valorem tax and City Code Section 150-48 authorizes the collection fee for delinquent ad valorem tax, to be held by the City for payment to the vendor, and thus is not City General Fund revenue. The City handles all items listed on a tax bill (tax, interest, and collection fee) in a uniform manner by recording the collections in a fiduciary agency fund consistent with GASB standards. Distributions are made from the fiduciary agency fund to other governments for their taxes and to the city's private collection company for its collection fee as is required by City Code Section 150-48, without including these revenues in the city's operating budget as that would not be appropriate for revenues in a Fiduciary/Agency fund.

The OIG report accepted this payment practice in some instances but not in all. The inspector accepted as appropriate the payment of \$410,000,000 relating to the payment of tax and interest from the agency fund, but questioned the \$4,000,000 of collection fees paid to the outside collector of delinquent ad valorem taxes as required by City Code Section 150-48. The City believes that both kinds of payments are appropriate for a Fiduciary/Agency Fund distribution under current ordinances, and other governmental funds are treated similarly.

For example, the State of Louisiana Budget Act, Revised Statue 39:1301-1315 also notes that internal service funds or agency funds do not require budgeting and encumbrances. The State Budget Act mandates the preparation of a comprehensive budget for general funds and special revenue funds *only*.

Additionally, Louisiana's Attorney General opined in Opinion Number 03-0300, that the State Budget Act applies only to Government Funds. It further defined Government Funds as general funds and special revenue funds as stated above.

Finally, GAAFR guidance provides that encumbrances/purchase orders are used to track commitments for budget appropriations. It also notes that while encumbrance accounting is useful, *it is not necessary for all types of commitments and all types of funds*.

Given this background, the City's responses have been developed to ensure a consistent accounting approach is adopted going forward for these kinds of transactions, given the current legal authority.

RESPONSE TO RECOMMENDATIONS

Recommendation 1: The city should require purchase orders before issuing payments to vendors in order to ensure adequate financial controls and to comply with the Code of the City of New Orleans.

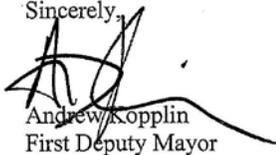
- The city concurs with the OIG's recommendation to use encumbrance control for Special Revenue Funds, such as vendors providing services to the Office of Cultural Economy.
- The City disagrees with the OIG's recommendation to use encumbrance control for Internal Service Funds payments such as that for Group Life Insurance.
- The city agrees that payments for collection agency for Sanitation fees should be budgeted and will propose this in the 2013 budget. However, the legal authority for the city's private collection company for ad valorem taxes defines the collection fee as not being City revenue, and so the current practice for payments is appropriate. The city is planning to rebid the ad valorem tax collection service in early 2013 and is also reviewing current litigation regarding its constitutionality. As part of these initiatives and in response to this OIG report recommending that collection fees be treated as governmental funds, we will add this issue to our review and may well recommend that the City Council amend current ordinances so that these revenues would not be considered fiduciary funds.

Recommendation 2: The city should include payments made to collection contractors for delinquent Ad Valorem taxes and Sanitation fees in its budget.

- The city concurs with the OIG's recommendation to use budgetary controls for Government Funds.
- The City does not agree with the OIG's recommendation to use budgetary controls for Internal Service Funds and Agency Funds as a general matter, for the reasons stated above.

On a going forward basis the City will use encumbrance and budgetary controls for payments made in governmental funds. Additionally the City will continue to ensure that the use of internal service funds, agency funds, and payments made within those fund types are in compliance with State Statutes, City Code and Generally Accepted Accounting Principles.

Sincerely,



Andrew Kopplin
First Deputy Mayor
City of New Orleans

Cc: Norman Foster
Michelle Thomas
Jeff Cashill