

**To the Mayor and Members of the City Council****January 28, 2020**

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SUBJECT: UPDATE ON ONGOING EFFORTS TO IMPROVE THE CITY-WIDE ACCOUNTS PAYABLE PROCESS

This Informal Report provides an update to the Mayor and City Council on the continuing efforts to improve the city-wide Accounts Payable (vendor/supplier payment) process.

Background Information

Currently, the vendor/supplier payment process is decentralized. Each city department is responsible for approving, procuring (working through the Central Purchasing division), ordering, and receiving a variety of goods and services to support their operation. An approved Purchase Order ("PO") is required to be created in the City's PeopleSoft ERP system ("PeopleSoft") prior to placing an order for all goods and/or services in excess of \$3,000 with some limited exceptions (e.g. issuing refunds, settlement payments, etc.). The PO serves as approval and authorization to place an order with a vendor/supplier and encumbers the commitment (for budgetary control purposes). Upon receipt of the ordered goods or services, city departments are required to confirm receipt in PeopleSoft, detailing the unit quantity and dollar value of goods and/or services received. City departments electronically submit the vendor invoice, which must be "matched", at the line item level, to the receiving information in PeopleSoft in order to be paid. Staff in Central Accounts Payable within Financial Management Services Department ("FMS"), performs a quality control review prior to issuing payment. Payments to vendor/suppliers are made by printed check, Automated Clearing House ("ACH"), and in some limited cases, by wire transfer.

As a point of reference, during FY2019, the City paid approximately 72,000 invoices totaling \$1.409 billion.

Comprehensive Accounts Payable Policy

FMS will be finalizing a comprehensive city-wide Administrative Regulation for processing vendor/supplier invoices. The comprehensive Accounts Payable regulation will supersede the current Accounts Payable related Finance Directives that provide only a basic framework. The new Regulation will be substantially more detailed is designed to greatly reduce the likelihood of city-wide vendor/supplier payment challenges such as:

- Paying the incorrect vendor/supplier;
- Paying duplicate vendor/supplier invoices;
- Inappropriately paying freight charges that were included in the cost of goods or not allowed under the contract/agreement;
- Paying sales or other taxes the City is exempt from paying;
- Overpaying vendor/suppliers due to remitting payment from statements, pro-forma invoices, work orders, proposals, or quotes (results in a duplicate payment when the invoice is also paid);
- Payment of fraudulent invoices;
- Failure to record expenditures in the correct accounting period in accordance with Generally Accepted Accounting Principles; and
- Failure to pay vendor/supplier invoices within 30 days as required by State Law.

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In addition, this Regulation provides strict requirements for requested department pick up of vendor/supplier checks (to reduce the potential for fraud).

Finally, the Regulation will require each operational department to perform a quality control audit of their vendor/supplier invoices covering a minimum of 2% of their annual invoice payment volume. This quality control audit must be performed by an appropriate management level employee in the department. The Regulation provides detailed criteria for the quality control audit.

The Administrative Regulation incorporates best practices from professional organizations such as the Government Finance Officers Association (GFOA), the Government Treasurers' Organization of Texas (GTOT), and information gathered from a review of policy from similar governmental entities. The Regulation is on track to be finalized by the end of January 2020.

Other Vendor/Supplier Payment Process Improvements

Consistent with the GFOA and GTOT best practices pertaining to vendor/supplier invoice payments, FMS has made a concerted effort to transition vendors to electronic payments or ACH. The ACH payment method is more cost effective than traditional paper check because it eliminates the cost of check stock, postage, the labor cost associated with check handling and escheatment, as well as paper check fraud. During fiscal year 2019, Central Accounts Payable issued approximately 59% of vendor/supplier payments by ACH, representing approximately 65% of dollars disbursed. To mitigate the risk associated with fraudulent changes to vendor/supplier ACH bank account information, the Central Purchasing – Vendor Management division of FMS has implemented a robust procedure for validating vendor/supplier requested ACH account changes. This procedure includes objective confirmation with the vendor/supplier and requires multiple levels of approval (which includes review/approval by an appropriate management level employee) before the change is completed.

As an additional fraud prevention measure, the FMS Treasury division implemented Payee Verification protection on the City's Accounts Payable controlled disbursement bank account. Payee Verification or Payee Positive Pay is a fraud prevention tool whereby the bank systematically compares the payee name, dollar amount, and check number of checks presented for payment to the City's check issue file ensuring the information on the check matches. Any mismatch of this information requires authorized city staff to review and either accept or reject the check payment. A robust procedure requiring dual review (which includes review/approval by an appropriate management level employee) of every positive pay exception was implemented to ensure altered or fraudulent checks are properly rejected.

FMS recently completed an internal reorganization to create a dedicated payroll disbursements supervisor position. Previously, one supervisor was responsible for the oversight of both Central Accounts Payable and Payroll disbursements. Upon completion of the payroll supervisor recruitment, the reorganization will address current challenges associated with one supervisor being responsible for two very critical and complex city-wide processes.

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FMS is carefully considering the feasibility and the pros and cons of outsourcing all payment disbursements to the City's depository bank. An opportunity has been presented that could potentially reduce the City's vendor invoice payment risk exposure while earning a substantial rebate through the Single Use Account payment method.

Automated Invoice Management System Implementation

I am excited to announce that the FMS Treasury division is piloting a state of the art Automated Invoice Management ("AIM") system that will further enhance the vendor/supplier payment process by leveraging advanced Optical Character Recognition ("OCR") and three-way match (Invoice→PO→Receipt) technology. Essentially, vendor/supplier invoices will be received electronically by Central Accounts Payable (or converted to an electronic image if received in paper format). The AIM system will extract pertinent invoice information from the vendor/supplier invoice (i.e. PO number, vendor/supplier invoice number, line item detail, etc.) and will automatically create an invoice payment voucher in PeopleSoft utilizing OCR technology (to reduce/eliminate data entry). Upon successful (automated) matching of the vendor/supplier invoice line item(s) to the approved PO and receiving information entered into PeopleSoft, the invoice will automatically be processed (without human intervention) for payment. With this technology, vendors/suppliers that are paid electronically by ACH could be paid within as little as two business days from receipt of their invoice if the systematic three-way match is successful.

The initial implementation phase went live on November 8, 2019 and includes the Information Technology Solutions and FMS departments. A plan has been developed to phase in this new technology across the City over the next several fiscal years. While this implementation will require significant business process changes within the operational departments, the system will greatly improve visibility and internal controls around the vendor/supplier payment process (through invoice processing centralization and computer assisted data extraction). As this technology is implemented, the FMS management team will make recommendations on the allocation of staffing across the City as a result of a concentration of workload within FMS due to the continued and future centralization of vendor/supplier invoice processing.

If you have any questions, please call Reginald Zeno, Director of Financial Management Services / Chief Financial Officer, at 817-392-8500.

David Cooke
City Manager