



City of
ALBUQUERQUE
Office of Internal Audit

**STRATEGIC REVIEW
17-306**

**ACCOUNTS PAYABLE
INTERNAL CONTROLS
BEST PRACTICES**

JUNE 28, 2017

INTRODUCTION

In April 2017, the City of Albuquerque (City) Administration requested that the Office of Internal Audit (OIA) research, compile, and provide best practices and regional city information for the Department of Finance and Administrative Services (DFAS) – Accounts Payable Division. The request came after the City fell victim to electronic payment fraud.

OBJECTIVE

The objective of this review was to research, compile, and document best practices and other regional and comparable organization data to help the City's Accounts Payable Division strengthen its electronic payment change policies and procedures.

SUMMARY

OIA contacted 13 regional and comparable organizations, to assist in identifying beneficial best practices and common controls for electronic payment changes. Responding organizations acknowledged the importance of internal controls in protecting against electronic payment fraud. Among the organizations, common controls were identified:

- Written policies and procedures,
- Submission of updated forms,
- Authentication of revised bank information, and
- Verification of changes with vendor.

Industry best practice and guidance for internal control exist and include the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and the Government Finance Officers Association (GFOA).

COSO includes and defines:

- The *COSO Internal Control-Integrated Framework (COSO Framework)*, and
- Five components of internal controls.

GFOA recommends:

- State and local governments adopt the *COSO Framework* as the conceptual basis for designing, implementing, operating, and evaluating internal control.
- Governments review and make necessary changes to business processes, safeguards, and applicable internal controls when processing electronic payments.
- Internal control procedures over financial management be documented.
- Documented internal control procedures should include some practical means for lower level employees to report instances of management override of controls that could be indicative of fraud.
- Governments hold individuals accountable for their internal control responsibilities by taking disciplinary action if conduct is not consistent with expected performance.

DFAS management is responsible for designing and implementing internal controls and maintaining related policies and procedures. OIA did not design, approve, or implement DFAS's policies and procedures during this review.

RESULTS

The information in this report is based on research, interviews, and review of DFAS draft electronic payment policy.

According to Merriam-Webster, the term *best practice* refers to “a procedure that has been shown by research and experience to produce optimal results and that is established or proposed as a standard suitable for widespread adoption.”

Common Regional and Comparable Organizations Internal Controls

OIA contacted 13 regional and comparable organizations in an effort to gather best practices and common internal controls regarding electronic payment changes for DFAS to consider. Of those that responded to OIA’s inquiries, common internal controls pertaining to electronic payment setup and changes were identified and are listed below.

- **Written Policies and Procedures**
The organizations acknowledged the importance of having detailed, written policies and procedures – even if the entities themselves did not have established policies.
- **Standard Forms and Processes**
The organizations require updated forms, voided checks containing banking information, and maintain adequate separation of duties between related activities.
- **Verification of Changes with Vendor**
The organizations contact the vendor by telephone to obtain verbal confirmation of changes, and via email to obtain written confirmation of changes. One city requires the vendor to provide/confirm the vendor’s previous bank information prior to authorizing any changes.
- **Authentication/Verification of Bank Information**
The organizations independently verify the updated banking information and confirm the information with the vendor’s financial institution.

Industry Best Practices – COSO

COSO developed the *COSO Framework*, to assist organizations in “designing, implementing, and conducting internal control and assessing its effectiveness.” The *COSO Framework* has gained global acceptance and is considered best practices for internal controls. OIA uses the *COSO Framework* as a standard by which to measure the design and effectiveness of internal controls.

COSO defines internal control as “a structure of policies and procedures designed to systematically provide reasonable assurance that management will help entities achieve its objectives, including operations, financial reporting and compliance.”

The COSO Framework provides general guidance to enable entities to establish a fully-developed system of internal control, which is made up of the following five integrated components:



The five components of internal control are defined below.

1. **Control environment** is the set of standards, processes and structures that provide the basis for carrying out internal control across the organization.
2. **Risk assessment** involves a dynamic process for identifying and analyzing risks to achieving the entities objectives, forming a basis for determining how risks should be managed.
3. **Control activities** are the actions established through policies and procedures that help ensure that management's directives to mitigate risks to the achievement of objectives are carried out. They may be preventive or detective in nature and may encompass a range of manual and automated activities such as authorizations and approvals, verifications, reconciliations, and business performance reviews.
4. **Information** is necessary for the entity to carry out internal control responsibilities in support of achievement of its objectives. **Communication** occurs both internally and externally and provides the organization with the information needed to carry out day-to-day controls. Communication enables personnel to understand internal control responsibilities and their importance to the achievement of objectives.
5. **Monitoring activities** involve on-going evaluations, separate evaluations, or some combination of the two, which are used to ascertain whether each of the five components of internal control is present and functioning.

Industry Best Practices – GFOA

The Government Finance Officers Association (GFOA) provides guidance to government organizations, entities and agencies by publishing best practice information and advisories. GFOA Best Practices “identify specific policies and procedures as contributing to improved government management.” GFOA Advisories identify “specific policies and procedures necessary to minimize a government’s exposure to potential loss in connection with its financial management activities.”

GFOA recommendations:

- State and local governments adopt the COSO Framework as the conceptual basis for designing, implementing, operating, and evaluating internal control so as to provide reasonable assurance that they are achieving their operational, reporting, and compliance objectives.
- Governments review and make necessary changes to business processes, safeguards, and applicable internal controls when processing electronic payments.
- Internal control procedures over financial management be documented.
 - Documented internal control procedures should include some practical means for lower level employees to report instances of management override of controls that could be indicative of fraud.
- Governments hold individuals accountable for their internal control responsibilities by taking disciplinary action if conduct is not consistent with expected performance.

ADDITIONAL CONSIDERATIONS

DFAS is taking steps to improve its internal controls in an effort to protect the City against fraud. The items below are categories and questions DFAS may consider addressing in its updated internal controls policies and procedures.

- Authorization & Separation of Duties
 - What level of City employee (position title) is authorized to receive the change request?
 - What level of employee (position title) is authorized to verify the information?
 - What level of employee (position title) is authorized to input the changes into PeopleSoft?
- Confirmation of Submitted Changes
 - What contact information must be used? (Contact information on file/in original bid file? Specify not to use submitted changed information?)
 - What level of confirmation is acceptable from vendor (who/what level of employee/position title at vendor may confirm change)?
- Verification of Previous Information
 - Should the vendor be required to provide its previous bank account information prior to the City authorizing any changes?
- Documentation

- How will verification of submitted changes be documented?
 - In writing,
 - Initialed, or
 - Dated?
- Where will verification documentation be retained? Hard copy/electronic file?
- Miscellaneous Items
 - If suspicious activity exists, suspend ACH payments and send paper checks.
 - Indicate on new form that all other forms are invalid.
 - Ensure receipt of all original documents/original signatures.
 - Make electronic payment/information forms available only via secure means.

CONCLUSION

The *COSO Framework* acknowledges that “an effective system of internal control demands more than rigorous adherence to policies and procedures: it requires the use of judgment.” In a world in which social engineering (actions that incorporate any and all human-intelligent interactions and are designed to elicit an involuntary or unconscious response that serves the social engineer’s need) is on the rise, a well-designed and comprehensive internal control framework is vital.

As management is responsible for the design and implementation of internal controls, it is important that DFAS management takes an active role in ensuring that internal controls are operating effectively. A comprehensive internal control framework is the primary defense against fraud. However, the best-designed internal controls are of little value if they are not actually followed in practice.

Although the City was a victim of electronic payment fraud, DFAS is taking the necessary steps to prevent such occurrences from happening again. Improvements to internal policies and procedures, coupled with the awareness of such fraudulent activities will assist the City in its on-going fraud detection and prevention efforts.

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