

County of San Bernardino

Auditor-Controller/Treasurer/Tax Collector
Internal Audits Section

Risk Management: Master Vendor File Audit



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February 4, 2016

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SUBJECT: MASTER VENDOR FILE AUDIT

In compliance with Article V, Section 6, of the San Bernardino County Charter and County Policy 05-20 entitled Internal Operational Auditing, we have completed an audit of the Risk Management Department for the period of July 2013 through June 2014. The objectives of the audit were to determine if the policies and procedures over the Master Vendor File control and maintenance were adequate (1) to protect the Department against the creation and/or activation of unauthorized vendors and (2) to ensure that payments were made only to authorized and approved vendors. We conducted our audit in accordance with the International Standards for the Professional Practice of Internal Auditing established by the Institute of Internal Auditors.

We identified several procedures and practices that should be established or improved. We have listed these areas for improvement in the Audit Findings and Recommendations section of this report.

We sent a draft report to the Department on October 21, 2015 and discussed our observations with management on November 4, 2015. The Department's response to our recommendations is included in this report.

We would like to express our appreciation to the personnel at the Risk Management Department who assisted and cooperated with us during this engagement.

Respectfully submitted,

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Risk Management Department: Master Vendor File Audit

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Summary of Audit Results

Our findings and recommendations are provided to assist management in improving internal controls and procedures relating to the Department's master vendor file.

The table below summarizes the audit findings and recommendations for this audit engagement. For further discussion, refer to the *Audit Findings and Recommendations* section of this report.

Finding No.	Findings and Recommendations	Page No.
1	Finding: Controls over the Master Vendor File could be improved.	6
	Recommendation: We recommend that a secondary employee review the input of new vendors into the system and that management review status reports for additions, deletions, and other changes to the Master Vendor File. We also recommend the Department identify and deactivate any inactive vendors from the master file.	
2	Finding: There were no written policies or procedures regarding the Master Vendor File.	7
	Recommendation: We recommend Management immediately create policies and procedures manuals regarding the Master Vendor File.	
3	Finding: The Department did not consistently report Use Tax.	9
	Recommendation: We recommend the Department report use tax in accordance with California Board of Equalization (BOE) guidelines.	
4	Finding: The Department was not issuing 1099 Forms to all of the required parties.	9
	Recommendation: We recommend that the Department follow the IRS guidelines in regards to Form 1099 reporting. Another employee should also review new vendors entered into Valley Oak Systems (iVOS) to verify the tax information is accurate.	



Finding No.	Findings and Recommendations	Page No.
5	Finding: Adequate supporting documentation was not always properly maintained.	12
	Recommendation: We recommend that the Department maintain adequate supporting documentation for all vendor and claimant payments.	



MASTER VENDOR FILE AUDIT

The Department

The San Bernardino County Risk Management Department (Department) administers the County's self-insured workers' compensation, public liability, property conservation, safety and risk reduction programs and its insured programs. All programs are paid from self-insurance funds and financed by charging general fund and non-general fund departments, as well as Board-Governed Special Districts and County Service Areas. Each is billed for its specific coverage for the cost to pay losses under the self-insured programs and the cost of insurance for the insured programs.

The Department is composed of four sections, which are safety and loss control, workers' compensation claims administration, liability claims administration, and finance and administration. Safety and loss control is primarily responsible for loss prevention consulting, safety inspection, employee training and emergency responses. The workers' compensation claims administration handles open and new claims generated from work-related injuries and illnesses. The liability claims administration processes and manages open and new claims related to auto accidents, law enforcement, tort and many other general liabilities. The finance and administration section handles all fiscal database operations.

Valley Oak Systems (iVOS)

In June 2008, the Department converted to a new, online automated insurance claims management system known as iVOS (Valley Oak Systems). The iVOS "one-system" solution consolidated insurance lines - including workers' compensation, disability, property, and liability claims - onto a single platform for increased operational efficiency.

The Master File

A master vendor file's data shows the most current, accurate, and authoritative permanent or semi-permanent record of information maintained over an extended period of time. A master vendor record is the central reference that an organization uses to determine how the accounts payable system manages a vendor's activity. The master vendor records are the source of the payee names and addresses that are printed onto vendor checks. Inaccurate, incomplete, or



unauthorized master file records may greatly increase the chances for duplicate or erroneous payments or fraud.



Scope and Objectives

Our audit examined the Department's master vendor files for the period of July 2013 through June 2014.

The objectives of our audit were to determine if the policies and procedures over the Master Vendor File control and maintenance were adequate to:

- protect the Department against the creation and/or activation of unauthorized vendors.
- ensure payments were made only to authorized and approved vendors.

Methodology

In achieving the audit objectives, the following audit procedures were performed, including but not limited to:

- Gain understanding of software applications.
- Interview of Risk Management Department personnel.
- Review of the Department's policies and procedures.
- Examination of original source documents and system-generated reports.



Finding 1: Controls over the Master Vendor File could be improved.

According to *Accounts Payable: A Guide to Running an Efficient Department* by Mary S. Schaeffer, proper maintenance and control over a company's master vendor file will greatly decrease the chances for duplicate and erroneous payments and fraud. In addition, the County's Internal Controls and Cash Manual (ICCM) Chapter 2 states that all transactions and pertinent events should be accurately and properly recorded on documents and records.

The following conditions were identified:

- There was no secondary review of vendor information when it was inputted into Valley Oak Systems (iVOS).
- Management was not reviewing iVOS status reports.
- The Department was not performing regular clean-up of files, such as deactivating inactive vendors.
- There were multiple vendor names associated with the same Taxpayer Identification Number (TIN).
- Inputted duplicate vendors did not have matching TINs.

Neither the department staff nor management was reviewing the input of new vendors into the system. In addition, the Department had not reviewed and purged any inactive vendors that had been entered into the system. When there is no verification of information that is inputted into the system, erroneous information and duplicate or unauthorized vendors would not be detected.

Recommendation:

We recommend that a secondary employee review the input of new vendors into iVOS to verify the information is accurate and avoid duplicate or unauthorized vendors. We also recommend Management run iVOS status reports on a monthly basis to review any additions, deletions or changes made in the system. These reports can also identify vendors that have been inactive for at least five years, helping the Department identify which vendors to deactivate from the system.

Management's Response:

- We agree that this new vendor information should be verified. Currently when new vendor information is processed, Workers' Compensation and Liability adjusters collect the W-9 from the vendors and complete a Department Vendor Registration Form, these forms are reviewed and approved by the Payroll Specialist. On a weekly basis, we will use a report from iVOS showing all new vendors from the prior week, to ensure all new vendors have been entered correctly. Effective July 1, 2016, when we switch to our new claims system, this practice will continue. Once keyed, the Payroll Specialist emails the Liability Adjusters and the OA II (Office



- Assistant II) who submitted the form so they can verify the information keyed. Also, The Staff Analyst I will review the weekly report against the Department Vendor Registration Forms submitted during that period.
- Development of improved status reports should be possible through the new claims system, Systema, which will go into effect July 1, 2016. The Supervising Liability Claims Representative and the Supervising Workers Compensation Adjuster will be reviewing this report for changes to existing vendors and to make sure all new vendors are keyed.
 - ISD is finalizing an iVOS report that will list all active vendors and their last payment date. This will enable us to inactivate all vendors who have not been paid in the past three fiscal years. Annually, staff will review the entire Vendor File to inactivate all vendors who have not been paid in the past three years. Systema is being developed with features to prevent duplicate vendors from being entered.
 - Multiple vendor names associated with one main company is a common occurrence in the billing process. When this does occur a new W-9 is requested and processed every time a new, "doing business as" (dba) is introduced for payment. The main company's TIN number is then verified with the Internal Revenue Service. Occasionally, the dba has been registered as well, in that case, the dba can be verified, but this is not always the case. iVOS does require that we enter each dba individually, but the TIN of the original, main company is used. This allows for all payment information to be captured for the 1099 tax form for the main company.
 - The department is aware of vendor duplication that occurred when we switched from the previous claims system (Gensource) to iVOS. iVOS automatically created a duplicate vendor for each vendor in Gensource, the Payroll Specialist does inactivate these when she comes across them. We will only export current active vendor records and inactivate vendors specially tied to an actual claim file (duplicates will not be transferred to Systema) regardless if it is an active or closed claim file.

Auditor's Response:

The Department's actions and planned actions will address the deficiencies noted in the finding.

Finding 2: There were no written policies or procedures regarding the Master Vendor File.

The premise of an effective internal control structure is the Department's control environment, which includes elements such as management's philosophy and operating style and personnel policies and practices. It is imperative that



management establish internal controls, such as policies and procedures, and communicate them to the operating personnel.

There were no written policies and procedures in regards to:

- the process of Master Vendor File operations
- the positions required to perform the various functions
- naming convention policies

Without written policies and procedures in place, existing employees do not have manuals to consult for questions and any new employees will not know what correct procedures to follow to effectively do their job.

Recommendation:

We recommend Management immediately create policies and a procedure manual regarding the Master Vendor File. The creation of a manual will help establish an organizational structure, and provide guidelines for employee responsibilities and duties. In addition, well-established naming convention policies will decrease the chance of duplicate vendor names.

Management's Response:

We partially agree with the recommendation. The Risk Management Department provided the attached procedure from iVOS during the audit. Since then, the department developed a Standard Practice to address the process of adding/changing vendor information in the Master Vendor File. All necessary forms were updated associated with this new Standard Practice. This process will again be updated as needed as we transition to our new claim system.

Auditor's Response:

The procedures provided by the Department described adding a vendor to the master vendor file. It did not indicate policies and procedures for the entire process of the operations, including the positions required to perform the various functions, such as the accounting, monitoring, and general oversight of the Master Vendor File operations. The manual should clearly outline the specific duties, authority and responsibility for all employees. In addition, good master vendor policies dictate that there be a consistent vendor naming policy in order to eliminate duplicate files for the same vendor.



Finding 3: The Department did not consistently report Use Tax.

California Board of Equalization (BOE) states that use tax generally applies to the storage, use, or other consumption in California of goods purchased from retailers in transactions not subject to the sales tax. Use tax may also apply to purchases shipped to a California consumer from another state, including purchases made by mail order, telephone, or Internet.

Based on a query for Fiscal Year (FY) 13-14, only one transaction reported use tax. This transaction was processed by the Auditor-Controller/Treasurer/Tax Collector (ATC) Accounts Payable section using a manual payment voucher. No other payments have been coded to fund XXR, which is the self-assessed use tax fund.

When the Department does not keep track of purchases such as medical equipment that require use tax payments, the correct amount of use tax is not reported and paid to the BOE.

Recommendation:

We recommend that the Department staff actively review any out-of-state purchases and report use tax in accordance with California BOE guidelines.

Management's Response:

We agree with the recommendation. This is a training issue and has been addressed with all adjusters and other staff in the department. In all future purchases made through a claim or directly from a vendor, the adjusters and fiscal staff will ensure that tax is being paid on all items that would require the collection of tax. Fiscal staff is reviewing purchases made outside California during 2015 for possible use tax.

Auditor's Response:

The Department's planned actions will correct the deficiencies noted in the finding.

Finding 4: The Department was not issuing 1099 Forms to all of the required parties.

The Internal Revenue Service (IRS) states that a Form 1099-MISC (Miscellaneous Income) should be filed for each person that has been paid at least \$600 for services performed by someone who is not an employee, for



medical and health care payments and for payments to an attorney during the year. The IRS 2009 Chief Council Memo (CCM) designated as the PMTA 2009-035 (Program Manager's Technical Advice No. 2009-035) requires that if a governmental agency pays gross settlement proceeds via a joint check made payable to the plaintiff and attorney, the gross settlement proceeds be reported to both the plaintiff in Box 3 "Other Income" and to the attorney in Box 14 "Gross Proceeds Paid to an Attorney". In addition, the Institute of Finance and Management clarifies that while not all payments are taxable, the IRS still uses this information to determine whether the recipient has properly reported the payment.

The following conditions were noted:

- Based on conversations with Management, settlement payments were reported on 1099 forms that were sent to the attorneys. The claimants or clients did not receive a 1099 form. A review of one settlement payment revealed that a 1099 was issued to the attorney only.
- During a review of twenty new vendors that were inputted into iVOS for FY 13-14, one company had "no 1099" incorrectly checked on their account. The company was a court reporting service that should have been receiving a 1099 form.

Because the departmental staff believed that the division of settlement payment amounts was agreed upon between the attorney and the client, the amount was only reported on the attorney's 1099 form. When payments are not properly reported, this can result in IRS fines and penalties. When there is no secondary review of new vendor input into iVOS, there is no verification that the vendor's tax status is accurate.

Recommendation:

We recommend that the Department follow the guidelines as outlined by the IRS in the "Instructions to Form 1099" and the PMTA 2009-035. We further recommend that another employee review the input of new vendors into iVOS to verify the tax information is accurate.

Management's Response:

We partially concur with the recommendation. Typically on liability claim settlement payments, we do not issue 1099's to plaintiffs or claimants because they are not taxable. Settlements become taxable to plaintiffs and claimants only if the settlement agreement contains language that the settlement includes wages, loss of income, benefits, etc. In those instances there is usually a specific amount stated. If that is the case, the settlement payment is coded with pay code 8T. We will then provide EMACS with the settlement release so they can issue the 1099.



According to County Counsel: "Pursuant to Internal Revenue Code section 104(a) (2) recovery from personal injury lawsuits is not taxable. Personal injury has been defined as nonphysical injuries to the individual such as emotions, reputation or character as well as physical injury. See U.S. v. Burke (1992) 504 U.S. 229, 235; Commissioner v. Schleier (1995) 515 U.S. 323, 338. However, lawsuits that return any type of wages or earnings are taxable as earned wages. Accordingly, we do not routinely supply 1099's to plaintiff's recovering damages from personal injuries in tort cases.

Our policy instead obtains the W-9 from the Plaintiff's attorney. The attorney will take the proceeds of the judgement or settlement and disburse it to the costs of the case, the plaintiff's share, and the attorney's share. Any other tax documentation over the proceeds would be provided to the IRS by the attorney. We would not ordinarily know the precise amount that the plaintiff would receive as that amount of money would be determined by the contractual agreement between the plaintiff and the plaintiff attorney. In situations where the plaintiff is not represented by an attorney, the plaintiff receives the full settlement or judgment recovery without a 1099, because the amount is not taxable.

In response to finding 4, the Department should be filing 1099 forms for all vendors, experts and other services that exceed \$600. As far as marking box 3 "other income", under the current state of the law, this would apply to only those plaintiffs recovering money from lawsuits challenging income, wage and hour earnings such as wrongful termination. Risk Management utilizes a coding system to ensure those settlements supply 1099's under the Tax Code. Should a new vendor need to be processed, the Liability adjuster will collect the W-9 from the vendor and complete the Vendor Registration Form, giving the completed form to the Supervising Liability Claims Representative for review and approval. The new vendor paperwork is then given to the Payroll Specialist for keying. Once keyed the Payroll Specialist emails the Liability Adjuster who submitted the form so they can verify the information keyed.

Auditor's Response:

ATC Internal Audits recognizes the Department's stance that some 1099 forms may not be issued to plaintiffs or claimants because they are not taxable. Because each settlement case is different and components within the case should be reviewed to determine if taxable or non-taxable, settlement payments should be evaluated by the Department on a case-by-case basis. For example, payments to compensate for emotional damages and pain and suffering are taxable and reportable, unless they arise from an underlying claim alleging personal physical injury. The Department may be subject to fines and penalties with the IRS due to incorrect tax reporting. The Department's planned actions in regards to another employee reviewing the input of new vendors into iVOS will correct the second condition noted in the finding.



Finding 5: Adequate supporting documentation was not always properly maintained.

The County's Internal Controls and Cash Manual (ICCM) Chapter 2 states that all transactions and pertinent events should be accurately and properly recorded on documents and records. Additionally, sufficient and relevant data should be recorded to provide an audit trail and to document evidence that a transaction took place. The audit trail allows an independent person to validate a specific transaction by tracing it from summary report to original documentation.

During a review of thirteen payments made to claimants, one did not have adequate supporting documentation on file. It was a manual check that was issued in September 2008, but entered into iVOS as September 2028. The Department was able to identify the claimant name and number, but could not locate the appropriate documentation.

The Department uses an offsite storage service to keep its older records and files. If there are missing or incomplete records, there is no validation that payments are made only to authorized and approved claimants.

Recommendation:

We recommend that the Department maintain adequate supporting documentation in regards to all vendor and claimant payments.

Management's Response:

We agree with the recommendation. In April of 2014, we began scanning all supporting documents for all payments that we receive back from fiscal and it has been very successful. Fiscal staff ensures all payments have the necessary supporting documents prior to processing each payment.

Auditor's Response:

The Department's actions address the deficiencies noted in the finding.