Report of the Vermont State Auditor

June 4, 2010

IMPROPER PAYMENTS

Internal Control Weaknesses Expose the State to Improper Payments

Thomas M. Salmon, CPA
Vermont State Auditor

Rpt. No. 10-02

Mission Statement

The mission of the State Auditor's Office is to be a catalyst for good government by promoting professional audits, financial training, efficiency and economy in government and service to cities and towns.

THOMAS M. SALMON
STATE AUDITOR

STATE OF VERMONT
OFFICE OF THE STATE AUDITOR

June 4, 2010

The Honorable Shapleigh Smith
Speaker of the House of Representatives

The Honorable Peter D. Shumlin
President Pro Tempore of the Senate

The Honorable James Douglas
Governor

Mr. James Reardon
Commissioner, Department of Finance & Management

Mr. David Dill
Secretary, Agency of Transportation

Ms. Patricia Moulton Powden
Commissioner, Department of Labor

Dear Colleagues,

My office recently completed an audit searching for improper payments made from the VISION system. Improper payments made by State government, whether inadvertent or deliberate, reduce the funds available to execute its programs and policies. In these times the State cannot afford to expend precious resources unnecessarily. A commitment to strong internal controls and efficient operations can have significant benefits to the State, including safeguarding taxpayer dollars and preventing improper payments.

This report evaluates some of the internal controls related to the accounts payable processes at both the statewide and department levels. Overall, we found that the departments are generally following the State's accounts payable and internal control guidance, but many departments have not implemented some of the key elements of this guidance. Accordingly, we are making a number of recommendations intended to improve the controls over the accounts payable function and make the process more efficient.

I would like to thank the management and staff of the departments we audited for their cooperation, professionalism and commitment to improving their processes. If you would like to discuss any of the issues raised by this audit, I can be reached at (802) 828-2281 or at auditor@state.vt.us.

Sincerely,

Thomas M. Salmon CPA

Thomas M. Salmon, CPA
State Auditor

132 State Street • Montpelier, Vermont 05633-5101
Auditor: (802) 828-2281 • Toll-Free (in VT only): 1-877-290-1400 • Fax: (802) 828-2198
email: auditor@state.vt.us • website: www.auditor.vermont.gov

Contents

Report

Charts

Contents

Abbreviations

AOT	Agency of Transportation
AP	Accounts Payable
DOL	Department of Labor
FISCAM	Federal Information Systems Audit Manual
F&M	Department of Finance & Management
GAO	Government Accountability Office
PY	Prior Year
SAO	State Auditor's Office
VMRF	Vendor Maintenance Request Form

Introduction

Improper payments made by government, whether inadvertent or deliberate, may reduce the funds available to execute the government's programs and policies. Improper payments are a widespread and significant problem receiving increased attention in today's economic climate and may cause increased demands on state government resources. Improper payments may include inadvertent errors, such as duplicate payments and miscalculations; payments for unsupported or inadequately supported purchases; payments for services not rendered; payments to ineligible beneficiaries; and payments resulting from outright fraud and abuse by program participants, state employees, contractors or suppliers.[1]

In the public sector, improper payments can translate into serving fewer citizens, wasteful spending or increase the burden on taxpayers. The risk of improper payments increases in programs with a high volume of transactions, an emphasis on expediting payments, or complex criteria for computing payments. Given these factors as well as the billions of dollars Vermont State programs collectively disburse, there is clearly a need for State government to be vigilant in the design, implementation and maintenance of strong internal controls to adequately prevent improper payments.[2]

The U.S. Government Accountability Office has estimated the level of improper payments made by federal agencies at around 4 percent of the $1.8 trillion of reported outlays for the related programs, or $72 billion for fiscal year 2008[3]. Given the high dollar value and volume of payments made by the State and potential for erroneous payments, our office performed an audit focusing on detecting certain kinds of improper payment. This report, *Internal Control Weaknesses Expose the State to Improper Payments*, addresses processes and

[1] *Strategies to Manage Improper Payments* (US Government Accountability Office, GAO-02-69G, October 2001).

[2] *Ibid.*

[3] *Improper Payments* (US Government Accountability Office, GAO-09-628T, April 2009).

internal controls related to accounts payable. A second report, *Results of Review of VISION Payments made during 2007 and 2008*[4], addresses improper payments in the system the State uses to pay vendors, VISION[5].

Our audit objectives were to (1) assess the extent to which the departments implemented the State's accounts payable internal control guidance and (2) ascertain whether additional centralized internal controls could improve the State's accounts payable process.

To perform this audit, we evaluated the accounts payable processes of 25 departments[6] against key elements of the State's accounts payable internal control guidance. In addition, we reviewed relevant manuals, policies and procedures, interviewed key staff, and reviewed relevant supporting documentation. Appendix I provides more detailed information on our scope and methodology. In addition, Appendix II contains a glossary of terms used throughout this report.

[4] This report may be found on the Vermont State Auditor website at http://auditor.vermont.gov.

[5] The State uses other systems or contracts for payment processing for some of its larger programs like Medicaid and Unemployment.

[6] The term "department" is used generically throughout this report and refers to agencies, departments or other business units of the State.

Highlights: Report of the Vermont State Auditor

Improper Payments: Internal Control Weaknesses Expose the State to Improper Payments

(June 2010, Rpt. No. 10-02)

Why We Did This Audit

The State of Vermont is accountable to its stakeholders for how its departments spend billions of taxpayer dollars and is responsible for safeguarding those funds against improper payments as well as for recouping those funds when improper payments occur.

What We Recommend

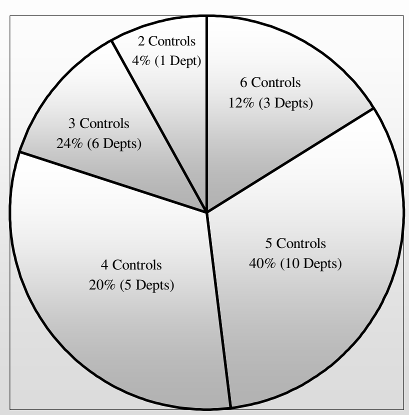
We provided a variety of recommendations to improve the State's internal controls and processes over VISION payments. For example, we recommended the State strengthen its process to ensure departments' compliance with the Department of Finance and Management (F&M) guidance, including Internal Control Standards and Best Practices. We also recommended the State modify the current VISION user access control practice to restrict the same individual from both entering and approving vouchers, and develop and implement standard policies and procedures for approving, maintaining and monitoring vendors.

Findings

Overall, we found that the departments are generally following the State's accounts payable and internal control guidance, but many departments have not implemented some of the key elements of this guidance. Seventy-two percent of the 25 departments we reviewed implemented four or more of the six internal controls we evaluated. However, only 12 percent of the departments implemented all six internal controls. See Chart 1 below for further details. Segregation of duties was the most common internal control implemented among the departments. The most common control not implemented by departments related to maintaining a list of authorized approvers. Although many departments have implemented much of the F&M guidance, failing to implement all key elements of this guidance can result in internal control weaknesses and improper payments.

Additional centralized controls could improve the State's accounts payable process. The State is vulnerable to improper payments as result of weaknesses in accounts payable user access controls in VISION (State's primary financial system). Many VISION users have the ability to both enter and approve vouchers, allowing them to complete a transaction in the system without the appropriate segregation and review. In addition, the SAO found significant weaknesses in F&M's vendor file management process, particularly relating to approving, maintaining and monitoring vendors. In the absence of well established procedures over the vendor master file data, errors or inappropriate use of master file data may go undetected. F&M has not established comprehensive procedures, written or otherwise, addressing key control areas of vendor file maintenance and monitoring. Without well established procedures and controls covering these critical aspects, the State is at risk for erroneous and/or fraudulent improper payments to vendors.

Chart 1: Summary of Departments' Adherence to Internal Controls



Background

The State of Vermont is comprised of six agencies and over 75 departments located across the State, employing approximately 8,000 full-time employees.

The State's organizational structure is primarily decentralized. The departments are responsible for maintaining adequate internal controls for their accounts payable processes. To assist departments with their responsibility to maintain internal controls, F&M has provided the departments with guidance such as Internal Control Standards, Best Practices and the VISION accounts payable manual.[7] It is the clear expectation of F&M that, absent a valid business reason, departments will strive to integrate this guidance.[8]

The State uses an Oracle/PeopleSoft® enterprise financial management system, called VISION, to manage its general ledger, accounts payable, purchasing, accounts receivable, billing, asset management, inventory, and subrecipient grant tracking. The system is managed by the Department of Finance and Management in conjunction with the Department of Information & Innovation's PeopleSoft® Technical Unit. VISION data are stored in a relational database with a complex table structure.

VISION has some embedded application controls[9] over voucher processing, including:

- Duplicate voucher checking controls that check for existing vouchers with matching invoice number, date, gross amount, vendor ID and vendor type.
- A vendor master list, which almost all departments making VISION payments must use.
- On-line system approval process of all invoices entered into VISION .

[7] *Other VISION Documentation: Warrant Process for Accounts Payable* (Department of Finance and Management, November 2007, AP-01)

[8] *Best Practice Series: Best Practices Overview* (Department of Finance & Management).

[9] According to the Federal Information Systems Controls Audit Manual (FISCAM), application controls, sometimes referred to as business controls, are incorporated directly into computer applications to help ensure the validity, completeness, accuracy, and confidentiality of data during application processing and reporting.

Generally, business process controls[10] are developed and implemented by the departments.

Currently, most departments' process invoices through the VISION system to pay vendors. Although most departments use VISION to pay invoices, they have much autonomy in designing their business processes. During 2007 and 2008, VISION users processed more than 1,000,000 vouchers and the State made more than 580,000 payments to vendors, totaling approximately $8 billion.

Vouchers for payment of invoices are entered by VISION users in the departments. Many departments have staff dedicated to entering and processing vouchers. Some departments have multiple accounts payable units who process vouchers, while others have only a single VISION user.

Some departments use their own accounting systems that feed data to VISION for payment processing. For example, the Agency of Transportation (AOT) uses a system called STARS and the Department of Labor uses a system called FARS. These systems maintain duplicate voucher checking controls independent of VISION. Transactions entered into these feeder systems are sent electronically to VISION, from where they are paid.

[10] According to the FISCAM, business process controls are the automated and/or manual controls applied to business transaction flows. They relate to the completeness, accuracy, validity and confidentiality of transactions and data during application processing. They typically cover the structure, policies, and procedures that operate at a detailed business process (cycle or transaction) level and operate over individual transactions or activities across business processes.

Many Departments Could Improve Adherence to Accounts Payable Internal Control Guidance

Overall, we found only 12 percent of the departments had implemented all six control areas we reviewed. However, we found that 72 percent of the departments have implemented at least four of the controls. The departments that we reviewed implemented from a low of two to a high of all six of the control areas that we reviewed (Chart 1). These controls areas including having written procedures, requiring original invoices, maintaining a one to one relationship between invoices and vouchers, maintaining a list of authorized approvers, appropriately segregating duties, and receiving and processing invoices centrally are key components in reducing the likelihood of improper payments. Chart 2 summarizes the level of implementation among departments for each of the six internal control areas we reviewed. Segregation of duties and processing invoices centrally were the most common internal controls among the departments, implemented in at least 88 percent of the departments we reviewed. Maintaining a list of authorized approvers was the least implemented internal control, implemented in only 56 percent of the departments.

Chart 1: Summary of Departments' Adherence to Internal Controls

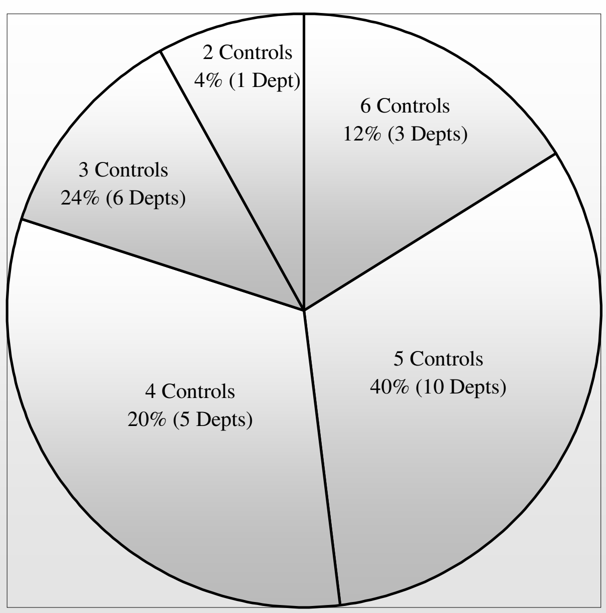
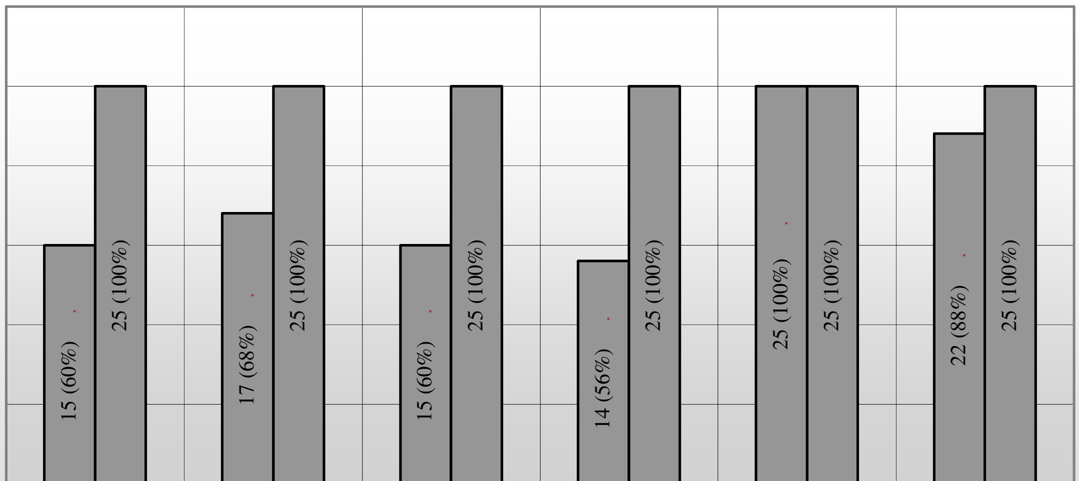


Chart 2: Summary of Compliance by Type of Internal Control



	Established written procedures	Pay vouchers from original invoices	Maintain a 1 to 1 relationship for vouchers	Maintain list authorized approvers	Have appropriate segregation of duties	Receive or process invoices centrally
# of Depts Implemented	15	17	15	14	25	22
# of Depts Reviewed	25	25	25	25	25	25

Written Procedures. F&M guidance states that written procedures should be established regarding the initiation, review and approval of all accounts payable expenditures.[11] Our results indicated that 60 percent (15 of 25) of the departments had established written procedures for the accounts payable process, however, 40 percent (10 of 25) of the departments did not have written procedures or these "written procedures" lacked detail and did not provide the "who, what, when, where and why" of the initiation, review and approval phases of the accounts payable process. In one case, written procedures were maintained by an agency documenting how the agency processed invoices after they received them pre-coded and approved from the departments, but neither the agency nor some of its departments maintained written procedures addressing how the departments received, coded and approved the invoices. Without clearly written, comprehensive procedures which are clearly communicated to and understood by employees, duties may

[11] *Internal Control Best Practices: Accounts Payable* (Department of Finance & Management, July, 2006).

not be properly performed, conflicts can occur, poor decisions can be made and serious harm can be done to the department's reputation and financial well-being. Further, the efficiency and effectiveness of operations can be adversely affected. [12]

Original Invoices. According to F&M guidance, payments should only be made upon receipt of the original invoice because processing vouchers from non-original documentation such as copies of invoices can result in duplicate payments.[13] Our results indicated that 68 percent (17 of 25) of the departments implemented internal controls to pay vouchers from original invoices. However, we identified internal control deficiencies related to this internal control in 32 percent (8 of 25) of departments we reviewed. Numerous improperly processed payments were identified within these departments. Approximately 13 percent (39 of 301) of the payments we reviewed, totaling $126,000, fell into this category. For example, a vehicle repair bill for $2,616 was paid in duplicate by paying both the original invoice billed to the State and the carbon copy maintenance slip received and submitted by the driver. In another instance, a department paid an original invoice for resource materials totaling $3,163. The same amount was paid again from an account statement received the following month.

In these cases the duplicate payment controls established in the payment system, VISION, appear to have been unintentionally circumvented by the department that did not implement controls to ensure that only original invoices were processed. Since key information, such as invoice dates, for these duplicates were entered differently, VISION did not detect them as potential duplicates. Proper safeguards against duplicate payments can only be achieved when VISION application controls are complemented with strong business processes. The VISION application controls alone do not provide the departments with sufficient safeguards over the accounts payable process. Departments that do not implement strong internal controls over the accounts payable process, such as making payments only from original invoice, increase the risk of making duplicate payments.

[12] *Internal Control Standards: A Guide for Managers* (Department of Finance & Management).

[13] *Internal Control Best Practices: Accounts Payable* (Department of Finance & Management, July, 2006).

Maintaining a One to One Relationship between Invoices and Vouchers. F&M guidance states there should be a one to one relationship between a vendor's invoice and a VISION voucher. That is, for every invoice a department receives, only one voucher should be entered in VISION. Invoices should not be split into multiple vouchers. This rule seeks to facilitate the duplicate invoice checking controls across all departments using VISION and mitigate the risk of paying a vendor invoice more than once for the same service or product.[14] Although we found no instances of splitting invoices in 60 percent (15 of 25) of the departments we reviewed, our results indicated that 40 percent (10 of 25) of the departments we reviewed were splitting invoices, contrary to F&M guidance. Splitting invoices was widespread among the payments we reviewed, occurring in 20 percent (60 of 301) of the transactions we reviewed, totaling $415,000. For instance, one department split its annual rent bill three ways, paying half in December and the other half over the following two quarters. In another instance, a department split a waste management invoice in half in order to distribute the costs to different appropriations.

Splitting invoices may be a convenient way for a department to distribute costs, but is not necessary since VISION facilitates the distribution of costs among funds and programs, and doing so circumvents VISION's duplicate voucher checking controls. In the case that the original invoice were to be processed again for its full amount, the duplicate controls would be negated, sharply increasing the likelihood the invoice would be improperly paid.

Maintaining a List of Authorized Approvers. According to F&M guidance, all invoices must be reviewed and approved by an authorized person prior to payment. Departments should maintain a list of those persons who may authorize and approve invoices to ensure that transactions are initiated and executed by those designated by management.[15] Our results indicated that the majority of the departments appeared to maintain a listing of authorized invoice approvers, but some departments did not. Fifty-six percent (14 of 25) of departments maintained such a list and 44 percent (11 of 25) did not. Moreover, 3 percent (10 of 301) of the transactions we examined, totaling $29,000, were not properly authorized. In the absence of clearly documented

[14] *VISION Accounts Payable Manual* (Department of Finance & Management, September, 2008)

[15] *Internal Control Best Practices: Accounts Payable* (Department of Finance & Management, July, 2006).

and communicated approval requirements, the departments may not ensure that significant transactions are approved and executed (prior to VISION approval) only by persons acting within the scope of their authority.[16]

Segregation of Duties. F&M guidance states that the responsibility for approving invoices[17] and posting to accounting records should be segregated and assigned to different persons. Segregation of duties is the division of key duties and responsibilities among different people to reduce the opportunities for any individual to be in a position to commit and conceal errors (intentional or unintentional), or perpetrate fraud in the normal course of their duties. The fundamental premise of segregated duties is that different personnel should perform the functions of initiation, authorization, record keeping, and custody. No one individual should control or perform all key aspects of a transaction or event.[18]

We found that all 25 departments we reviewed appeared to have separate persons assigned to approving invoices prior to entry into VISION.

Receiving and Processing Invoices Centrally. According to the F&M Internal Control Best Practices for accounts payable, all invoices should be received in a central location, such as business office.[19] Our results indicated that many departments' procedures were designed to receive and process invoices centrally. Eighty-eight percent of the departments we reviewed had processes developed to receive and process invoices from a central location. In these instances, invoices were designed to be received at one location within the department or agency. In three departments (12 percent), invoices were received and processed at field offices or divisional offices as well as at the business office.

An example of how processing invoices at multiple locations can have adverse consequences was observed at one department whose field office

[16] *Internal Control Standards: A Guide for Managers* (Department of Finance & Management).

[17] Prior to entering and approving the invoice in VISION.

[18] *Internal Control Standards: A Guide for Managers* (Department of Finance & Management).

[19] *Internal Control Best Practices: Accounts Payable* (Department of Finance & Management, July, 2006).

ordered uniforms totaling $2,220. The invoice included a charge for a miscellaneous item for $45 which was ordered for the business office. The field office processed and paid a voucher for $2,175 representing their portion of the invoice. The field office forwarded the invoice to the business office to pay $45 for the item. The business office incorrectly processed and paid a voucher for $2,220, instead of $45, resulting in a duplicate payment to the vendor for $2,175. Departments that receive and process invoices at multiple locations and do not have strong compensating internal controls like well defined and communicated invoice routing and handling procedures may increase their likelihood that invoices will be improperly paid.

While F&M has shifted the responsibility for developing and maintaining processes and internal controls to the departments, this does not obviate F&M's responsibility to actively monitor the departments to ensure that sufficient internal controls have been implemented and that State guidance is being followed.

F&M has established some resources to assist the departments with establishing internal controls, such as F&M policies, VISION procedures, Internal Control Standards, Best Practices and the required annual self-assessment. Although this guidance contains useful information, it is discretely presented and generally focused on specific subject matter. Establishing a comprehensive accounts payable user manual which further develops and links all of the State's accounts payable guidance would provide a stronger vehicle to enable the departments to ensure the adequacy of the their accounts payable internal controls.

Other ways to assist the departments with establishing and maintaining strong internal controls could include creating an accounts payable user group, providing additional training and increasing the monitoring and enforcement of applicable guidance beyond the current F&M annual self-assessment process.

Additional Centralized Controls Could Improve the Accounts Payable Process

Our review of the State's centralized accounts payable (AP) processes, such as the access that users have been given, found that although the State has some internal controls over these areas, additional centralized controls could improve the accounts payable process. In particular, the State could benefit from strengthening access controls over VISION user privileges which currently allow some users to both enter and approve the payment of invoices. In addition, the State has not established comprehensive procedures addressing vendor file maintenance and monitoring. Moreover, the duplicate voucher controls can be circumvented by VISION users. Furthermore, certain information currently is not tracked in VISION, such as who approves vouchers. This lack of audit trail limits the State's ability to monitor transactions and identify potential improper payments. Lastly, the controls related to checking for duplicate invoices in transactions coming from feeder systems could be improved.

VISION User Privileges Lack Segregation

The State has defined the accounts payable security roles in VISION. Currently there are six accounts payable security roles defined in VISION. Common roles among VISION users are the AP Voucher Data Entry and AP Manager Voucher Processing roles. Generally, as privileges increase, users are granted more functionality. For example, a user with AP Manager Voucher Processing privileges can both enter and approve vouchers. Whereas, a user with AP Voucher Data Entry privileges can only enter vouchers but cannot approve them.[20]

Many users have the ability to both enter and approve vouchers, allowing them to complete a transaction without the appropriate segregation of duties. As of April 2009, at least 18 percent or 330 of the total VISION users (1,800) had the ability to both enter and approve vouchers in VISION. Of the 330 users, 186 employees, designated as VISION AP Managers, entered 312,000 vouchers totaling $2.5 billion during 2007 and 2008.

Currently, VISION does not restrict AP Manager Voucher Processing users from entering vouchers. According to the Director of Financial Operations, when VISION was first implemented in 2001, voucher processing features known as "accounts payable work flow" were enabled in VISION. Enabling accounts payable work flow is one way to segregate duties over voucher entering and approving by allowing vouchers entered by one user to be electronically routed to another user for approval. After several months of implementation, management concluded that the accounts payable work flow was significantly limiting the operational performance of VISION. Although

[20] *State of Vermont Project VISION Security Roles Overview* (Department of Finance & Management, July 2001)

a formal analysis was not performed, management decided to discontinue use of accounts payable work flow and instead manage the accounts payable process by defining the accounts payable user roles which would provide better operational performance than work flow. Management elected to define the accounts payable user roles in a manner that provides more user flexibility but allows certain users to both enter and approve vouchers. Although this decision provides more user flexibility, segregation of duties over entering and approving vouchers in VISION cannot be achieved, exposing the State to a higher risk of inappropriate behavior.

Effective segregation of duties is designed to prevent the possibility that a single person could be responsible for critical functions in such a way that errors or misappropriations could occur and not be detected in a timely manner, in the normal course of business processes. Although segregation of duties alone will not adequately ensure that only authorized activities occur, inadequate segregation of duties increases the risk that erroneous or fraudulent transactions could be processed.[21]

Vendor File Management Process Could Be Improved

F&M is responsible for vendor set up, maintenance and monitoring of the vendor master file. The SAO found significant weaknesses in F&M's vendor file management process, particularly, relating to the vendor file maintenance and monitoring. F&M has not established comprehensive procedures, written or otherwise, addressing the key control areas of vendor file maintenance and monitoring. Improvements could be made to strengthen the vendor maintenance request approval process. In addition, F&M could benefit from segregating the vendor maintenance entering and reviewing process. Moreover, implementing monitoring procedures over the vendor master file would further strengthen the internal controls in this area.

Master data in information systems, such as a vendor master record, are shared with multiple functions. Vendor master records contain key information such as vendor number, shipping address, billing address, key contact and payment terms. Because master data serves as the basis for accounts payable transaction processing, it is critical that controls exist over the integrity and quality of the data. An erroneous master data record will

[21] *Federal Information System Controls Audit Manual: 4.1. Application Level General Controls* (General Accountability Office, February, 2009).

compromise the integrity of whatever transactions use the field values stored in the master data.[22]

According to the Federal Information Systems Controls Audit Manual (FISCAM), a key element to master file setup and maintenance is establishing master data maintenance procedures, including approval, review, and adequate support for changes to master data. In our opinion, F&M does not have a strong process in place to ensure that vendor set-up or maintenance requests are appropriately approved or reviewed. F&M relies on the internal controls at the department level for ensuring that vendor setup and maintenance requests are properly authorized and that such requests are for legitimate business purposes.

In order to add or change vendor master file data, departments are instructed to complete a Vendor Maintenance Request Form (VMRF) developed by F&M. This form contains areas to input the vendor name, address, type of vendor, description and bank account information but does not have an area for departments to document their approval. This form is assumed by F&M to be approved by the departments. Once received by F&M, the VMRF are entered into VISION by the VISION Maintenance Coordinator without verification or confirmation that the request has been appropriately approved at the department level. Without a strong approval and verification process over vendor maintenance requests, the State runs the risk that changes to the vendor master file will not be for legitimate business purposes and improper payments could be made.

In addition, F&M could benefit from segregating the vendor maintenance entering and reviewing processes. Currently, the VISION Maintenance Coordinator is responsible for entering and reviewing changes to the vendor master file. These changes are not regularly reviewed, approved or monitored by other F&M personnel. In the absence of other strong compensating internal controls, such as monitoring changes to the vendor master file by someone separated from the process, the current process may subject the State to erroneous and/or inappropriate changes to the vendor master file.

[22] *Federal Information System Controls Audit Manual: 4.2. Business Process Controls (*General Accountability Office, February, 2009).

Moreover, there is no regular maintenance initiated by F&M personnel on the vendor master table, such as archiving inactive vendors. Departments can request that vendors be inactivated or payments may be made to "one-time" vendors that will automatically inactivate after one payment. No other measures are currently taken to inactivate vendors beyond these methods. As of April 2009, there were approximately 108,000 "active" vendors in VISION. Seventy-six percent or 82,000 of these vendors had not been used in more than one year (64 percent or 69,000 in more than two years). Having a large number of active vendors may degrade system efficiency, impede management's ability to detect an improper payment and increase the likelihood that payments will be made to incorrect vendors.

The FISCAM states another key element to master file setup and maintenance is implementing an effective auditing and monitoring capacity.[23] Currently, F&M does not actively monitor vendor master data file activities. An effective auditing and monitoring capacity should allow changes to master data records to be recorded and reviewed when necessary. In the absence of well-established monitoring procedures over the vendor master file data, errors or inappropriate use of master file data may go undetected.

Duplicate Voucher Controls Can be Circumvented

Our review identified several scenarios in which the VISION duplicate voucher checking features have been circumvented by a user.

VISION is programmed to check for duplicate vouchers. Prior to posting each voucher, VISION checks key fields against other vouchers to prevent duplicate vouchers from posting. The fields that are checked for duplications are:

- Vendor ID,
- Vendor Type,
- Invoice Date,
- Invoice Number and
- Gross Amount.[24]

[23] *Federal Information System Controls Audit Manual: 4.2. Business Process Controls (*General Accountability Office, February, 2009).

[24] *VISION Accounts Payable Manual: Business Process* (Department of Finance and Management, Revised September, 2008).

F&M instructs departments at year end to code invoices with a PY prefix to facilitate year end accounting which could contribute to duplicate controls circumvention if the departments do not properly process their invoices. Except for coding invoices with a PY prefix, duplicate control circumvention is not permitted by F&M. To ensure that costs are recorded in the fiscal year in which they are incurred the State developed a process to identify invoices from goods and services received in one fiscal year but paid in a subsequent fiscal year. To accomplish this, F&M has established a process in which the departments are directed to add a PY prefix in the certain invoice fields in VISON.[25] For example, departments were instructed to identify all vouchers and journals entered in FY 2010 that pertain to prior year payables (goods or services received or performed prior to July 1, 2009) by using a PY prefix in the invoice number field in VISION.[26]

Coding vendor invoices in this manner can circumvent the VISION duplicate voucher checking controls. VISION checks for exact matches between five VISION fields as mentioned above. Adding a PY prefix to invoice number increases the risk of improper payments. An invoice entered twice, once with PY included in the invoice number field and once without will not be detected as a duplicate in VISION. Ten duplicate payments, totaling $73,000, were identified from our review as a result of this scenario.

In addition, during our review we observed some instances of inadvertent circumvention of VISION's duplicate voucher checking controls. Some of these instances resulted from splitting invoices into multiple vouchers or not processing vouchers from original invoices. One VISION user inadvertently circumvented the VISION duplicate voucher checking controls by processing a monthly statement as well as the corresponding original invoice for educational materials. One voucher was processed using the statement date (December 31, 2006) and the other was processed using the original invoice date (December 19, 2006). The VISION duplicate voucher checking controls did not flag these vouchers as potential duplicates since the invoice dates were not matching, resulting in a voucher being paid in error.

---

[25] *FY 2009 Year End Closing Instructions: FY 2010 Instructions, FY 2010 Transactions for Prior Year Payables* (Department of Finance and Management, July 2009).

[26] *FY 2009 Year End Closing Instructions: FY 2010 Instructions, FY 2010 Transactions for Prior Year Payables* (Department of Finance and Management, July 2009).

Without effective duplicate voucher checking controls, which cannot be easily circumvented by the user, and are complemented by effective business process controls, the State remains susceptible to improper payments.

Lack of Implementation of Audit Trail in VISION

VISION has the capability to maintain audit trail records. The system can be enabled to capture time-stamped audit trails to independently record the date and time of operator entries and actions that create, modify, or delete electronic records. However, the State is not utilizing these features.

According to the FISCAM, audit trails should be monitored on a regular basis to help ensure that transactions are processing as intended. Controls over the processing of data should preclude or detect the erroneous or unauthorized addition, removal, or alteration of data during processing.[27] Internal control systems should generally be designed to ensure ongoing monitoring occurs in the course of normal operations.[28] An audit trail, created by an automated log, should include sufficient information to establish what events occurred and who (or what) caused them. In general, an event record contained within the audit trail should specify when the event occurred, the user ID associated with the event, the program or command used to initiate the event, and the result.

By not utilizing audit trail functionality in VISION, important accounts payable information, such as who approved a voucher, is not captured in VISION and may significantly limit management's ability to monitor, review and ensure transactions have been appropriately approved. Currently, VISION only captures the user name of the person(s) who entered and last updated each voucher. In many instances the person who last updated the voucher is also the voucher approver, but can also be the person who saves the voucher after it has been approved. This limitation can make it more difficult to determine the appropriateness of transactions.

We reviewed one transaction because a worker compensation payment was made to the spouse of the person who last updated the voucher. Based on

---

[27] *Federal Information System Controls Audit Manual: 4.2. Business Process Controls (*General Accountability Office, February, 2009).

[28] *Internal Control Standards: A Guide for Managers* (F&M, 2006).

this information we could not verify that the employee did or did not approve in VISION the payment to her spouse. Although it was inappropriate for the employee to update her spouse's transaction, we were only able to determine the payment was legitimate and properly authorized by reviewing the written approval documents.

Management has decided not to enable the audit trail feature in VISION because of expressed concerns over system performance, but no formal analysis has been performed to determine the cost benefit of utilizing this feature.

Without the use of the VISION audit trail feature, it is difficult for the State to sufficiently monitor the voucher transactions and identify internal control weaknesses and potential improper payments. These limitations expose the State to an increased risk that improper payments will be processed and go undetected, or, if detected, the responsible individual may not be identified.

Internal Controls of Feeder Systems[29] Could be Improved

We found that AOT and DOL could improve the effectiveness of their accounts payable internal controls.

According to the F&M Internal Control Standards, internal control systems should generally be designed to ensure ongoing monitoring occurs in the normal course of operations. Proper monitoring ensures that controls continue to be adequate and function properly.

The design of the AOT duplicate voucher checking process has reduced the effectiveness of the agency's review resulting in vouchers not being thoroughly reviewed or reviewed at all. The imprecision of the agency's

[29] The Agency of Transportation (AOT) and Department of Labor (DOL) use separate accounting applications, known as feeder systems, to facilitate their operational needs. According to the departments, these feeder systems generally provide the departments with more functionality than VISION. The design and operating capabilities of these systems including the accounts payable processes and internal controls are unique to the departments. When feeder systems are used by these departments, the duplicate invoice checking is performed at the feeder system level.

duplicate voucher checking controls[30] typically results in a high volume of flagged vouchers often including many false positives.

- We found that the agency does not review or monitor a large number of its vouchers that are flagged as potential duplicates. According to the Financial Director I, the agency does not review utility vouchers because they have historically resulted in a higher rate of false positives since many of them do not use unique invoice numbers. The agency processed at least 25,000 utility vouchers totaling approximately $5 million during 2007 and 2008. The agency does not have additional compensating controls to ensure these vouchers were appropriately paid. In the absence of a strong process for identifying duplicates among the agency's utility vouchers, the agency may not detect duplicates which may result in additional improper payments.
- Our review identified 21 non-utility duplicate payments, totaling $102,000, which met the agency's criteria for review but were not detected because they were not thoroughly reviewed by the agency. These represented 43 percent of the improperly processed payments we identified at the agency and 7 percent of the overall payments we reviewed. Without the proper balance between the volume of flagged transactions and thoroughness of their review, the agency's duplicate voucher checking controls may be ill-equipped to efficiently and effectively prevent duplicate payments.

The Department of Labor could benefit from improving its internal controls over processing vouchers.

- Currently, the department's accounts payable system does not display vendor names to accounts payable personnel as vouchers are being entered. The ability to view vendor names as vouchers are being processed helps to ensure vendor IDs have been correctly entered and prevent incorrect vouchers from being improperly processed or paid. Although the department reviews voucher information, including the

[30] The agency's duplicate voucher checking controls use four criteria for determining duplicates, including vendor ID, invoice number, invoice date and gross amount. The system primarily checks for three matches of these fields to flag potential duplicates. These include (1) matching invoice number, (2) matching invoice number, gross amount and vendor ID and (3) matching invoice date, gross amount and vendor ID.

vendor ID, from query reports after vouchers are processed in VISION, this process alone may not be sufficient to detect improperly processed vouchers. Our review identified seven vouchers, totaling $43,000 that were improperly processed as result of the vendor ID being incorrectly entered. These represented 58 percent of the improperly processed payments we identified at the department and 2 percent of the overall payments we reviewed. In the absence of strong preventive controls, the department remains vulnerable to processing inefficiencies and an increased risk of improper payments.

Conclusions

Overall, we found that most departments we reviewed had implemented many of the accounts payable internal control best practices issued by F&M. Eighty percent of the departments implemented four or more of the six internal controls we evaluated. Although many departments adopted some good internal controls, there is room to improve the strength and consistency of internal controls across State departments. We found that only 16 percent of the departments implemented all six internal controls we evaluated. The most common controls not implemented by departments related to establishing written procedures and maintaining a list of authorized approvers. The Internal Control Standards and Best Practices guidance, which includes these controls, provides some fundamental internal control concepts and should be fully adopted by all departments to the extent possible. To accomplish this, F&M should consider strengthening its process to ensure departments' compliance with State guidance. Tools such as a comprehensive accounts payable user manual, establishing an accounts payable user group, additional training and increased monitoring could assist the departments in strengthening their processes and internal controls.

Additional centralized internal controls could improve the State's accounts payable process. A change in VISION's access controls, specifically to prevent users from both entering and approving vouchers would significantly increase the effectiveness of the accounts payable internal controls. The State could also improve internal controls by establishing policies and procedures addressing vendor approval, maintenance and monitoring to ensure that payments are made to only appropriate vendors. Moreover, F&M should consider measures to discourage and/or prevent the VISION duplicate voucher checking controls from being circumvented by users. In particular, an alternate method should be found to identify prior year invoices that would not circumvent controls to prevent duplicate payments. Furthermore, F&M could strengthen monitoring controls by enabling the audit trail functionality in VISION. Lastly, AOT and DOL could benefit from a review of the design of their feeder system accounts payable processes and internal controls.

Recommendations

We recommend that the Commissioner of the Department of Finance and Management:

1. Strengthen the process to ensure departments' compliance with F&M guidance, including Internal Control Standards and Best Practices. Consider (a) establishing a comprehensive accounts payable user manual, (b) creating an accounts payable user group, (c) providing additional training and (d) increasing monitoring and enforcement of applicable guidance.

2. Modify the current VISION user access control practice to restrict the same individual from both entering and approving vouchers.

3. Develop and implement standard policies and procedures for approving, maintaining and monitoring vendors.

4. Develop measures to prevent users from unauthorized circumvention of VISION duplicate voucher checking controls.

5. Consider alternative methods for identifying prior year invoices at the end of the fiscal year other than using "PY" in the invoice number field that

maintain the effectiveness of VISION's duplicate voucher checking controls.

6. Review the feasibility of utilizing the audit trail functionality in VISION to assist with voucher monitoring.

We recommend that the Secretary of the Agency of Transportation:

1. Review the design of its duplicate voucher checking internal controls in its feeder system to establish the proper balance of effectiveness and efficiency. Consider (a) the criteria used to flag potential duplicates, (b) when vouchers should be flagged as potential duplicates and (c) the level of review needed to address flagged transactions.

2. Develop a process to periodically review utility transactions to identify potential duplicate payments.

We recommend that the Commissioner of the Department of Labor:

1. Implement procedures to ensure that the correct vendor ID is entered during voucher processing in the DOL feeder system. Consider modifying the voucher entry screen to allow the vendor name to be viewed during data entry.

Management's Response and Our Evaluation

On May 10, 2010, the Commissioner of Finance & Management provided a written response to this report on behalf of the Agency of Administration, which can be read in its entirety in Appendix III of this report. The Commissioner indicated that the Department of Finance and Management did not disagree with the findings and recommendations related to our internal control review. In his response, the Commissioner cited a 4-step corrective action plan.

In his response, the Commissioner stated that F & M would continue to evaluate ways to ensure departments strengthen and document their internals controls and adhere to F& M published best practices. Our findings identified weaknesses in many departments in important internal controls over; 1) maintaining lists of authorized approvers, 2) having written procedures, 3) maintaining a one to one relationship between invoices and vouchers and, 4) paying vouchers from original invoices. We believe that these critical controls would be strengthened through our recommendation to establish a comprehensive accounts payable user manual. This would be a valuable tool to educate AP staff as well as ensure consistency in accounts payable processes across all State departments. We urge F&M consider implementing our recommendation rather than solely performing an evaluation.

The Commissioner did not explicitly address our finding and recommendation regarding the modification of VISION user access controls that would restrict the same individual from both entering and approving vouchers. In his response, he stated that F&M would only evaluate the possibility of modifying the current controls, but did not specify beyond this. Our audit identified that 186 employees, designated as AP Managers, entered and approved 312,000 vouchers totaling $2.5 billion during 2007 and 2008. We believe this weakness exposes the State to significant potential loss, and should be addressed immediately.

The Commissioner committed to reviewing the existing VISION duplicate voucher controls. We support this action, but also believe that the current system controls as implemented, combined with F&M's approved circumvention exception for year-end PY designated invoices continues to place the State at risk for duplicate payments. As we recommended, alternative methods for identifying prior year invoices at the end of the year, including VISION software modifications, should be considered.

The Commissioner did not address our recommendation of implementing the audit trail functionality contained within VISION. An automated audit trail can identify actions carried out electronically and help to identify unusual activity within the VISION system. Currently, the State must rely on current practices to monitor all of its AP voucher transactions, which may not be sufficient to monitor certain transactions. Implementing the use of the audit trail function would enhance the State's ability to sufficiently monitor voucher transactions, and identify internal control weaknesses and potential improper payments.

In regards to our findings relating to the internal controls over feeder systems, on March 16, 2010, the Director of Finance and Administration for the Agency of Transportation provided a written response to this report, which can be read in its entirety in Appendix IV. The Director indicated that the Agency concurred with the findings and recommendations related to the audit.

On March 10, 2010, in an e-mail response to our inquiry, the Financial Director of the Department of Labor stated that they were moving forward to determine if the department's FARS software could be modified to correct the identified deficiency in displaying the VISION vendor name when entering vendor payment information. We believe that modification to the FARS system, such as enabling AP personnel to view vendor names as vouchers are being processed, is a strong internal control that will help the department prevent improper payments.

Appendix I

Scope & Methodology

To address both of our objectives we reviewed accounts payable and internal control guidance from the State, including the Accounts Payable manual, F&M policies, VISION procedures, internal control standards and best practices. In addition, we identified and reviewed guidance and research related to internal controls that were published by the Government Accountability Office.

As part of our first objective, we reviewed the accounts payable processes and related internal controls for 25 departments (Chart 3). We evaluated these departments by comparing six internal controls from the F&M Internal Control Standards and Best Practices accounts payable guidance to existing practices of the departments and transactions examined. The internal controls we evaluated related to (1) written procedures, (2) original invoices, (3) maintaining a one to one relationship between invoices and vouchers, (4) maintaining a list of authorized approvers, (5) segregation of duties and (6) receiving and processing invoices centrally.

We discussed with accounting staff at the 25 departments their processes and existing internal controls around vouchers and payment processing. To assist with our assessment we examined the departments' written procedures (if available) and internal control self-assessments, visited their Intranet and Internet sites, made observations while at the departments sites, and reviewed original documents in order to analyze the design of the departments' internal controls

In addition, we examined 301 vouchers totaling $3 million among the 25 departments which included 30 inter-governmental transactions to determine if they had been processed in accordance with the State's guidance. We examined the original supporting documentation to assist with our assessments.

Appendix I

Scope & Methodology

Chart 3: Summary of Departments' Reviewed

Agency of Agriculture
Agency of Commerce & Community Development
Agency of Human Services Central Office
Agency of Transportation
Attorney General's Office
Center for Crime Victim Services
Department for Children & Families
Department of Buildings & General Services
Department of Corrections
Department of Disabilities, Aging and Independent Living
Department of Education
Department of Environmental Conservation
Department of Fish & Wildlife
Department of Forests, Parks and Recreation
Department of Human Resources
Department of Labor
Department of Liquor Control
Department of Public Safety
Department of Taxes
Enhanced 911 Board
Military Property & Installations Office
Natural Resources Board
Office for Vermont Health Access
Office of the State Treasurer
Vermont Department of Health

We examined the duplicate voucher checking internal controls of the interfaced feeder systems maintained by the Agency of Transportation and Department of Labor by reviewing the accounts payable process and internal controls in depth with accounting personnel and examining numerous vouchers to corroborate our understanding. Our review included an evaluation of their criteria used to flag potential duplicates by these systems.

To address our second objective, we held extensive discussions and interviews with staff from both the Department of Finance & Management and the Department of Information & Innovation. We met with the Director of Statewide Accounting to discuss the vendor set up and maintenance processes and review security roles. We met with VISION Maintenance Coordinator to discuss vendor set and maintenance processes. We also met with several VISION system developers to gain a better understanding of VISION tables and fields.

Appendix I

Scope & Methodology

We conducted this performance audit in accordance with generally accepted government auditing standards except for the standard that requires that our system of quality control for performance audits undergo a peer review every three years.[31] Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

[31] Because of fiscal considerations, we have opted to postpone the peer review of our performance audits until 2011.

Appendix II

Glossary

Department	An agency, department, board, commission or unit of the state government.
Feeder System	A system that provides information or data to support the main application. For example, in a payroll system the time and attendance system may be a feeder system for the main application (per the Government Accountability Office's Federal Information System Controls Audit Manual).
Interface	A process that moves data from one system to another.
Invoice	A document submitted by a vendor, showing the character, quantity, price, terms, nature of delivery, and other particulars of goods delivered or of services rendered
Improper Payment	Any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements. It includes any payment to an ineligible recipient, any payment for an ineligible service, any duplicate payment, payments for services not received, and any payment that does not account for credit for applicable discounts. Payments that were made as they should have been but were processed or accounted for contrary to state procedures are excluded from this definition and are not discussed in this report.
Improperly Processed Payment	A payment that was not paid in accordance with State's financial guidance and laws and regulations.
Payment	The check, wire or electronic transfer of State funds to an entity. Payments are generally made by the Treasurer's Office based on a warrant that includes vouchers authorized for payment.

Appendix II

Glossary

Segregation of Duties	An internal control activity to detect errors and prevent wrongful acts. It requires that different personnel perform the functions of initiation, authorization, record keeping and custody.
VISION	The state's primary accounting system, used by most departments and agencies. VISION is an implementation of PeopleSoft®.
Voucher	The VISION accounting document that serves as the basis for cutting checks or generating payments and recording financial transactions to pay a vendor.
Warrant	A document produced from a VISION Pay Cycle which, when approved by F&M, authorizes the Treasure's Office to generate a payment.

Appendix III

Department of Finance & Management Response

VERMONT

State of Vermont
Agency of Administration
Department of Finance & Management
Pavilion Office Building
109 State Street
Montpelier, VT 05609-0201
www.finance.vermont.gov

[phone] 802-828-2376
[fax] 802-828-2428

Jim Reardon, Commissioner

RECEIVED
MAY 12 2010
VERMONT
STATE AUDITOR

May 10, 2010

Thomas Salmon, State Auditor
132 State Street
Montpelier, VT 05633

Dear Auditor Salmon:

The Department of Finance and Management would like to thank your office for the opportunity to respond to the draft findings and recommendations relating to your Improper Payment Review.

We agree fully that improper payments i.e. duplicate payments, reduce the funds available for the State of Vermont to execute its programs and policies. We further agree that the best way to prevent duplicate payments is to develop an environment where strong internal controls exist, best practices are followed, and documented polices and procedures are understood and followed.

While there can be no tolerance for any type of improper payment, duplicate payments are an inescapable fact of business. The Institute of Internal Auditors have found that duplicate payments make up between 0.5% and 0.1% of annual invoices processed. In other words, approximately 1 in a 1,000 payments are likely to be duplicates. The Department of Finance and Management is very pleased with the results of your extensive data mining. Of the more then 1,000,000 vouchers totaling $8 billion that we processed in a 2 year period, your data mining identified 52 duplicate payments (or 1 in 20,000 vouchers) of which 34 had been recovered prior to your audit. At the time of this response, 15 of the remaining 18 duplicate payments have been recovered and 3 are still in the process of being recovered.

We are very pleased that our error rate for duplicate payments was significantly less than the national average, suggesting that our staff, systems and processes are reasonably effective in preventing and detecting duplicate payments. More importantly, your data mining methods, which included matching vendor information with employee databases, did not detect any potentially fraudulent activity or payments.

As effective as our internal controls are, we do recognize they alone do not guarantee success. Our internal controls have been designed to provide the Department of Finance and Management with reasonable assurance, not absolute assurance. Even the best designed internal controls can breakdown due to human error. Staff may misunderstand instructions, make errors in judgment or commit errors due to carelessness, distraction, or fatigue.

Appendix III

Department of Finance & Management Response

Our corrective action plan is as follows:

1. The Department of Finance and Management understands that strong internal controls and compliance is achieved through a continuous process of improvement. In the coming year we will continue to evaluate ways to assure departments strengthen and document their internal controls and adhere to our published best practices.

2. The Department of Finance and Management will evaluate the possibility of modifying the current VISION user access control to restrict the same individuals from both entering and approving vouchers.

3. The Department of Finance will document and strengthen policies and procedures for approving, maintaining and monitoring vendors.

4. The Department of Finance and Management will review the current VISION duplicate voucher controls in an effort to strengthen its detection capabilities and minimize unauthorized circumvention.

Once again, thank you for the opportunity to respond to this draft.

Sincerely,

James Reardon
Commissioner

Appendix IV

Agency of Transportation Response

VERMONT

State of Vermont
Finance and Administration
1 National Life Drive
Montpelier, VT 05633-5001
www.aot.state.vt.us

[phone] 802-828-2067
[fax] 802-828-2024
[ttd] 800-253-0191

Agency of Transportation

March 16, 2010

Thomas Salmon, State Auditor
132 State Street
Montpelier, VT 05633

Dear Auditor Salmon,

VTrans would like to thank the State Auditor's Office for the opportunity to respond to the draft findings and recommendations.

We concur with the findings and recommendations offered by the State Auditor's Office. However, we wish to point out that these findings were a result of data mining and not a typical statistical audit sample. Only potential duplicate payments were selected. The result for VTrans, at less than 1%, was below the norm for duplicate payments.

We do utilize a feeder system which bypasses VISION's duplicate payment checking. The checking performed in STARS is actually on fewer fields than VISION, increasing the likelihood of a duplicate payment being caught and reported. This also increases the likelihood of a "false duplicate" necessitating that we make judgment calls on certain types of payments, utility payments for example.

At some point, VTrans will be moving to the VISION accounting system and utilize its duplicate payment checking. However, that is not possible right now because the modules we need are not owned by the State; they must be purchased and implemented. This will come with time and expense that is not feasible in this economic climate.

Our corrective action plan is as follows:

- The Accounts Payable unit will focus on following their procedures with an emphasis on duplicate payments. Accounting staff will begin a quarterly review to verify that duplicate payment controls are in place and verify that procedures are being followed.

- The Accounts Payable unit currently reviews utility payments to monitor duplicate payments only when two or more payments contain an identical vendor, invoice date and amount. This was omitted from the procedure. This process will continue and the procedure updated. Accounting staff will begin a quarterly review of utility transactions to identify potential duplicate payments.

Sincerely,

Thomas A Daniel

Tom Daniel
Director of Finance and Administration, VTrans

VTrans Working to Get You There