



MICHIGAN

OFFICE OF THE AUDITOR GENERAL

AUDIT REPORT



THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

“...The auditor general shall conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state established by this constitution or by law, and performance post audits thereof.”

– Article IV, Section 53 of the Michigan Constitution

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Michigan
Office of the Auditor General
REPORT SUMMARY

Performance Audit
Procurement Card Program
Office of Financial Services
Department of Management and Budget

Report Number:
 07-705-04

Released:
 August 2005

The State of Michigan's Procurement Card Program began in June 1995 as a method to reduce the administrative expense associated with procuring and paying for low dollar items through the standard purchase order process. State employees may use procurement cards for noncontract purchases of \$2,500 or less.

Audit Objective:

To evaluate the State's effectiveness in utilizing the Procurement Card Program to reduce purchasing costs and maximize the procurement card vendor rebate.

Audit Conclusion:

We concluded that the State was generally effective in utilizing the Procurement Card Program to reduce purchasing costs and maximize the procurement card vendor rebate. However, we noted reportable conditions related to procurement card usage and purchasing discounts (Findings 1 and 2).

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Audit Objective:

To assess the effectiveness of selected departments' monitoring of procurement card purchases to ensure that charges were for legitimate business purposes and within designated spending limits.

Audit Conclusion:

We concluded that selected departments were moderately effective in monitoring procurement card purchases to ensure that charges were for legitimate business purposes and within designated spending limits. We noted reportable conditions related to the monitoring of procurement card purchases, the issuance of procurement cards, split transactions, procurement card purchases, and merchant category codes (Findings 3 through 7).

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Agency Response:

Our audit report includes 7 findings and 7 corresponding recommendations. The Department of Management and Budget's preliminary response indicated that it agrees with all 7 of the recommendations.

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August 18, 2005

Ms. Lisa Webb Sharpe, Director
Department of Management and Budget
Lewis Cass Building
Lansing, Michigan

Dear Ms. Sharpe:

This is our report on the performance audit of the Procurement Card Program, Office of Financial Services, Department of Management and Budget.

This report contains our report summary; description of program; audit objectives, scope, and methodology and agency responses; comments, findings, recommendations, and agency preliminary responses; a summary of surveyed states' effective rebate rates and a summary of audit testing results, presented as supplemental information; and a glossary of acronyms and terms.

Our comments, findings, and recommendations are organized by audit objective. The agency preliminary responses were taken from the agency's responses subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after release of the audit report.

We appreciate the courtesy and cooperation extended to us during this audit.

AUDITOR GENERAL

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Description of Program

The State of Michigan's Procurement Card Program began in June 1995 as a method to reduce the administrative expense associated with procuring and paying for low dollar items through the standard purchase order process. State employees may use procurement cards* for noncontract purchases of \$2,500 or less.

The Office of Financial Services, Department of Management and Budget (DMB), is responsible for the overall administration of the Procurement Card Program. Each department has its own procurement card program administrator who is responsible for the administration of its departmental program. Employees may use a procurement card to make purchases related to their job with the State of Michigan in person, by mail, by telephone, or via the Internet within their designated account limits. Authorized cardholders must comply with the policies and procedures established in the DMB Administrative Guide and the State of Michigan Procurement Card Program Cardholder Manual.

The State receives an annual rebate from the procurement card vendor based on the State's total procurement card spending, promptness of payment, and average spending per card. DMB uses the rebate as Program revenue to offset its administrative costs associated with managing the Procurement Card Program.

DMB reported total Statewide procurement card purchases and vendor rebates for fiscal years 2001-02, 2002-03 and 2003-04 as follows:

	Fiscal Years		
	2001-02	2002-03	2003-04
Purchases	\$47,078,000	\$41,717,000	\$40,507,000
Rebates	\$ 412,000	\$ 433,000	\$ 475,000

As of May 2004, departments issued 3,561 procurement cards to employees.

* See glossary at end of report for definition.

Audit Objectives, Scope, and Methodology and Agency Responses

Audit Objectives

Our performance audit* of the Procurement Card Program, Office of Financial Services, Department of Management and Budget (DMB), had the following objectives:

1. To evaluate the State's effectiveness* in utilizing the Procurement Card Program to reduce purchasing costs and maximize the procurement card vendor rebate.
2. To assess the effectiveness of selected departments' monitoring of procurement card purchases to ensure that charges were for legitimate business purposes and within designated spending limits.

Audit Scope

Our audit scope was to examine the program and other records of the Procurement Card Program and selected departments' procurement card programs. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Audit Methodology

Our audit procedures, conducted from May 2004 through January 2005, included examination of the Procurement Card Program's and selected departments' procurement card program records and activities primarily for the period October 1, 2001 through July 31, 2004.

We conducted a preliminary review of the Procurement Card Program's operations to formulate a basis for defining the audit objectives and scope. Our review included interviewing the State's Procurement Card Program manager and selected departments' procurement card program administrators; reviewing the DMB Administrative Guide, the State of Michigan Procurement Card Program Agency Administrator Manual, and the State of Michigan Procurement Card Program

* See glossary at end of report for definition.

Cardholder Manual; reviewing the procurement card vendor contract; and analyzing available Program data and statistics to obtain an understanding of the Program.

To evaluate the State's effectiveness in utilizing the Procurement Card Program to reduce purchasing costs and maximize the procurement card vendor rebate, we contacted other states to obtain information about their procurement card programs' card usage and rebate earnings (see Exhibit 1, presented as supplemental information). We obtained procurement cardholder lists for each department to analyze the departments' procurement card usage. We also analyzed alternative payment processes used by departments to determine if procurement cards could have been an efficient payment alternative. We reviewed cardholder purchasing totals to determine if cardholders actively used their procurement cards. We reviewed the procurement card vendor rebate calculation process and rebate earnings totals to verify that the State received both the appropriate and maximum rebate amount.

To assess the effectiveness of selected departments' monitoring of procurement card purchases to ensure that charges were for legitimate business purposes and within designated spending limits, we reviewed a sample of 1,258 procurement card transactions occurring between October 1, 2003 and June 30, 2004 for 4 departments. We selected departments based on the number of procurement card users; volume of procurement card transactions; and an assessment of various risk factors, such as transactions within merchant category codes (MCCs) that we considered to be susceptible to inappropriate charges, transactions that exceeded cardholder spending limits, holiday and weekend purchases, potential split transactions, and travel or hotel related transactions. As a result of our data analysis, we selected the Department of Corrections, Department of Human Services (DHS), Michigan Department of State Police, and Michigan Department of Transportation. In addition, our audit included reviewing procurement card transactions for the Michigan Commission for the Blind, which was organizationally within DHS during a portion of our audit period but was transferred to the Department of Labor and Economic Growth, effective December 7, 2003. We reviewed the transactions to verify that they were properly supported by a receipt and appeared to be for legitimate business purposes, that the cardholder was the person who used the procurement card to make the purchase, that the purchase was within the cardholder's spending limits, and that the cardholder's supervisor reviewed and approved the purchase in a timely manner.

Agency Responses

Our audit report includes 7 findings and 7 corresponding recommendations. DMB's preliminary response indicated that it agrees with all 7 of the recommendations.

The agency preliminary response that follows each recommendation in our report was taken from the agency's written comments and oral discussion subsequent to our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and DMB Administrative Guide procedure 1280.02 require DMB to develop a formal response to our audit findings and recommendations within 60 days after release of the audit report.

COMMENTS, FINDINGS, RECOMMENDATIONS,
AND AGENCY PRELIMINARY RESPONSES

EFFECTIVENESS IN UTILIZING THE PROCUREMENT CARD PROGRAM

COMMENT

Audit Objective: To evaluate the State's effectiveness in utilizing the Procurement Card Program to reduce purchasing costs and maximize the procurement card vendor rebate.

Conclusion: We concluded that the State was generally effective in utilizing the Procurement Card Program to reduce purchasing costs and maximize the procurement card vendor rebate. However, we noted reportable conditions* related to procurement card usage and purchasing discounts (Findings 1 and 2).

Noteworthy Accomplishments: The Department of Management and Budget (DMB) significantly increased the procurement card vendor rebate earnings during our audit period. DMB increased earnings by reducing the time required to process procurement card payments, which is a key component in the rebate calculation, and by renegotiating more favorable rebate rates with the procurement card vendor.

FINDING

1. Procurement Card Usage

DMB should evaluate procurement card usage to identify additional ways for departments to maximize procurement card usage. We estimated a potential operating savings of up to \$1.6 million during our audit period from reduced processing costs and increased procurement card rebate earnings.

Departments may use procurement cards for purchases of \$2,500 or less for most goods that are not included on a State purchasing contract. Departments also use direct vouchers to pay for purchases under \$2,500 when the vendors do not accept procurement cards and the agencies do not have an existing contract for the commodity. The advantages of using a procurement card instead of a direct voucher include reducing administrative expenses associated with processing and paying for small dollar items through the normal purchasing process and increasing rebates from the procurement card vendor.

* See glossary at end of report for definition.

Departments processed approximately 326,000 direct vouchers totaling approximately \$107 million for purchases under \$2,500 between October 1, 2001 and May 31, 2004. The State's procurement card vendor conducted an analysis of direct vouchers processed during fiscal year 2001-02 and estimated that 50% of the direct vouchers were for payments to vendors that would accept the State's procurement card. Using this information, we estimated that departments could have used their procurement cards instead of processing the transaction with a direct voucher for approximately 163,000 of the 326,000 transactions. DMB calculated the cost of processing a procurement card transaction to average \$6.55 less than processing a direct voucher transaction. Based upon these estimates, departments could have saved approximately \$1.1 million between October 1, 2001 and May 31, 2004 in transaction processing costs had they used procurement cards instead of direct vouchers for these purchases.

In addition, the State earns an annual rebate from the procurement card vendor, based primarily upon the total number and amount of procurement card transactions. Therefore, we estimated that had departments used their procurement cards for these purchases instead of payments by direct voucher, the State could have earned approximately \$500,000 in additional procurement card rebates for the period October 1, 2001 through May 31, 2004.

DMB stated that all direct voucher transactions may not be eligible for payment by procurement cards because of the Procurement Card Program restrictions, such as payments to various service vendors, but agreed that the potential exists for considerable savings in other areas in which departments are using direct vouchers. In addition, DMB indicated that it can advise departments on ways to maximize the use of procurement cards, but it cannot require the use of a procurement card.

RECOMMENDATION

We recommend that DMB evaluate procurement card usage to identify additional ways for departments to maximize procurement card usage.

AGENCY PRELIMINARY RESPONSE

DMB agrees and informed us that it will comply by September 30, 2005. DMB will comply by creating and delivering reports to each department. The reports will identify vendors who accept the credit card that were paid using direct vouchers.

DMB also informed us that it has been supportive of increasing the number of purchases paid by the procurement card and decreasing the use of direct vouchers. DMB indicated that its Procurement Card Program staff have met with the Departments of Corrections, State Police, and State and with DMB Acquisition Services to review specific reports on vendors that were used and accept the credit card. DMB also indicated that it has presented at procurement card administrator meetings and at an administrative officers meeting identifying the benefits of using the procurement card. Additionally, DMB informed us that Procurement Card Program staff have worked closely with Acquisition Services to expand usage under Statewide contracts with appropriate risk/control analysis.

DMB informed us that MasterCard has provided assistance to DMB by matching State payments of \$2,500 or less to merchants that accept the credit card. However, accepting the card is not the only criteria for allowing the card to be used with these vendors. State policies and legal issues that can limit the credit card usage include:

- 1) Purchasing services that are prohibited.
- 2) Reportable services that require CS-138 authorizations.
- 3) Tracking of training activity that must be reported to the Department of Civil Service.
- 4) Tracking of and reporting services to the Internal Revenue Service (1099 reportable).
- 5) Availability of the procurement card.

FINDING

2. Purchasing Discounts

DMB should analyze departmental procurement card spending and utilize the information and its buying power to negotiate purchasing discount agreements with frequently used vendors. For the selected departments in our review, we estimated that obtaining purchasing discounts from frequently used vendors could have resulted in approximately \$2 million in cost savings.

Our review of the selected departments' procurement card purchasing procedures disclosed only 10 of 84 instances in which departments claimed to have established discounts with frequently used vendors. Generally, cardholders did not seize opportunities to obtain more favorable prices for their procurement card purchases. We summarized procurement card purchases made by selected departments from individual vendors for the period October 1, 2001 through June 30, 2004. Listed below are the number of vendors from which the departments purchased more than \$100,000 in goods and services during our review period and the total amount of purchases:

Department	Number of Vendors	Total Purchases
Department of Corrections (DOC)	40	\$ 12,040,000
Department of Human Services (DHS)	9	2,715,000
Michigan Department of State Police (MSP)	4	565,000
Michigan Department of Transportation (MDOT)	31	8,974,000
Total	84	\$ 24,294,000

During our review of procurement card transactions, we identified instances in which departments received purchasing discounts that ranged from 25% to 44%. We conservatively estimated that if these selected departments had obtained a discount of 10% for their procurement card purchases from these vendors, the departments could have realized savings of approximately \$2 million during our audit period. DMB stated that it leaves it up to the individual departments to establish discount agreements with vendors. However, an analysis by DMB of departmental procurement card spending may provide data that it could use to negotiate Statewide discount agreements with frequently used vendors to maximize savings.

RECOMMENDATION

We recommend that DMB analyze departmental procurement card spending and utilize the information and its buying power to negotiate purchasing discount agreements with frequently used vendors.

AGENCY PRELIMINARY RESPONSE

DMB agrees and informed us that it will comply by September 30, 2005. DMB will prepare an analysis and develop a plan to work with Acquisition Services and the departments. This will include:

- 1) Preparing an analysis of purchases by vendor by department.
- 2) Developing a plan to utilize this information to leverage the State of Michigan buying power to negotiate purchasing discount agreements with frequently used vendors.
- 3) Maintaining documentation of where discounts are already received and where new discounts have been obtained.
- 4) Communicating information on available discounts to cardholders.

DMB also informed us that it has provided spending information by vendor for each department to Acquisition Services and that Acquisition Services is using this information when evaluating the purchasing processes and controls in each department.

EFFECTIVENESS OF MONITORING PROCUREMENT CARD PURCHASES

COMMENT

Audit Objective: To assess the effectiveness of selected departments' monitoring of procurement card purchases to ensure that charges were for legitimate business purposes and within designated spending limits.

Conclusion: We concluded that selected departments were moderately effective in monitoring of procurement card purchases to ensure that charges were for legitimate business purposes and within designated spending limits. We noted reportable conditions related to the monitoring of procurement card purchases, the issuance of procurement cards, split transactions, procurement card purchases, and merchant category codes (MCCs) (Findings 3 through 7).

FINDING

3. Monitoring of Procurement Card Purchases

Selected departments did not sufficiently monitor procurement card transactions to ensure that purchases were in compliance with State and department procurement card program policies and procedures. Insufficient monitoring of transactions increases the risk that errors and irregularities could occur and not be identified and corrected in a timely manner.

Authorized individuals may use procurement cards for the purchase of goods related to their job within designated spending limits. The State and departments have issued policies and detailed procedures governing the use of procurement cards to help prevent and detect any misuse or abuse of the cards.

We reviewed 1,258 separate purchases totaling \$821,066 from the selected departments in our review for the period October 1, 2003 through June 30, 2004 (see Exhibit 2, presented as supplemental information). Our review disclosed:

a. Departments did not provide sufficient oversight of procurement card usage:

- (1) Cardholders did not obtain or retain sufficient supporting documentation for 92 (7%) purchases to identify the items purchased. As a result, departments could not ensure that and we could not verify whether the purchases were for official State business and not for personal or other inappropriate uses.

The State of Michigan Procurement Card Program Cardholder Manual states that cardholders are responsible for obtaining adequate documentation to support the purchases made with their cards, including sales receipts or vendor invoices.

- (2) Supervisors did not always perform detailed reviews of procurement card purchases made by staff and/or did not review procurement card purchases in a timely manner. In 146 (12%) instances, there was no indication that the supervisors reviewed the procurement card transactions. Also, in 216 (17%) instances, the supervisors' reviews occurred more than one month after the end of the billing cycle (over 44 days after the transaction). In addition, in 199 (16%) instances, the

supervisors did not document when they reviewed the transactions so we could not determine if their reviews were completed in a timely manner.

Timely review of procurement card transactions could identify misuse of the card or violation of State policies and department controls. State policy requires that, at the end of each two-week billing cycle, cardholders match all procurement card transactions to supporting documentation and forward documentation to the cardholders' supervisors for review.

- (3) Cardholders allowed other employees to use their assigned procurement cards. Thirty-four (3%) purchases were made by someone other than the cardholders listed on the procurement cards. In addition, in 209 (17%) instances, we could not determine who made the purchases because the transaction documentation or transaction detail reports were not signed by the cardholders.

Use of the procurement card by employees other than the assigned cardholder increases the risk of unauthorized or inappropriate purchases. The State of Michigan Procurement Card Program Cardholder Manual specifies that the cardholder is responsible for the security of the procurement card and the purchases billed to the card. Only the cardholder is authorized to use the procurement card and its use by others is prohibited. Violations of the procurement card rules could result in the revocation of use privileges and/or disciplinary action, up to and including termination of employment.

- (4) Departments did not always include equipment purchased using procurement cards in department inventory records. From our sample of 17 equipment items purchased using procurement cards, we noted 10 instances in which the items were not included in department inventory records. Our review did not disclose any instances of missing equipment; however, failure to record equipment in inventory records could result in the loss of equipment going undetected.

The DMB Office of Financial Management's Financial Management Guide requires agencies to record in departmental accounting records all equipment items that have an acquisition value of \$5,000 or greater. The Financial Management Guide also recommends that equipment with a

value of less than \$5,000 that is susceptible to theft be recorded in the accounting records. The procedure was established to help prevent and detect theft or losses of such assets.

- (5) Procurement card account numbers were not removed from receipts or other documents. In 193 (15%) instances, procurement card account numbers were displayed on the procurement card receipt or the supporting documentation.

The State of Michigan Procurement Card Program Cardholder Manual states that the procurement card should always be treated with a level of care that will reasonably secure the card and that the account number should be carefully guarded. Procurement card account numbers should be removed from all documents to prevent someone from inappropriately obtaining and using the account numbers to make purchases.

- b. Departments distributed transaction detail reports in a format that could allow inappropriate changes to be made to the reports. The biweekly transaction detail reports received from the procurement card vendor can be obtained in various formats, including Excel, Word, Adobe, and hardcopy. We noted that if the reports were distributed in an Excel or a Word document, they could be altered by the recipient.

Cardholders and procurement card supervisors or coordinators use the transaction detail reports to reconcile the accounting records to the procurement card purchase receipts. Distributing transaction detail reports in a format that enables the reports to be altered could allow inappropriate procurement card purchases to go undetected. Therefore, DMB should develop control procedures to ensure that departments use unaltered transaction detail reports for the reconciliation of procurement card purchases.

RECOMMENDATION

We recommend that departments sufficiently monitor procurement card transactions to ensure that purchases are in compliance with State and department procurement card program policies and procedures.

AGENCY PRELIMINARY RESPONSE

DMB agrees and informed us that it has complied. DMB indicated that at the request of the DMB director and the State Budget Director, all departments have recently completed an internal audit of their controls over the Procurement Card Program. DMB also indicated that it has revised its Administrative Guide, including a new policy on the responsibility for and importance of proper supervisory review. In addition, DMB indicated that in 2005, a separate tool for conducting a detailed evaluation of procurement card controls in each department was incorporated into the 2004 Biennial Internal Control Evaluation process.

FINDING

4. Issuance of Procurement Cards

DMB and departments issued procurement cards to employees who rarely used their cards, issued employees multiple cards, and issued cards to employees responsible for procurement card program management. Issuing procurement cards to employees who do not actively use them, issuing multiple cards, or issuing cards to employees responsible for procurement card program management increases the State's exposure to procurement card misuse.

Each department's procurement card program administrator is responsible for establishing new procurement cardholder accounts, training cardholders and agency staff about the proper use of the procurement cards, processing account and cardholder changes, establishing cardholder spending limits, and processing account closures. Our review disclosed:

- a. DMB and departments did not routinely cancel procurement cards held by cardholders who rarely used their procurement cards. Our review of procurement card charges made by cardholders for the selected departments in our review disclosed a large number of cardholders who rarely used their

procurement cards. The table below summarizes the results of our review of selected departments' fiscal year 2002-03 cardholder activity:

Department	Number of Cardholders	Number of Cardholders Who Rarely Used* Cards	Percentage of Cardholders Who Rarely Used Cards
DOC	556	172	31%
DHS	443	167	38%
MSP	592	314	53%
MDOT	588	197	34%
Total	2,179	850	39%

* Procurement card used 12 times or less for the year.

DMB, in conjunction with all departments, monitors procurement cards for activity. In January 2003, departments eliminated approximately 1,600 procurement cards that had no activity for the previous 18 months. Inactivity can also negatively impact the rebate received from the procurement card vendor because a portion of the rebate is calculated based upon average spending per card.

- b. DMB and departments did not prohibit the issuance of multiple procurement cards to individual users to limit the risk of procurement card misuse. A Statewide review of active cardholders as of May 2004 disclosed 152 employees who were issued between 2 and 6 procurement cards. Departments informed us that they issued more than one card to employees for use in making purchases for specific sections or programs. However, issuing multiple cards to separate purchases is usually not necessary because assigning program expenditure coding can be performed during the cardholder's or the supervisor's/coordinator's reconciliation of accounting records to the procurement card receipts.

Maintaining multiple cards increases the cardholder's cumulative spending limits, which elevates the State's exposure to potential fraudulent or abusive purchases. Departments should review those instances in which employees maintain multiple cards and eliminate any cards not considered necessary.

- c. MSP and MDOT did not have adequate separation of duties between cardholders and those assigned to manage the procurement card program. MSP issued 121 procurement cards to procurement card supervisors and

MDOT issued 59 procurement cards to procurement card coordinators. Procurement card supervisors and coordinators are responsible for reviewing and reconciling cardholder purchase receipts to the accounting records and performing procurement card vendor payment functions to help ensure that only allowable purchases are made in accordance with Statewide and departmental policies and procedures. To maintain effective separation of duties and reduce the risk of procurement card misuse, departments should not issue procurement cards to persons with procurement card transaction review and reconciliation responsibilities.

RECOMMENDATION

We recommend that DMB and departments routinely analyze employees' use of procurement cards and eliminate those cards not actively used or needed and those cards issued to employees responsible for procurement card program management.

AGENCY PRELIMINARY RESPONSE

DMB agrees and informed us that it has complied in part and will comply in total by September 30, 2005. DMB informed us that it changed its Administrative Guide to require a separation of duties between supervisory review and card usage. Regarding setting standards for account usage, DMB indicated that it has consistently applied an industry standard to close unused accounts. DMB also indicated that an analysis of card usage determined that an account that is used six times per year is cost neutral and that if the cards with six or fewer purchases per year were eliminated, the additional revenue from the procurement card company would offset the cost of processing through a direct voucher. DMB will develop an Administrative Guide policy by September 30, 2005 to establish usage standards. Accounts that do not meet the standard will be closed.

Regarding multiple accounts to an employee, DMB will review each case in which employees are assigned multiple accounts with the departments and, if a business case cannot demonstrate the efficiency or need for multiple accounts, the employee will receive training and the accounts will be closed. DMB indicated that this review will be completed by September 30, 2005.

FINDING

5. Split Transactions

All four departments in our review did not sufficiently review procurement card purchases to identify and deter procurement card users from splitting transactions to circumvent the single item purchase limit. Splitting transactions enables cardholders to avoid purchasing guidelines designed to ensure that purchasers obtain proper levels of supervisory approval and to ensure that purchasers obtain goods through a cost-effective purchasing process.

We identified 392 potentially split transactions totaling approximately \$1.9 million from October 1, 2003 through June 30, 2004 for selected departments in our review. Split transactions are purchases made from the same vendor on the same day that, when combined, exceed the single item transaction limit. We reviewed 71 of these transactions and concluded that, in 49 (69%) instances, the purchases were split to avoid the single item transaction limits. The table below summarizes our transaction review and the total number of split and potentially split transactions:

Department	Number of Transactions Reviewed	Split Transactions	Value of Split Transactions	Potentially Split Transactions	Value of Potentially Split Transactions
DOC	15	7	\$ 22,109	163	\$ 586,191
DHS	12	12	42,511	35	119,670
MSP	16	9	33,308	29	105,006
MDOT	28	21	147,254	165	1,062,803
Total	71	49	\$245,182	392	\$1,873,670

The State's procurement card policy prohibits the splitting of purchases from specific vendors that exceed the single item transaction limit for the cardholder. Generally, the transaction limit is \$2,500; however, DMB can approve an increase in the transaction limit if a department shows that there is a need for an increase. State purchasing procedures require program staff to obtain price quotes from vendors for purchases from \$2,500 to \$25,000 and require a formal bid process for purchases above \$25,000.

RECOMMENDATION

We recommend that departments sufficiently review procurement card purchases to identify and deter procurement card users from splitting transactions to circumvent the single item purchase limit.

AGENCY PRELIMINARY RESPONSE

DMB agrees and informed us that it has complied. DMB informed us that software tools are recently available from the vendor to notify departments when purchases are made that appear to be split purchases. DMB also informed us that it now requires this notification to be made to the department contacts and that departments are required to report to the Statewide program administrator on a quarterly basis.

DMB further informed us that to alleviate potential misunderstandings and varying interpretations, DMB will work with the departments to develop a definition of split transactions. DMB indicated that this will provide additional assurance that the procurement card transactions do not result in a conflict with established policies and procedures.

FINDING

6. Procurement Card Purchases

MDOT cardholders made unauthorized purchases with procurement cards, and DHS did not maintain supporting documentation and exceeded authorized group meal reimbursement rates. Inappropriate use of procurement cards could result in fraudulent or abusive procurement card purchases. In addition, both departments receive a significant amount of federal funding; therefore, misuse of procurement cards could result in questioned costs for federal programs.

Our review of procurement card purchases from October 1, 2003 through June 30, 2004 disclosed:

- a. MDOT used its automobile and equipment (A&E) procurement cards to make purchases that were outside the procurement cards' approved and intended use. MDOT issued 66 A&E procurement cards to employees to purchase A&E repairs and parts. MDOT received permission from DMB to increase the A&E procurement card transaction spending limit per transaction from \$2,500

to \$5,000 for the specific purpose of paying for the repair of heavy truck rear axles, transmissions, and engines. The spending limit remained at \$2,500 per transaction for all other repairs and parts. For our review period, MDOT made 200 A&E procurement card purchases totaling \$734,000 within the increased transaction spending limit.

We reviewed a sample of 31 A&E procurement card transactions amounting to \$110,000 for purchases within the increased transaction spending limits. Our review disclosed that 30 (97%) of the sample transactions included purchases that did not relate to the specific purpose of the A&E procurement card to justify exceeding the normal \$2,500 spending limit. For example, our sample transactions included purchasing metal cutters and cargo trailers, renting dump trucks, and refilling oil tanks, none of which related to heavy truck repairs. Although we did not identify any fraudulent transactions in our review, the use of A&E procurement cards for items other than those approved is a control weakness and could result in MDOT employees circumventing proper Statewide and departmental purchasing approvals.

- b. DHS did not maintain supporting documentation for all group meal and catering services. Also, DHS exceeded the DMB standardized meal reimbursement rate for some group meals. As a result, DHS could not support that purchases made were for legitimate business purposes and, therefore, we questioned the benefit of these purchases to DHS's programs.

During our review period, DHS had 401 transactions for meals and catering services that totaled more than \$62,000. We reviewed 81 of these purchases and noted 29 (36%) questionable purchases that amounted to \$11,770:

- (1) Twenty of the 29 questionable purchases either exceeded the standardized meal reimbursement rate or did not appear to provide a benefit to DHS's programs. For example, on 2 occasions DHS purchased group meals that amounted to about \$29 and \$19, respectively, per person in attendance. However, the DMB standardized meal reimbursement rate allows only \$10.25 per person for a group lunch meeting. The DMB standardized rates are set to help ensure that State employees are fairly compensated without placing an excessive burden on the taxpayers. Also, on 3 different occasions, DHS spent \$1,025 on meals for its employees to celebrate workplace diversity. DHS did not

retain supporting documentation on how many or which employees attended these lunches; therefore, these lunches did not appear to benefit DHS's programs.

- (2) Nine of the 29 questionable purchases did not have supporting documentation of the purpose for the meals and/or the names of the attendees. Therefore, we could not determine whether the meal purchases were for legitimate business purposes, in compliance with DMB regulations, or of benefit to DHS's programs. DHS should maintain documentation of the purpose for the meals and who attended the meals to support that the purchases are beneficial to DHS's programs.

RECOMMENDATION

We recommend that departments ensure that procurement cardholders make authorized purchases with procurement cards and maintain supporting documentation and do not exceed authorized group meal reimbursement rates.

AGENCY PRELIMINARY RESPONSE

DMB agrees and informed us that it has complied by revising its Administrative Guide, including a new policy on the responsibility for and importance of proper supervisory review.

DMB also indicated that it will work with MDOT and DHS to develop and implement action plans to address the specific findings.

FINDING

7. Merchant Category Codes (MCCs)

DMB did not analyze the effectiveness of MCC controls and make necessary adjustments to the MCC groups to improve controls over procurement cards.

DMB and departments can use MCC groups as a control to block credit card purchases from vendors with MCCs that they determine to be high risk for inappropriate use and outside the scope of the departments' operations. Procurement card controls could be further enhanced by regularly analyzing procurement card purchasing activity and blocking access to MCCs for vendors that are susceptible to inappropriate use, are rarely used by State agencies, and

are not normally associated with employees' job responsibilities. MCCs are standard codes used by the credit card industry to classify merchants based on the type of business or services provided.

DMB and departments established groupings of approved MCCs and then assigned cardholders to the grouping that best fits their job responsibilities. We noted:

- a. DMB did not routinely monitor procurement card usage by MCC. There are approximately 1,000 MCCs available to State procurement card users. We analyzed these MCCs and identified approximately 180 MCCs that appeared to have the highest risk for misuse. We analyzed procurement card transactions for the selected departments in our review from October 1, 2003 through June 30, 2004 and noted that approximately 60 of these codes were not used during that time frame. We concluded that the State could reduce the risk of misuse by blocking the 60 codes that were not used. In addition, routine monitoring of all MCCs could identify more codes that are not used or are not relevant to a particular department's mission or purpose.
- b. DMB and departments did not effectively block MCCs by department or job responsibility. DMB created five different MCC groupings for departments' use in limiting procurement card purchases to specific vendors; however, most cardholders (approximately 3,050 [86%] of 3,560 cardholders) were assigned to the "default" grouping. Other groupings available to departments to limit the MCCs either were not used or were so similar to the default group that the additional groupings were ineffective in limiting cardholder purchases.

The default grouping primarily blocks purchases from vendors with MCCs related to gambling establishments, dating services, financial institutions and insurance companies, massage parlors, pawn shops, rental cars, time shares, and tax payments. However, this grouping did not block other procurement card transactions that were prohibited by the State's procurement card policy, such as purchases for travel-related services, medical services, or legal services. Only MDOT had developed MCC restrictions on its road materials procurement cards (66 cardholders) to help limit purchases to road material vendors.

Blocking the use of certain MCCs could limit the risk that a cardholder will make inappropriate purchases. For example, DMB and departments could block purchases from vendors with MCCs pertaining to art dealers, boat dealers, golf courses, jewelry stores, souvenir shops, spas, or sporting goods stores when these types of purchases were outside of the employees' regular job responsibilities.

DMB informed us that it believed that, by blocking access to MCCs, it would be limiting the departments' flexibility to make purchases in an emergency situation, limiting the departments' ability to make purchases in the most cost-effective manner, and creating an administrative burden on the departments. However, most departments have procedures in place to reimburse employees for emergency type purchases. In addition, we believe that the use of MCC controls could provide a substantial cost benefit if they prevent or limit fraud and abuse, thereby justifying the use of a direct voucher for selected purchases and the cost of administering the MCC controls.

RECOMMENDATION

We recommend that DMB analyze the effectiveness of MCC controls and make necessary adjustments to the MCC groups to improve controls over procurement cards.

AGENCY PRELIMINARY RESPONSE

DMB agrees and informed us that it will comply by September 30, 2005. DMB indicated that it has initiated a plan to work with the service provider to review spending by MCC and will establish additional groupings of MCCs to limit access to high risk codes as determined by the industry or low use codes for most procurement cards. DMB will assign cards to the MCC groupings based on business needs.

DMB also indicated that the restrictions on MCCs can be complicated because vendors are assigned an MCC when they are added to the network and this classification may not represent the purchases that are made by State employees. Further, DMB indicated that substantial restrictions on the MCCs may limit the effective use of the procurement card.

SUPPLEMENTAL INFORMATION

PROCUREMENT CARD PROGRAM
 Department of Management and Budget
Summary of Surveyed States' Effective Rebate Rates

State	Number of Procurement Cards Issued	Procurement Card Purchases	Procurement Card Rebate Earnings	Effective Rebate Rate
Michigan (procurement card contract for fiscal year 2002-03)	4,689	\$ 45,439,622	\$ 432,626	0.95%
Pennsylvania (calendar year 2003)	5,000	\$ 130,000,000	\$ 1,200,000	0.92%
Maryland (fiscal year 2003-04)	7,607	\$ 195,782,180	\$ 1,644,570	0.84%
Maine (fiscal year 2002-03)	629	\$ 18,000,000	\$ 128,000	0.71%
Georgia (fiscal year 2002-03)	16,830	\$ 209,004,378	\$ 1,335,889	0.64%
Florida (fiscal year 2002-03)	18,200	\$ 480,000,000	\$ 2,014,912	0.42%
Kentucky (calendar year 2003)	4,486	\$ 39,915,977	\$ 159,652	0.40%
Virginia (procurement card contract for fiscal year 2003-04)	12,000	\$ 198,000,000	\$ 300,000	0.15%

Note: Amounts reported can vary among the states because of differences in procurement card program guidelines, spending limits, allowable purchases, and the use of procurement cards for travel-related purchases.

PROCUREMENT CARD PROGRAM
 Department of Management and Budget
 Summary of Audit Testing Results
For the Period October 1, 2003 through June 30, 2004

<u>Department</u>	<u>Total Number of Procurement Card Transactions</u>	<u>Value of Total Procurement Card Transactions</u>	<u>Number of Transactions Reviewed</u>	<u>Value of Transactions Reviewed</u>
Department of Corrections	34,622	\$ 9,109,144	300	\$ 122,918
Department of Human Services	10,699	2,845,533	360	193,867
Michigan Department of State Police	12,649	2,079,830	299	156,528
Michigan Department of Transportation	27,254	6,822,569	299	347,753
 Total	 <u>85,224</u>	 <u>\$ 20,857,076</u>	 <u>1,258</u>	 <u>\$ 821,066</u>

<u>Insufficient Documentation</u>	<u>No Supervisor Review</u>	<u>Supervisor's Review More Than 44 Days After Transaction</u>	<u>No Date of Supervisor's Review</u>	<u>Purchase Made by Someone Other Than Cardholder</u>	<u>Unable to Determine Who Made Purchase</u>	<u>Equipment Not Inventoried</u>	<u>Credit Card Numbers Displayed</u>
2	34	12	95	2	31	2	10
56	29	95	55	8	10	1	61
7	71	94	45	19	98	0	43
27	12	15	4	5	70	7	79
<u>92</u>	<u>146</u>	<u>216</u>	<u>199</u>	<u>34</u>	<u>209</u>	<u>10</u>	<u>193</u>

GLOSSARY

Glossary of Acronyms and Terms

A&E	automobile and equipment.
DHS	Department of Human Services.
DMB	Department of Management and Budget.
DOC	Department of Corrections.
effectiveness	Program success in achieving mission and goals.
MCC	merchant category code.
MDOT	Michigan Department of Transportation.
MSP	Michigan Department of State Police.
performance audit	An economy and efficiency audit or a program audit that is designed to provide an independent assessment of the performance of a governmental entity, program, activity, or function to improve public accountability and to facilitate decision making by parties responsible for overseeing or initiating corrective action.
procurement card	A credit card issued to State employees for purchasing commodities and services in accordance with State purchasing policies.

reportable condition

A matter that, in the auditor's judgment, represents either an opportunity for improvement or a significant deficiency in management's ability to operate a program in an effective and efficient manner.

