SPECIAL REVIEW –

SMALL PURCHASE CHARGE CARD PROGRAM

DECEMBER 1, 2000

Auditor of Public Accounts

COMMONWEALTH OF VIRGINIA

AUDIT SUMMARY

The Small Purchase Charge Card program has been effective in reducing paperwork and streamlining the small purchases of goods and services. The Commonwealth has recognized cost savings from the program.

Our objective was to determine whether the program has controls that minimize the risk of undetected, unauthorized use of small purchase charge cards. We found weaknesses in the administration of the Charge Card program that could hinder the timely detection of unauthorized use of small purchase charge cards.

- There are no limitations on the number of charge cards issued to an individual or on the number of employees with charge cards within an agency. Also, most charge cards are issued with higher purchase limits than necessary.

- The charge card contractor authorized transactions and issued cards that exceeded established dollar limitations and processed transactions made with expired or cancelled charge cards. Also, in most cases, the contractor does not provide reports with sufficient purchase details.

- We also identified a training issue that hinders the effectiveness and efficiency of the Charge Card program.

Our recommendations include:

- Agencies should analyze purchasing needs before setting cardholder transaction limits and limit the number of charge cards to those employees whose duties routinely involve small purchases.

- The Department of Accounts should monitor charge card transactions to ensure that the charge card contractor does not allow cardholders to exceed purchasing limits or authorize transactions or issue cards that exceed purchasing limits.

- The charge card contractor should provide automated billing statements with detailed purchase and vendor information.

- The Department of Accounts, the Department of General Services' Division of Purchases and Supply, and the charge card contractor should develop an updated, continuing training plan and require training attendance before charge cards are issued.

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SPECIAL REVIEW - SMALL PURCHASE CHARGE CARD PROGRAM

Background

The Small Purchase Charge Card program gives agencies and institutions a means to streamline the process to buy goods and services. Charge Cards reduce transactions and administrative costs by eliminating individual merchant invoices and consolidating multiple vendor payments into a single monthly payment to a charge card company. Other benefits include reduced check processing fees, postage costs, and a shift in paper processing from agencies to the charge card contractor.

The Commonwealth contracted with American Express as the charge card contractor for the program in January 1995. The initial contract extended through September 1999. American Express received a new contract in August 1999, which extends through July 2002, and contains an option for up to four one-year renewals. The Department of Accounts (Accounts) administers the contract, sets statewide policy regarding charge cards, and conducts training.

The Charge Card program has grown significantly since its inception. In fiscal year 1996, statewide charge card purchases of goods and services totaled approximately $6.7 million. In fiscal year 2000, that amount had increased to almost $112 million. Accounts expects that the use of charge cards will continue to increase over the next several years. The following table illustrates the growth of the Charge Card program.

Charge Card Program Growth

	FY 1996	FY 1997	FY 1998	FY 1999	FY 2000
Total Purchases	$6.7 million	$31.0 million	$57.4 million	$92.8 million	$111.7 million
# Of Agencies Participating	108	132	168	176	186
# Of Cards Issued	2,530	5,214	7,458	8,157	9,158
Average Transaction	$125	$159	$175	$209	$223

Source: Department of Accounts.

The program's initial intent was to reduce the volume of checks written to vendors for smaller purchases typically under $1,000. Accounts did a survey and cost analysis of the number of checks and petty cash funds used for small purchases, which found that for purchases under $25, the Commonwealth spent as much money in time and paper work paying a vendor as the cost of the purchase. In addition, Accounts found that many of the small purchases were with one vendor, but because multiple agencies purchased from the vendor, there was no way to consolidate the billing and reduce costs.

Charge Card Controls

The Charge Card program relies on the individual agency's controls and those controls the charge card contractor includes as part of the contract. In this section of the report, we will briefly discuss the controls at each level of the program.

Agency Controls.

The most important factor in preventing fraudulent use of charge cards is strong control procedures at individual agencies. Agencies should have written procedures for using charge cards that include restrictions on who can have a card, guidelines regarding the individual's use of the card, mandatory record keeping, card limits, and finally, actions an agency would take if the cardholder does not follow the procedures. In addition, the Commonwealth of Virginia Accounting Policies and Procedures Manual requires agencies to create procedures to review the individual cardholder's records, check them against the monthly statement, and then record and pay the statement.

Each agency appoints a program administrator who is their liaison with Accounts, the Department of General Services' Division of Purchases and Supply (Purchases and Supply), and the charge card contractor. The administrator issues and cancels cards either by direct communication with the contractor or through the contractor's Internet website. At most agencies, the administrator receives monthly billings, as well as any additional statements or management reports that the agency might have requested. The administrator also coordinates the agency's control of the charge cards including canceling cards when an employee resigns.

At their option, agencies can receive charge cards with lower limits than the Commonwealth's maximums of $5,000 per transaction and $100,000 per monthly billing cycle. Agencies can also designate that cards have other restrictions such as the use in only specified industries or with only specified merchants. The administrator must make these arrangements with the charge card contractor before the contractor issues the card.

In many agencies, the administrator also has responsibilities for training and ensuring that employees have an understanding of their duties and responsibilities when using the card. Before receiving a charge card, individual cardholders must sign an employee agreement form in which they acknowledge their responsibilities for following agency procedures when using the card. Cardholders must also maintain a purchasing log, which records information regarding individual purchases. Cardholders also reconcile purchases to the monthly American Express Cardholder Statement. The cardholder's supervisor reviews and approves the reconciliations.

Contractor Controls.

The contractor, American Express, has controls that should deny authorization of any purchase that exceeds a charge card's restrictions. They also issue charge cards only at the request of an agency's program administrator.

Accounts' Controls.

Accounts, as the statewide contract administrator, sets policies within which agencies establish their controls. These policies address card distributions, record keeping, accounting, and the control framework agencies should consider. Additionally, the contractor supplies Accounts with special information that allows staff to monitor the program, however, much of this information provides only post audit review. Accounts coordinates between the agencies and contractor the types of information and services available. Finally, Accounts' decentralized auditors check for agency compliance with charge card program policies during their periodic reviews.

Training

Since the Charge Card program began in 1995, Accounts, American Express, and Purchases and Supply have provided agencies with several methods of training including: classes, presentations, workshops, newsletters, and Commonwealth Accounting Policies and Procedures Manual updates. Also, American Express has a representative on-site at Accounts to assist with individual questions. Some program administrators provide in-house training when an employee receives a card.

Study Purpose and Methodology

Because of the tremendous growth in the use of charge cards throughout the state and questionable transactions at several state agencies and institutions, our office undertook a review of the program to determine what measures exist to minimize the risk of undetected, fraudulent, or other unauthorized use of small purchase charge cards.

In performing the review, we researched the Commonwealth of Virginia Accounting Policies and Procedures Manual to determine the Charge Card program's administrative requirements. We analyzed fiscal year 2000 charge card purchases and card member listings. We also queried 74 agencies and institutions throughout the Commonwealth to determine their card issuance, accountability, and review procedures. Finally, we reviewed the Commonwealth's contract with American Express to determine deliverables and the adequacy of contractor-provided control measures.

Findings and Recommendations

Control Issues.

Many of the agencies using the charge cards did not address which employees should be issued cards and why those employees needed the cards. Some agencies limited cards to their purchasing personnel, who handled small purchases of goods or services, or other personnel, who arranged air or rail transportation or other meetings. Other agencies saw the cards as a means of eliminating petty cash purchases and funds. While both of these approaches represent viable uses of the charge cards, the internal control structure and accounting of the two processes are very different.

Accounts established general statewide Charge Card program guidelines. However, recognizing that control requirements would vary depending upon the extent of charge card use, Accounts let agencies establish detailed controls based upon their individual needs. We believe most agencies did not anticipate the high volume of charge card transactions, and therefore, did not set up adequate internal accounting structures to monitor and control card usage.

Also, we believe that without a clear objective concerning the use of the charge cards, many program administrators and agency personnel have failed to institute the appropriate transaction limits and restrictions on the cards. Following are some examples of the concern we have over the administrators' distribution of charge cards.

In several agencies, the percentage of employees with charge cards ranged from 30 to 65 percent. For example, 15 of 23 employees (65 percent) of a small agency had charge cards. Another agency with 138 authorized positions issued charge cards to 58 individuals (42 percent.) Because agencies did not examine their needs, we found administrators issuing cards to employees without regard to job positions or purchasing needs.

Administrators have the authority to add, delete, and execute card changes, as well as review and monitor cardholder activity. We found one agency had 58 program administrators with only 200 cardholders. Over half of these individuals also administered their own cards. This lack of segregation of duties increases the chance for fraudulent use of charge cards.

Administrators are not limiting the number of cards issued to an individual cardholder. We reviewed American Express' cardholders list for May 2000 and noted that 266 cardholders had between two and five cards issued in their names. Twelve cardholders had more than five cards and one cardholder had 13 cards. Cardholders retaining more than one card with frequent changes in card limitations make reconciliation, coding, and management review more difficult. Issuing multiple cards to individuals could lead to a higher probability of fraudulent use of charge cards. In some very limited situations, the issuing of more than one card to an individual may be necessary. In these situations, there should be clear and compelling evidence of need and agencies should document the reason for the multiple cards.

We found that because most agencies do not analyze individual cardholder purchase needs, many charge cards are merely set at the maximum transaction and monthly purchase limits. Approximately 50 percent of cardholders have limits set at the default maximum amounts of $5,000 per transaction and $100,000 per month. Our analysis of fiscal year 2000 purchases found that the majority of these cardholders made purchases totaling several thousand dollars less than their maximum single transaction limits. By not restricting the limits and the use of charge cards, agencies are unknowingly assigning purchase authority to employees with limited procurement knowledge and responsibilities, which increases the risk of noncompliance with procurement guidelines and regulations.

We also found that administrators set the per transaction limits for two charge cards at $10,000 and $25,000. Also, 29 cards had zero dollar transaction limits. Administrators can easily change a card's transaction limit as often as desired by simply accessing American Express' Internet site. It appeared that in some cases, individual card transaction limits fluctuated to accommodate individual purchases.

Approximately 30 percent of those agencies queried in our survey did not have procedures to consider an employee's duties and responsibilities before assigning them a charge card. This could increase the chances of assigning cards to individuals who could have the opportunity to make improper purchases and cover up their actions.

Recommendation: **Agencies should limit charge cards to those employees whose duties routinely involve small purchases. Excessive numbers of charge cards within agencies tend to make purchase monitoring and reconciliation more difficult. Further, in only rare instances should agencies issue more than one card per cardholder.**

Recommendation: **Agencies should analyze cardholder purchase needs and job responsibilities before determining individual charge card transaction limits. This would minimize the need for agencies to change limits. Administrators should not request charge cards from the contractor with transaction limits that exceed the Commonwealth's maximum of $5,000. Agencies should also cancel cards with zero limitations.**

Recommendation: **Accounts should analyze the number of program administrators at each agency to help ensure proper segregation of duties.**

American Express provides printed monthly statements that show only a standard industry code for most purchases. Standard industry codes merely identify businesses as retail, wholesale, etc. Using this monthly statement, management can tell the merchant used in most cases, but cannot determine what was actually purchased. Management must rely on cardholder maintained purchase logs to determine what goods or services were purchased. Currently, matching the purchase log with receipts to the printed cardholder statements is a very time consuming manual process

Although American Express provides automated monthly purchase data, the data has the same limitations on information that exists with the printed bill. Only 17 of the more than 180 agencies participating in the Charge Card program receive this data. Those agencies receiving the purchase data must still perform extensive manual efforts to check the data against the purchase logs. Accounts is working with American Express to provide agencies with reconciliation data. Accounts estimates that this information may be available via the Internet in early 2001.

American Express offers some tools to assist agencies in reviewing cardholder statements and purchases. For example, a third party vendor offers automated card holder statements for an annual cost per agency ranging from $15,990 to $26,990 plus a percentage-based maintenance fee and travel costs. Another tool available to agencies is an accounting link with American Express. Costs per agency range from $1,000 for a basic link to $9,000 for a more complex custom accounting link with additional maintenance fees. The accounting link will upload purchase data to an agency's general ledger or financial system, which can simplify the posting of transactions and payments.

A fundamental concern in implementing this program was the reduction of the cost of processing small purchases. While this program has succeeded in reducing the cost of processing accounting information and check data, offsetting these savings are increased costs of tracking purchases, reviewing and checking monthly statements, and investigating questionable purchases. Automating this process would allow management to more easily check purchasing logs to the monthly statement and also reduce manual accounting efforts.

While the technology exists to streamline the process, the system costs for most agencies would offset any efficiency savings. Since they act as the statewide coordinator of this program, Accounts could attempt to have the charge card contractor either improve their billing and purchases information or have the contractor negotiate with an outside vendor to provide the information. Additionally, if the contractor cannot provide the information, Accounts could help develop a standard automated method that would continue to achieve savings in the monthly statement process.

Recommendation: **Before exercising renewal options, Accounts should require the charge card contractor to provide automated billing statements and maximize purchasing details. Accounts should solicit for a new contract if the current contractor is unable to provide these enhancements. Automated billing statements and detailed purchase data would streamline such agency accounting functions as reconciliation and expense reporting and allocation, and would enhance the monitoring and review of charge card purchases. As an alternative, Accounts could work with the agencies to develop a system to provide this information.**

Accounts receives monthly purchase information from American Express. This data exchange method is very time-consuming and outdated. American Express provides the information on 30 to 40 diskettes each month. Accounts must then use editing software to add the agency numbers to some transactions so that they can analyze agency-purchasing activity. Accounts and American Express are working to streamline this process and eliminate the diskettes.

Recommendation: **Accounts should continue to work with American Express to update their method for monthly data exchange. Expediting this process will minimize the need to manipulate and load data, which will provide more time for additional program monitoring and data analysis.**

Our analysis of purchase data showed that American Express authorized transactions that exceeded individual charge cards' established limits. We found eight transactions that exceeded the program's $5,000 maximum limit. We also found that American Express authorized transactions made with expired charge cards. The periods of expiration ranged from five days to four months.

American Express also issued two charge cards with transaction limits set higher than the Commonwealth's $5,000 maximum. Agency administrators had requested the higher transaction limits ranging from $10,000 to $25,000. Issuing cards with transaction limits exceeding $5,000 violates the contract.

Recommendation: **Accounts should monitor charge card transactions to detect if agencies are exceeding the purchasing limits. Further, Accounts should require the charge card contractor to comply with the contract and not authorize purchases that exceed transaction limits or process transactions for cancelled or expired charge cards.**

Other Issues.

After the initial implementation of this program, Accounts, Purchase and Supply, and American Express relied on the individual agencies to provide or request training in the program. On-going cardholder and administrator training is not a required prerequisite for participating in the Charge Card program.

American Express' contract requires them to provide a customized extensive training program to each agency's administrator. Many administrators and agency management are unaware of the availability of this training. As a result, some of the newer agency administrators have had only informal training from other internal administrators. We also found the following other training deficiencies:

- Forty-two of the 74 agencies queried provided only verbal training to cardholders. Another five agencies provided no training whatsoever.

- Agencies were unfamiliar with American Express reports, what information was available and the purposes of the data. Because of this unfamiliarity with program services, only 17 agencies receive monthly transaction reports in addition to monthly card statements.

- Three agencies had not established local policies or procedures for the program.

Recommendation: **Accounts and American Express should work with Purchases and Supply to develop an ongoing training plan for agency administrators. In addition, administrators should provide training to all cardholders before card issuance. Annually, administrators should require cardholders to sign a detailed list of rights and responsibilities surrounding the use of the card. Training is critical to the overall growth and success of the program. Effectiveness of the purchasing card program relies on comprehensive training for all cardholders in both procedures and benefits of the program, as well as procurement purchasing guidelines.**

Vendors on state contract are not the primary source for purchasing goods and services with charge cards. We noted that for fiscal year 2000, 11 of the Charge Card program's top 20 vendors were not on state contract. Charge card purchases from these 11 vendors exceeded $6 million. Many of the vendors on state contract offer the same or similar commodities as other vendors, but with the added benefit of contract negotiation to assure the state is receiving the best price. Buying goods and services from vendors not on state contract negates the purpose of state contracts and could hinder the Commonwealth's ability to buy quality products at the best possible price.

Recommendation: **Accounts should conduct an analysis, in conjunction with Purchases and Supply, to determine the feasibility of executing state contracts with Charge Card high-dollar volume vendors. Program administrators should ensure cardholders are familiar with procurement purchasing requirements and guidelines.**

The contract with American Express provides a revenue share feature in which the Commonwealth receives an annual payment based on the prompt payment of billing statements. The revenue share incentive offer was effective with the August 1999 contract and calls for annual payments, which become due within 60 days after the end of each contract year. Accounts has not received the first annual payment.

Recommendation: **Accounts should work with American Express so that the Commonwealth can receive its annual refund.**

Although the findings in this report have focused on improving controls surrounding charge card use, we found that some agencies have developed good controls and procedures. We noted, however, that there is not currently a mechanism to accumulate and disseminate charge card program best practices to other agencies. Accounts should develop a means to encourage agencies to share their best practices with each other.

Recommendation: **Accounts should develop a method to accumulate and then disseminate best practices to all agencies that participate in the Charge Card Program. Accounts could add a best practices section to their "News and Notes" quarterly publication. This could help promote the exchange of program information between participating agencies.**

Commonwealth of Virginia

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Walter J. Kucharski, Auditor

December 1, 2000

The Honorable James S. Gilmore, III
Governor of Virginia
State Capital
Richmond, Virginia

The Honorable Vincent F. Callahan, Jr.
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

Gentlemen:

The Auditor of Public Accounts has reviewed the Commonwealth of Virginia's Small Purchase Charge Card (Charge Card) program. Our objective was to determine if controls exist at both the state-wide and agency level that minimize the risk of undetected, unauthorized use of small purchase charge cards.

Conclusion

The Small Purchase Charge Card program has been effective in reducing paperwork and streamlining the small purchases of goods and services. The Commonwealth has recognized cost savings from the program.

We found weaknesses in the administration of the Charge Card program that could hinder the timely detection of unauthorized use of small purchase charge cards.

- There are no limitations on the number of charge cards issued to an individual or on the number of employees with charge cards within an agency. Also, most charge cards are issued at higher purchase limits than necessary.

- The charge card contractor authorized transactions and issued cards that exceeded established dollar limitations and processed transactions made with expired or cancelled charge cards. Also, in most cases, the contractor does not provide reports with sufficient purchase details.

- Data exchange between the charge card contractor and the Department of Accounts (Accounts) is inefficient.

We also identified a training issue that hinders the effectiveness and efficiency of the Charge Card program.

Although the findings in this report have focused on improving controls surrounding charge card use, we also found that some agencies have developed good controls and procedures. There is not currently a mechanism to accumulate and disseminate charge card program best practices to other agencies.

Our recommendations include:

- Agencies should analyze purchasing needs before setting cardholder transaction limits and limit the number of charge cards to those employees whose duties routinely involve small purchases.

- Accounts should monitor charge card transactions to ensure that the contractor does not allow cardholders to exceed purchasing limits or authorize transactions or issue cards that exceed purchasing limits.

- The charge card contractor should provide automated billing statements with detailed purchase information.

- Accounts should continue to work with the charge card contractor to establish an efficient monthly data exchange process.

- Accounts, the Department of General Services' Division of Purchases and Supply, and the charge card contractor should develop an updated, continuing training plan and require training attendance before charge cards are issued.

- Accounts should work with the charge card contractor so the Commonwealth can receive its annual refund.

- Accounts should work with the Division of Purchase and Supply to determine the feasibility of entering state contracts with high-dollar volume Charge Card vendors.

- Accounts should develop a method to accumulate and then disseminate best practices among agencies that participate in the Charge Card program.

Exit Conference

We discussed this report with representatives of the Department of Accounts on November 29, 2000.

AUDITOR OF PUBLIC ACCOUNTS

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