



OFFICE OF THE SENIOR VICE PRESIDENT--  
BUSINESS AND FINANCE

OFFICE OF THE UNIVERSITY AUDITOR  
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**PRESIDENT ATKINSON  
SENIOR VICE PRESIDENT DARLING  
SENIOR VICE PRESIDENT MULLINX**

Attached is a report from the Office of the University Auditor titled *Interim Internal Audit Report on Purchase Card Program--Review of Los Alamos National Laboratory Disposition of Matters Referred from the External Review*. The objective of this internal audit was limited to verifying and validating the efforts of LANL management to resolve questions raised in the Purchase Card External Review about certain purchase card transactions and incomplete evidence of timely reconciliations. The internal audit was undertaken at the direction of the President as one of the UCOP initiatives to oversee the resolution of current LANL controversies.

*The scope of this audit did not extend to other procurement methods (e.g., Just In Time System, Local Vendor Agreements, Blanket Purchase Orders, etc.) which are separately under review in a second phase of the External Review Team's effort. Additionally, property control matters, including the interface of purchasing and property control systems (e.g., bar coding of purchased equipment valued at over \$5,000 and sensitive items under \$5,000 in value) are the subject of separate reviews. A wall-to-wall inventory of equipment is also soon to begin. Accordingly, readers of this report should take care to understand its limited purpose and the broader related efforts being undertaken.*

The attached report is presented in two sections. Section I describes our procedures and presents our conclusions related to the verification and validation of LANL management's review and disposition project. Section II contains recommendations for further enhancement of the purchase card policies, procedures and internal controls. These recommendations supplement the actions taken to date by LANL management including the actions taken in response to the recommendations of the External Review Team.

We have requested from LANL management a written response to our recommendations, and will perform follow-up verification procedures at appropriate intervals.

We will be pleased to answer any questions.

Patrick V. Reed  
University Auditor

Attachment

cc: Interim Laboratory Director Nanos  
Vice President Broome  
Assistant Vice President Van Ness  
Associate Director Marquez

bcc: Assistant Vice President Reese  
Assistant Vice President Sudduth

**UNIVERSITY OF CALIFORNIA**  
**OFFICE OF THE PRESIDENT**  
**OFFICE OF THE UNIVERSITY AUDITOR**

**INTERIM INTERNAL AUDIT REPORT ON PURCHASE CARD PROGRAM--  
REVIEW OF LOS ALAMOS NATIONAL LABORATORY DISPOSITION OF  
MATTERS REFERRED FROM THE EXTERNAL REVIEW**

**February 2003**

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<sup>1</sup> “Not Credited” is the description on the listing provided by the External Review Team, however, many items had been credited but were not documented in the purchase card system. A more accurate description of the items on this listing would be Items Reflected as Disputed Without Documentations of Resolution.

## EXECUTIVE SUMMARY

At the request of University of California Office of the President officials, the University Auditor's Office (UAO) undertook a review of the efforts by LANL to review and dispose of matters referred for follow-up from an external review of the purchase card program. The review encompassed \$1.1 million of potentially questionable costs and unresolved disputed charges as well as \$3.8 million of "unreconciled" purchase card statements, for a total of \$4.9 million from the approximately \$120 million population of purchase card transactions reviewed.

*The scope of this audit did not extend to other procurement methods (e.g., Just In Time System, Local Vendor Agreements, Blanket Purchase Orders, etc.) which are separately under review in a second phase of the External Review Team's effort. Additionally, property control matters, including the interface of purchasing and property control systems (e.g., bar coding of purchased equipment valued at over \$5,000 and sensitive items under \$5,000 in value) are the subject of separate reviews. A wall-to-wall inventory of equipment is also soon to begin. Accordingly, readers of this report should take care to understand its limited purpose and the broader related efforts being undertaken.*

LANL employed a variety of techniques to address the matters referred to them for follow-up. A significant effort was made to search for and locate original documentation of manual reconciliations. Purchase cardholders were asked to prepare retroactive reconciliations for those not found to have pre-existed, although some cardholders had left the laboratory or their underlying records could not be located. A substantial volume of the potentially questionable costs were resolved through review of DOE contract terms and transaction documentation. For unresolved disputed charges, a search was made for unmatched credits and documentation was reviewed to determine if the dispute had been resolved through some means other than credit. Additional documentation was sought to assess the allowability of costs questioned in the external review.

The documentation reviewed was scrutinized for unusual elements similar to those associated with the transactions identified in the External Review report as requiring referral to appropriate authorities. That is to say that documentation was scrutinized for indications of possible fraud. Additionally, known exposure to potential abuse due to process deficiencies were considered. For example, rather than rely on transaction descriptions in the electronic records, such descriptions were compared to original vendor invoices and similar documents on a test basis.

The purpose of the review by the UAO was to verify and validate the results of the LANL project. UAO reviewed the LANL approach and methodology for review and disposition of the questioned items, selected samples of transactions and statements for detailed review, physically inspected selected purchased goods and interviewed cardholders and designated approvers.

## **Results**

Following is a tabulation of the outcome of the UAO review of the LANL project:

<u>Description</u>	<u>Amount</u>	<u>% of Population</u>	<u>% of Referred</u>
Purchase Card population (45 months)	\$120,402,716	100%	-
Total amount referred to LANL from			
External Review	\$4,888,692	4.1%	100%
Records destroyed in fire	\$5,664	.01%	.1%
Duplicate amounts referred to authorities from ERT	\$1,416	-	-
Favorably resolved	\$4,686,366	3.9%	95.9%
Costs Questioned as to Allowability—			
Specific Transactions	\$47,983	.04%	1.0%
Costs Questioned as to Allowability—			
Incomplete Documentation	\$147,263	.12%	3.0%

Included in the “total amount above referred to LANL” are transactions totaling \$591,677 that are associated with individuals whose names appeared on sensitive names lists provided by LANL management and the Office of Inspector General. These transactions were subject to a broader scope and higher degree of scrutiny by LANL and UAO. 100% of transactions in the forty-five month period were reviewed by either the ERT or LANL and were tested by UAO.

In conjunction with the effort to review the \$4.9 million described above, we identified another issue that gives rise to additional questioned costs. Our procedures included verifying the availability of funds for certain specific purposes permitted under the DOE contract, in addition to simply verifying that funds were expended for an approved purpose. The DOE contract provides for the establishment of an employee awards program with an overall limitation expressed as a percentage of payroll. These are typically “spot awards” and their relationship to the purchase card program is that frequently, the awards are given as gift certificates—for example to local restaurants—acquired with the use of a purchase card. In reviewing expenditures of awards program funds for 1999, it was determined that awards program funds were over-expended in total by \$125,000. Lab management was unable to determine if a waiver had been obtained from DOE for this over-expenditure, and pending further information, the amount is questioned as described below.

The audit resulted in certain costs being questioned as to allowability under the contract with DOE. For costs incurred to be allowable, they must be related to the contract performance, reasonable and substantiated. A portion of these costs (Appendix B \$15,066) were questioned as to allowability because of contract terms not being met or because the reasonableness of the expenditure was questioned after review of supporting documentation. The largest portion of the questioned costs resulted from an inability to locate sufficient

supporting documentation, either for the original procurement (Appendix B \$147,263), or the resolution of disputed transactions (Appendix B \$32,852). Although certain transactions lacked sufficient supporting documentation and were therefore questioned as to allowability, LANL, (and on a test basis UAO) reviewed available documentation. Such documentation included bank statements, partially completed or unapproved reconciliations, purchase documentation as available even where the related dispute was not sufficiently documented, and both contemporaneous and currently prepared descriptions and explanations by cardholders. Particular attention was paid to transactions that by their description or vendor may have been acquisitions of items with a possible personal use. No additional transactions warranting referral to appropriate authorities were identified in this portion of the review. However, there can be no assurance that the unlocated documentation does not mask inappropriate use of the purchase card or dispute function.

The allowability of costs incurred ultimately will be resolved in the normal course of LANL's dealings with the DOE contracting officer.

The detailed report also includes recommendations for additional control improvements that LANL management should implement in conjunction with their other efforts to strengthen the purchase card program.

## **SECTION I. The LANL Management Review and Disposition Project**

### **A. Introduction**

In late November 2002, LANL requested the assistance of the University Auditor's Office (UAO) in the review and disposition of items referred to LANL management by the Purchase Card External Review Team. At the same time, the University of California Office of the President (UCOP) was receiving preliminary information regarding the outcome of the External Review. This information and other evolving matters prompted President Atkinson to commit UCOP resources to a variety of activities, including committing the University Auditor's Office to this endeavor.

#### **Background**

In August 2002, an External Review of the Purchase Card System was commenced after an internal review and a suspect bank charge revealed certain questionable transactions. The External Review Team (ERT) was comprised of two former Inspectors General, assisted by forensic accountants from PricewaterhouseCoopers LLP.

The charge to the ERT was to conduct an "independent administrative review" broadly encompassing policies, procedures, and practices and to investigate suspect or abnormal purchase transactions, trends or patterns. This review covered transactions in the period October 1, 1998 through June 30, 2003 totaling approximately \$120 million.

To perform their transaction level testing, the ERT utilized various analytical and "data mining" procedures (i.e., search for predetermined risk factors) to identify transactions that were then subject to judgmental and targeted sampling. At the completion of their review, five lists were turned over to LANL management. One of these lists (List 1) contained matters that were determined to require referral to authorities, and four lists with purchase card activity totaling \$4.9 million required further review and disposition by LANL. These four lists are described as follows and are further explained in their respective sections of this report:

***List 2--Costs Requiring Additional Clarification***—(from data mining exercise)—This is a list of transactions considered possibly unallowable by the ERT based upon elements of the transaction description in the electronic record and needing further review to determine allowability.

***List 3--Costs Requiring Additional Clarification***—(after review of documentation)—This is a list of transactions which were reviewed, principally from the ERT's samples, and upon review were considered possibly unallowable and worthy of further review and justification.

***List 4--Statements Requiring Proof of Manual Reconciliations***—This is a listing of purchase card monthly statements that were not reflected in the electronic records as reconciled, and for which manual reconciliations were not provided to the ERT.

***List 5--Disputed Items Not Credited***—This is a listing of transactions marked as “Disputed” in the purchase card system for which the ERT was not able to locate a credit in the purchase card system using an electronic matching procedure.

These four lists became the subject of a LANL project to review, document or locate documentation for, justify, investigate, resolve and determine the ultimate disposition as appropriate.

### **Objective**

The objective of the review by UAO was to verify and validate the efforts by LANL in relation to the review and disposition of the items on the above lists. The review was designed to 1) verify the appropriateness, sufficiency and completeness of LANL’s review and disposition of all of the matters on the lists, and 2) validate the disposition determined by LANL through review of supporting documentation and other means described below.

### **B. Scope and Methodology**

***The scope of this audit did not extend to other procurement methods (e.g., Just In Time System, Local Vendor Agreements, Blanket Purchase Orders, etc.) which are separately under review in a second phase of the External Review Team’s effort. Additionally, property control matters, including the interface of purchasing and property control systems (e.g. bar coding of purchased equipment valued at over \$5,000 and sensitive items under \$5,000 in value) are the subject of separate reviews. A wall-to-wall inventory of equipment is also soon to begin. Accordingly, readers of this report should take care to understand its limited purpose and the broader related efforts being undertaken.***

The scope of transactions and reconciliations for our review encompassed all items on the above four lists provided by the ERT. A limited number of records were not available for review because of destruction in the Cerro Grande fire. We were able to review evidence of the property destroyed and the reasonableness of LANL’s assertion that the unavailable records were from the unit physically destroyed. This scope limitation related to 5 monthly statements accounting for \$5,664 of the total of \$4.9 million in our scope.

Our methodology included verifying that the activities carried out by LANL to review and dispose of the items on these lists did in fact occur as represented to us, that communications with LANL personnel requested information on all of the items on the lists, and that the various procedures employed by LANL were appropriate to the charge of the ERT in referring the matters to LANL.

Specifically we:

- Reviewed the instructions given to line management and cardholders for their participation in the documentation and reconciliation elements of the project,

- Reconciled the dissemination of requests to the original list,
- Reviewed purchase card program policies and the DOE contract provisions as appropriate,
- Reviewed on a sample basis the quality and sufficiency of standard documentation, explanations and justifications provided as described more fully in each of the sections below, but generally including: verifying purchase descriptions in the electronic records by comparison to original invoices (or comparable vendor documentation), assessing account coding, and assessing the use of special funds as permitted in the contract.
- In the absence of standard documentation for certain transactions, reviewed alternative and limited available documentation including: bank statements reflecting vendor names, dates and transaction amounts, purchase card forms (transaction initiation form) incomplete or completed but unapproved reconciliations, and/or cardholders comments and explanations.
- Physically inspected certain purchased items,
- Determined the availability of funds for the specific use for circumstances where the fund source or dollar limitations constituted part of the reason for costs being questioned, and
- For uncleared disputed items, assessed the risk of inappropriate transactions based on personal interest in the purchased items using transaction descriptions if available or vendor name.
- Ascertained that all activity for persons on the listing of “sensitive names” transacted in the forty-five month period were subject to heightened scrutiny by either the ERT or the LANL procedures.
- Interviewed personnel who were responsible for the LANL project as well as selected cardholders and designated approving officials.

We believe our procedures were reasonable in the circumstances and provide an adequate basis for the conclusions expressed in this report.

## **C. LANL Procedures and UAO Procedures and Conclusions**

### **C.1 Costs Requiring Additional Clarification (*from data mining exercise*)**

#### ***Description of the List’s Contents and Source***

List 2—Costs Requiring Additional Clarification (*from data mining exercise*) consisted of 841 transactions representing \$766,723. The list was generated by searching on key words in the description field of transactions in the purchase card system. This process was not intended to make a determination of cost allowability, but only to identify broad categories of transactions that may be unallowable under the DOE contract and federal procurement standards. The categories were as follows:

<u>“Searched” Description/Category</u>	<u>Amount</u>
Advertising	\$12,056
Bonds & Insurance	99
Costs of Gifts	2,638
Software Maintenance	643,810
Bids/Proposals	238
Memberships (e.g. scientific societies)	48,406
Awards	25,767
Entertainment	103
Personal/Luxury Items	278
Printing	33,328
Total	<u>\$766,723</u>

***Description of LANL’s Review and Disposition Effort***

To review the transactions in question, LANL reviewed the descriptions listed on the schedule as well as the allowable costs section of the contract between the University and DOE. This review enabled LANL to clear many of the transactions by relying on a more specific identification of the costs in relation to allowability standards. For example, while advertising is generally prohibited by the DOE contract, advertising for personnel recruitment purposes is specifically allowed. Accordingly, LANL reviewed vendor names and supporting documentation as appropriate to determine that the advertising costs on the list were for bona fide recruitment purposes. Similarly, memberships (scientific, trade and professional societies, etc.) are permitted so long as there is approval by the DOE. Therefore, LANL’s review of the transactions identified as memberships entailed a review of underlying documentation for evidence of DOE approval.

One category, software maintenance, accounted for nearly 84% of the total dollar value of the list, and as a result, LANL performed a more comprehensive review of these costs. Based on their understanding of allowable software costs (i.e., generally allowable unless they solely benefit the contractor) and a review of supporting documentation, LANL concluded that all of the software maintenance transactions were allowable.

All transactions in the caption labeled “personal or luxury items” were reviewed. \$180 was a morale fund purchase of mementos for a group golf outing and the remaining \$98 was questioned on List 3.

All of the cost categories were subject to specific review of the nature of the transactions and allowability provisions of the contract, and selected transactions were reviewed against underlying documentation.

***Description of UAO Procedures***

UAO verified that LANL's process addressed each transaction included on the list and applied the justification rationale consistently. To understand the cost allowability justification criteria, UAO independently reviewed the contract provisions for the applicable areas reflected on List 2 and applied these allowability criteria to the transactions. We further sampled transactions from each of the 10 categories to determine if the definitional criteria applied by LANL were appropriate, and if the transactions were permissible purchase card transactions given LANL's permissible criteria.

### ***UAO Conclusions***

UAO concluded that LANL undertook a comprehensive and thorough approach in reviewing the transactions. As a result of their review, LANL identified transactions totaling \$18,743 being questioned as to allowability under the DOE contract. UAO concludes based on the individual facts and circumstances that the determination of costs questioned as to allowability is reasonable. The causes are principally missing DOE transaction approval where required (e.g. memberships in professional or trade societies) or expenditures in excess of contract limitations. A description of the questioned transactions is contained in Appendix B.

UAO also identified transactions that, while allowable, were processed contrary to LANL's guidelines for permissible purchase card use.

## **C.2 Costs Requiring Additional Clarification (after review of documentation)**

### ***Description of the List's Contents and Source***

List 3 consists of 33 transactions totaling \$22,962 in ERT questioned costs. Similar to List 2, the transactions were initially questioned as to allowability based on their description. Unlike the transactions on List 2, the ERT reviewed supporting documentation for 29 of the 33 transactions on List 3. This list included transactions with potentially suspect vendors, e.g. retail stores, and purchases of items that on the surface are not necessary to performance of the contract. The items on List 2 are highly eclectic; including a recliner acquired for an employee with physical difficulties, a Christmas costume and other items that are most typically purchased for personal use. After their review of the supporting documentation, the ERT concluded that these transactions needed further clarification and justification by LANL management to determine their allowability.

### ***Description of LANL's Review and Disposition Effort***

The LANL project team requested from cardholders the source documentation for all 33 transactions, together with additional explanation and justification as necessary. LANL was ultimately able to review all but two of the transactions. The costs related to these two transactions were questioned based on lack of source documentation. LANL concurred that on the surface, many of the descriptions looked questionable as to allowability under the contract because of the possible personal use of the items. However, after review of the supporting documentation and telephone interviews

with department officials, LANL concluded that the majority of the transactions were justifiable expenditures.

***Description of UAO Procedures***

UAO independently reviewed all the available documentation, assessed the permissible purchase card usage (as outlined by the purchase card guidelines), and similar to procedures involved with List 2, UAO applied the applicable cost justification criteria to the transactions. We also verified that LANL addressed all the transactions and applied consistent criteria in determining the cost justification. Selected items (e.g. the recliner referred to above) were physically inspected to verify their existence and use in the laboratory setting.

***UAO Conclusions***

UAO concluded that LANL addressed each of the 33 questioned items on List 3 and their review was comprehensive and thorough. After review of all available documentation, physical inspection of the purchased item in certain cases, and consideration of justification rationale, UAO concluded that \$664 was inadequately documented to support the justification for the cost's allowability, although there were no indicators of inappropriate use of the purchase card. The majority of the costs specifically questioned totaling \$2,301 were viewed as unreasonable or unnecessary to perform the contract. We further noted that while the transactions on List 3, other than the amounts questioned, were favorably resolved by LANL during this review, most initially lacked sufficient business purpose descriptions to adequately justify the purchase.

**C.3 Statements Requiring Proof of Manual Reconciliation (List 4)**

***Description of the List's Contents and Source***

The ERT identified 1,595 monthly purchase card statements totaling \$3.78 million for the period October 1, 1998 through June 30, 2002 that had not been electronically reconciled and for which LANL did not provide to the ERT proof that manual reconciliations had been performed. Manual reconciliations are required by policy for statements not electronically reconciled during the 21-day period following receipt of the statement from the bank. List 4 contains the 1,595 statements and, for each item, displays the cardholder's name, the cardholder's employee number, the date of the statement for which proof of reconciliation is required, the cardholder's division and group, the total transaction amount for the month, and the number of individual transactions included on the statement. The ERT charged LANL management to follow-up on the items to ensure that all statements were reconciled and individual purchase card transactions were authorized, properly coded and for allowable business purposes.

***Description of LANL's Review and Disposition Effort***

LANL management's efforts to resolve the items on List 4 included the following activities:

1. Reviewed the manual purchase card reconciliations that had been previously submitted to the Purchase Card Program Office. The manual reconciliation process is essentially the same as the online process, except that the manual reconciliation is performed on paper, typically using a printout of the cardholder's statement as the control document. Once the manual reconciliation is complete (including evidence of review by the designated approving official), the cardholder is required to provide a copy of the reconciliation to the Purchase Card Program Office. LANL management organized and searched the existing manual reconciliation files for cardholder statements included on List 4. When a manual reconciliation was located, it was reviewed to ensure that the cardholder name matched, the statement month, year and amount matched, there was a description of the items purchased, and the reconciliation had been approved by the cardholder's approving official. If the reconciliation met the above criteria, it was considered complete and removed from the "Statements Requiring Proof of Manual Reconciliations" list.
2. Requested documentation for all manual reconciliations that had previously been prepared but not forwarded to the Purchase Card Program Office and required that manual reconciliations be completed immediately for all statements on List 4 for which proof of manual reconciliation did not exist or could not be found. Manual reconciliations submitted were reviewed for the same criteria described above. If all the criteria were met, the reconciliation was considered complete and removed from the "Statements Requiring Proof of Manual Reconciliations" list.

LANL management has been able to locate previously submitted manual reconciliations meeting the above criteria for approximately \$2.9 million of the \$3.78 million in transactions included on the "Statements Requiring Proof of Manual Reconciliations" list. \$2.3 million of the \$2.9 million was considered adequately addressed through this process. The difference represents statements requiring expanded review because they are associated with cardholders on the sensitive names list described below.

Through February 6, 2003, LANL has been able to provide proof of manual reconciliation for an additional \$789,235 through the current reconciliation efforts. LANL management has not been able to produce reconciliations for approximately \$96,146 in transactions. Accordingly, Appendix A includes \$96,146 in questioned costs due to reconciliations with incomplete documentation. Although the absence of a reconciliation caused these statements to be classified as costs questioned as to allowability, LANL reviewed available documentation for indications of inappropriate card usage. Specifically, LANL reviewed bank statements reflecting vendor names, dates and transaction amounts, purchase card forms (transaction initiation form) incomplete or completed but unapproved reconciliations, and/or cardholders assertions that documentation could no longer be located, LANL management has indicated they

intend to continue to search for supporting documentation and the ultimate allowability of these costs will be determined in consultation with their contracting officer from DOE.

#### “Sensitive Names” List

As previously indicated, several cardholders were identified for more in-depth scrutiny of their purchase transactions. The “sensitive names” list was comprised of cardholders who were the subject of other investigatory activities or inquiry by the DOE Inspector General. LANL management has reviewed these transactions in their entirety to determine the reasonableness and business purpose of the transactions. As a result, LANL concluded that the majority of the total \$591,677 for sensitive names’ transactions were proper business purchases. Accordingly, Appendix A reflects \$579,905 as favorably resolved for List 4. LANL questioned the business purpose for transactions totaling \$1,533, a \$50 transaction considered improper (within the \$65 in Appendix A), and documentation was incomplete for transactions totaling \$8,773 (included in the \$96,146 described above). Several unreconciled statements for one “sensitive name” individual included \$1,416 in transactions that were included on List 1 and were referred to authorities. Accordingly, the amount subject to review for List 4 was reduced by this amount so as not to duplicate these transactions. Procedures identical to those enumerated above for transactions lacking complete documentation were performed. These amounts are therefore reflected on Appendix A as costs questioned as to allowability.

#### ***Description of UAO Procedures***

To verify and validate the process used by LANL management to review and dispose of the items on the “Statements Requiring Proof of Manual Reconciliation” list, we:

- evaluated LANL management’s approach and criteria used to provide proof of manual reconciliations and clear the item from the list,
- judgmentally selected a sample of reconciliations and reviewed them using the criteria applied by LANL management to determine if we agreed with management’s classification based on their stated criteria,
- scanned the sample of reconciliations for evidence that account coding had been reviewed and modified as necessary,
- judgmentally selected a sample of transactions from the reconciliations accepted by LANL and reviewed supporting documentation for completeness and to assess whether the purchase was permissible under the purchase card program rules and appeared to be allowable under the terms of the Lab’s contract with the DOE,

- confirmed the existence of a sample of purchases through physical inspection of the item,
- interviewed a sample of cardholders and approvers to assess their understanding of their roles and responsibilities and to evaluate whether purchase card usage and reconciliation practices were consistently implemented,
- reviewed the work performed in connection with the expanded scope review of “Sensitive Names” list statements and assessed the comprehensiveness of the review effort and the reasonableness of the results,
- reviewed the available documentation for those reconciliations lacking complete documentation (e.g. bank statements reflecting vendor names, dates and transaction amounts, purchase card forms (transaction initiation form) incomplete or completed but unapproved reconciliations, and/or cardholders assertions that documentation could no longer be located).

### ***UAO Conclusions***

In general, except as noted below, we concurred with the process designed by LANL management to resolve the items included on List 4 and with management’s disposition of the items, including the review of the sensitive names transactions. There were several reconciliations for which we questioned management’s initial disposition. In those instances, management either provided us with additional documentation or explanation or changed the item’s disposition. There are no outstanding disagreements on the classification of any items as to whether or not they were resolved through review of acceptable manual reconciliations.

Additionally, our detailed testing of transactions identified two purchases in the amount of \$65 that were considered fraudulent and unallowable. The transactions were registration fees for an Internet music site (MusicMaker.com) and were made by an intern who had access to the cardholder’s account number. This amount is separately displayed in Appendices A and B.

### **C.4 Disputed Items Not Credited**

#### ***Description of the List’s Contents and Source***

List 5 consisted of 513 disputed transactions, totaling \$316,648 representing disputed charges for which the ERT could not locate evidence of a corresponding credit received from the bank and processed in the purchase card system. The ability to designate a transaction as “disputed” exists for instances in which a billing discrepancy has occurred, such as failure to receive the goods or services, an error in pricing or quantity, fraudulent or altered charges, etc. However, in practice, the dispute function was found to be invoked in error or for other reasons when the cardholder wanted to draw attention to a particular circumstance surrounding a

purchase. The ERT process involved an electronic matching of disputed items with credits received from the bank. Thus only direct matches were eliminated by this process. As a result, “disputed” items for which full credit from the bank was not expected would not have been cleared and were included on the lists referred to LANL for bank review. An example of a disputed item for which full credit would not be expected would be a transaction that is disputed only for taxes, freight, a single line item or portion of the charge (e.g., incorrect pricing).

***Description of LANL’s Review and Disposition Effort***

LANL performed a number of procedures to review the transactions on List 5, including researching credits received. In many cases, the amount disputed in the system and the corresponding credit differed for reasons described above (e.g. tax or freight) or the credit was received in increments over a period of time. As stated above, these items would not have been electronically picked up as a match. LANL requested supporting documentation from employees that proved receipt of credits, reasons why the dispute function was engaged (either intentionally or in error), and the final disposition of the transaction.

LANL reviewed all available supporting documentation for both the purchase and the dispute in an effort to understand if the dispute was genuine. LANL was able to identify several users who consistently used the dispute function in error and as a result, determined that all these transactions were disputed in error. LANL also discovered that cardholders engaged the dispute function while trying to resolve the transaction discrepancies directly with the vendor. Given that the current dispute system prevents the dispute indicator from being modified, those inquiries that were settled by the cardholder with the vendor were still listed as an outstanding disputed item in the purchase card system. For those transactions not cleared by bank credit or documented alternate resolution, LANL determined the amounts to be questioned as to allowability. For transactions lacking complete documentation LANL reviewed available documentation including bank statements reflecting vendor names, dates and transaction amounts, purchase card forms (transaction initiation form), and where available, cardholders descriptions of circumstances leading to the dispute designation and the manner of and expectations for resolution.

***Description of UAO Procedures***

UAO reviewed the steps conducted by LANL to resolve the dispute discrepancies and ensured that all the dispute transactions were addressed. As part of our review, we selected a sample of credits and traced them to the cardholder’s bank statement without exception. We also selected a sample of transactions that LANL identified as having adequate documentation to justify the dispute resolution, and concluded that the dispute resolution statements were reasonable. For transactions lacking adequate support of the dispute, we reviewed available documentation as described above for the purchase and dispute looking for indications of possible improper transactions for which the dispute function may have been triggered to mask an improper purchase, paying particular attention to purchases of items of potential personal interest.

### ***UAO Conclusions***

In summary, LANL identified \$240,854, for which the dispute amount has been cleared. Specifically, this represents \$124,645 of bank credits, \$32,684 related to user error of the dispute function, and \$83,525 in which the documentation sufficiently explains the dispute resolution. The remaining \$75,794 represents either transactions that lacked complete documentation (\$42,942) or transactions for which a credit is due and has not been received (\$32,852).

UAO concurs with this categorization and concludes that until resolved, the disputed charges lacking complete documentation should be treated as costs questioned as to allowability. Our review of the available documentation (e.g. bank statements reflecting vendor names, dates and transaction amounts, purchase card forms and where available, cardholders descriptions of circumstances leading to the dispute designation) for transactions lacking complete documentation (\$42,942) identified \$24,603 which appears to be acquisitions of items of little or no likely personal interest, and \$18,339 for items which may be of personal interest and are therefore at greater risk of being inappropriate transactions. In connection with the \$32,852 for which credits are still outstanding, the review of the available documentation identified \$330 of tax or freight amounts associated with valid purchases with no personal value, \$23,892 which appears to be acquisitions of items of little or no likely personal interest, and \$8,630 for items which may be of personal interest and as indicated above, are at a greater risk of being inappropriate transactions.

## **SECTION II. Recommendations**

### **Introduction**

The primary purpose of this audit was not to evaluate policies, procedures or controls related to the purchase card program. However, in the course of our procedures we observed first hand most of the deficiencies in the purchase card program enumerated in the ERT report and confirmed those and other issues requiring management's attention. The following recommendations are intended to be additive to the ERT recommendations and LANL management's previous and planned actions, all of which we endorse.

### **General Observations**

*There are fundamental issues that must be addressed as well as the need to strengthen control activities. Without attention to these matters the ability to sustain change will be in jeopardy.*

Both the ERT report and our project identified the need for numerous improvements in control activities related to the purchase card program, including such matters as reconciliation timeliness, treatment of exceptions, consequences for failure to comply with program guidelines, disposition of disputed items and many others. While implementing or improving these controls is critical to improving the program to an acceptable level, we observed four conditions that may be even more fundamental.

First, we are informed that the procurement program overall as well as the purchase card program have suffered from heavy turnover in recent years. This may contribute to our observation that the purchase card program appears to lack "ownership", and strong, competent leadership. In recent times, certain controls that had historically been at least reasonably effective in causing manual reconciliations to be performed and desk audits to be conducted have fallen dramatically in their performance and account for a disproportionate share of the exceptions for missing manual reconciliations occurring in 2002.

Second, as the ERT report states, "The reconciliation and approval process is the most important internal control governing the Purchase Card Program". Their report and the following section of this report, make numerous recommendations for improving the reconciliation and approval processes. However, the procedures themselves cannot provide assurance that the approval process is carried out conscientiously and diligently. Our interviews with cardholders and approvers identified some who know and understanding the importance of their responsibilities and take them seriously. But we also observed and heard anecdotes about approvers who do not, and who rely on the cardholder nearly exclusively. One of the ERT recommendations is to reinstitute the practice of providing supporting documentation to approvers in support of reconciliations. While this is appropriate and will certainly assist some in performing a more thorough review, we would anticipate that the increased burden will drive some approvers further from a conscientious review. If the laboratory is indeed going to rely on the reconciliation and approval process as "the most

important control in the Purchase Card Program,” the culture must be changed to cause approvers to universally accept this concept and carry out their duties accordingly. Additional training and careful consideration of the assignment of approver’s duties is also necessary. For example, we were informed that some approvers might not have the necessary knowledge of the unit’s accounting system to effectively review for assignment of the proper account code.

Third, there are a large number of cardholders (over 700). This fact alone exacerbates the control problems, as inevitably in this situation there are cardholders with infrequent usage and therefore less familiarity with the policy and procedure requirements of the program. The same is likely true for their assigned reviewers. As a consequence, procedural error rates and manual correction efforts may be higher for these users nullifying the presumption that purchase cards produce lower transaction costs than more formal purchase methods. Use of purchase cards by buyers also elevates the number of cards in use. Most typically, purchase cards are used as a vehicle for low value purchasing at a decentralized level and not by buyers who require high transaction and cumulative limits. While undoubtedly many of the buyers’ transactions are suited to the use of a purchase card, it appears that many are not and a loss of documentation and control results. If more complex transactions still require formal documents to deal with order requirements, delivery instructions and terms etc. then it appears that the use of a purchase card is used as more of a payment option than a procurement option, and the accounts payable controls are likely better suited. The lab should strongly consider reducing the number of cards in use as a fundamental way to gain better control over this program.

Lastly, we were informed that many cardholders fail to enter the complete and proper accounting data into the system as part of the ordering process. The result is the purchase accounting data (including the item description and the proper account code) are not captured at the time a purchase transaction is executed. The reconciliation procedure at a later date requires the cardholder to complete an order record, with description, account code, and other key information. This information is then matched to a charge record from the bank. However, if the cardholder fails to “reconcile” the bank charges within 21 days, the system uses the default information for that cardholder for the accounting record. This default information provides no item description or business purpose, and uses a standard account coding assigned by the cardholder. While there are manual procedures to document the transaction, the purchasing electronic record is not updated, and the financial information is updated through journal entry, if at all. It appears that this process contributes to incomplete accounting information in the electronic files and fails to capture critical data at the appropriate time. We believe that in addition to shoring up controls around the existing purchase card system, the entire purchase card system, and its linkages to other financial processes, including the order system and property system, should be reviewed.

As part of the continued review and enhancement of the purchase card program, LANL must address these and other fundamental issues and not simply focus on control procedures.

## Reconciliation of Purchase Card Transactions to Monthly Statements

Current procedures require that cardholders match individual purchase card transactions to transactions listed on the monthly statement from the bank. Cardholders must ensure that transactions have complete and accurate descriptions and have been charged to the proper account code; if no account code is provided, the transaction is charged to the default account, generally the department overhead account. The reconciliation should be completed online within 21 days of the statement date; otherwise, a manual reconciliation, requiring the same information, must be prepared. Online and manual reconciliations must be approved by the cardholder's approving official. Completed manual reconciliations are sent to the Purchase Card Program Office for filing.

Based on our understanding of the reconciliation process, review of a sample of manual reconciliations and supporting detail for selected transactions, and interviews with a sample of cardholders and approvers, we have the following recommendations for improvement, which should be implemented by LANL as soon as possible:

- ***Train cardholders to use the procurement database*** to capture purchase card transaction detail at the time of the purchase. The procurement database can serve as the control that can be matched to the purchase card transaction detail provided by the bank. After being matched, the record can be used as the source document to the financial system.
- ***Expand the timeframe for acceptance of online reconciliations.*** The manual reconciliations are not an adequate alternative to the online reconciliations because the description data is not captured in a system and because there is no mechanism to assure that the manual cost corrections triggered by the review of account codes are processed. The failure to capture description data limits the usefulness of systematic controls and the use of the data mining techniques recommended by the ERT.
- ***Consider modifying the timing of the review process*** so card holders and approvers can review and approve purchases on a daily and/or transaction basis, rather than a monthly summary level. This provides earlier notification of purchases and allows appropriate descriptions and account codes to be assigned more timely.
- ***Require the use of a standard manual reconciliation template*** for the infrequent instances when manual reconciliations would be necessary. The one developed during this special project would be appropriate for this purpose. The template should include all the elements that would be required for an online reconciliation, including vendor name, transaction amount, description, account codes, and approver's signature. If manual reconciliations continue, the description and account code data should be captured in the purchase card system retroactively. Changes to account coding resulting from manual reconciliations should be reviewed and approved by Budget Team Leaders.

- ***Reinstitute desktop audits*** as a means of ensuring that required information has been supplied and to monitor the reasonableness and appropriateness of vendor usage, purchase descriptions, transaction amounts, etc. Results of desktop audits can be incorporated into cardholder and/or approver training modules.
- ***Develop system edits and data-mining capabilities*** to prevent and detect questionable purchasing activities, to evaluate cardholder and reviewer performance, and to develop purchasing activity information that could benefit LANL management in a variety of ways. System edits and data-mining capabilities could help to identify questionable transactions as well as cardholders and approvers who are not satisfactorily performing their responsibilities. Both monitoring and exception reporting capabilities need expanding.
- ***Consider the use of profiling techniques*** similar to those used by credit card companies to highlight possible questionable card usage. Relatively simple analysis techniques could be used to funnel into the desk review process making it more risk based. For example, an exception report could be generated listing all monthly statements that reflect abnormal card usage, e.g., X% more than or X times a rolling twelve month average usage.
- ***Make more effective use of the ability to “block” transactions, and set the default to “reject”*** so transactions are rejected unless they have been specifically allowed, and coded to a proper account. For example, this capability could be used to prevent cash advances or transactions with certain categories of vendors, such as casinos or department stores.

***Improve business justification documentation.*** In addition to the above matters related to the reconciliation process, we also observed that transaction descriptions were frequently inadequate to describe the business purpose of the transaction in addition to the nature of the item purchased. This deficiency was most noteworthy in relation to purchases of items that did not have an obvious relationship to the laboratory’s mission, such as morale fund purchases or items that could have a personal use. Cardholders and approvers should be further instructed in the need for, and types of, appropriate additional explanation for purchases that on the surface could be of questionable allowability. If necessary, expand the description field to make business justification a required data element.

### **Disputed Items**

As observed by the ERT, the current process for monitoring and tracking disputes does not assure that all disputed charges have been resolved timely with proper approval and documentation. In addition, the current system provides limited capability to document the nature of the dispute and its resolution within the system.

In connection with the implementation of the ERT recommendations, we also recommend that:

- ***Disputed items should be automatically charged-back to the bank.*** The dispute process in the purchase card system should be linked to the bank charges as provided in the bank contract. If there is a need for denoting questionable charges that require alternative forms of research and resolution before the charge is disputed, then a separate capability should be created to denote such action.
- ***Develop a capability to dispute a portion of a charge,*** rather than the entire charge. In some cases the dispute results from inaccurate pricing or quantities, inclusion of freight or sales tax in error or other reasons that do not nullify the entire transaction. In order to match the subsequent credit with the disputed amount, a capability is needed to address this situation.
- ***Improve documentation of disputed items and their disposition.*** Documentation regarding the nature of the dispute, the resolution process and ultimate disposition is severely lacking and not subject to any standards. Forms and standards for their use need development.
- ***Approvers should review and approve all disputes and their resolution.*** Currently they have no role in the dispute process and there is therefore no supervisory control.
- ***The Purchase Card Program Office should track all unresolved disputed items.*** An electronic log should be maintained and regular follow-up performed on all open disputed charges. A report should be prepared periodically for higher-level review showing an aging of open items and resolution efforts. Approval by the Purchase Card Program Office should be required to abandon efforts to obtain credit.
- ***Create a link between credits and the original transaction*** to facilitate matching. The documentation of disputed charges within the system should enable matching of disputed charges with the related credits. Currently, the credit does not have specific identifying information that links it to the disputed charge.

## **Other Matters**

The following additional comments and recommendations result from our review of the exception lists provided by the ERT to LANL management.

- ***Strengthen approvers' role in potentially sensitive transactions.*** As previously mentioned, documentation of business purpose was frequently not adequate for items that did not obviously serve the laboratory's mission, such as morale fund purchase and items that could be used for personal purposes. Techniques to identify key description words, vendors or accounts charged could be used to give higher visibility to these transactions and alert reviewers to the sensitivity of the transaction.

- *Clarify guidance for the distinction between allowable uses of morale funds and award funds.*
- *Improve procedures or develop a mechanism to ensure that fund limitations (e.g. morale and award) are not exceeded.*
- *Reinforce the requirement for DOE approval for memberships* and the use of Government Printing Office subcontractors for printing through training and clear procedural guidance (e.g. documented process for obtaining DOE approval).
- *Chronicle frequent exceptions for training purposes, and possible program amendment.* The previously mentioned exception reports and data mining exercises could be used for this purpose. Certain types of transactions, for example those with special requirements not contemplated by the purchase card process, may not lend themselves to being a permissible use of the purchase card.

### **Implementation Strategy and Follow-up**

Lastly, we recommend the establishment of an implementation strategy to address all of the purchase card recommendations from this and other sources. Such strategy should include identifying the responsible parties, short-term and longer-term deliverables and expected dates of completion.

The plan should be documented and provided to UAO so that we may schedule appropriate follow-up review activities. We would appreciate a response and documented strategy within two weeks of receipt of this report.

**LANL Purchase Card Project  
Review and Disposition Results**

**Appendix A**

	LIST 2		LIST 3		LIST 4		LIST 5		COMBINED	
	Costs Requiring Additional Clarification		Costs Requiring Additional Clarification		Statements Requiring Proof of Manual Reconciliation		Disputed Items Not Credited			
	#	Amount	#	Amount	#	Amount	#	Amount t	#	Amount
Total Referred From External Review Team	841	\$766,723	33	\$22,962	1595	\$3,782,359	513	\$316,648	2982	\$4,888,692
Less:										
-Duplicate amounts referred to authorities from ERT						(1,416)				(1,416)
-Records Destroyed by Cerro Grande Fire					(5)	(5,664)			(5)	(5,664)
Total Subject to Review	841	766,723	33	22,962	1590	3,775,279	513	316,648	2977	4,881,612
Resolved Through:										
Manual Reconciliation Located					1087	2,308,395			1087	2,308,395
Manual Reconciliation Prepared					396	789,235			396	789,235
Review of Individual Transaction Allowability Confirmed:			16	19,997					16	19,997
Definitionally	614	706,396							614	706,396
By Transaction Review	145	41,584							145	41,584
Expanded Review of										
Sensitive Names List					36	579,905			36	579,905
Credit for Dispute Received							127	124,645	127	124,645
Disputed in Error							97	32,684	97	32,684
Dispute Resolved w/o Credit							157	83,525	157	83,525
Total Favorably Resolved	759	747,980	16	19,997	1,519	3,677,535	381	240,854	2,675	4,686,366
Costs Questioned as to allowability										
Costs which appear improper						65				65
Specifically Questioned Cost From Sensitive Names List	60	11,232	14	2,301	6	1,533	89	32,852	163	46,385
Transactions Questioned (Appendix B)	60	11,232	14	2,301	6	1,598	89	32,852	6	1,533
									169	47,983
Costs w/ incomplete documentation										
Partial internal documentation	22	7,511	3	664	15	8,528	43	42,942	83	59,645
Bank statement only					50	87,618				87,618
Total (B)	22	7,511	3	664	65	96,146	43	42,942	83	147,263
Total Costs Questioned as to Allowability	82	18,743	17	2,965	71	97,744	132	75,794	252	195,246
Total Reviewed	841	\$ 766,723	33	22,962	1,590	\$3,775,279	513	\$316,648	2,927	\$4,881,612

(A) \$318 of questioned costs appear on both list 2 and 3. For the purposes of the table, they have been reflected as questioned costs only in List 3 to avoid duplication.

(B) See narrative in report for alternative procedures performed.

**LANL Purchase Card Project  
Schedule of Costs Questioned as to Allowability**

	<u>LIST 2</u> <u>Amount</u>	<u>LIST 3</u> <u>Amount</u>	<u>LIST 4</u> <u>Amount</u>	<u>LIST 5</u> <u>Amount</u>	<u>Combined</u> <u>Amount</u>
<b>I Costs Questioned as to allowability with no indication of impropriety</b>					
<b>Transactions Missing Required DOE Contracting Officer Approval:</b>					
Costs related to memberships in trade, business, and professional organizations are allowable if approved by the DOE Contracting Officer. Memberships in these organizations at LANL were to be processed and paid centrally by a specific procurement buyer. For most memberships that were procured centrally, LANL was able to document DOE approval. The balance that remains questioned were memberships that were not processed centrally and there was no documentation submitted to show that these transactions had DOE approval.	7,002				7,002
<b>Transactions that Exceed Contract Cost Ceiling Limitation:</b>					
Costs related to employee performance awards are allowable if the contract limitation is not exceeded. In FY99, LANL incurred employee performance award costs up to the limitation established in Appendix A to Contract W-7405-ENG-36. These additional employee performance awards were identified for FY99 and because the entire contract limitation had already been expensed these costs are questioned.	3,774	120			3,894
<b>Reasonableness of Transactions:</b>					
To be allowable under Contract W-7405-ENG-36 a cost must be reasonable. A cost is reasonable if, in its nature and amount, it reflects the action that a prudent person would have taken under the circumstances prevailing at the time the decision to incur the cost was made. Transactions were identified by LANL and the Auditors that did not appear to be reasonable.	456	2,181	1,533		4,170
<b>Costs Questioned as to allowability with no indication of impropriety</b>	<b>\$ 11,232</b>	<b>\$ 2,301</b>	<b>\$ 1,533</b>		<b>\$ 15,066</b>
<b>II Costs Questioned as to Allowability--Unable to Determine Propriety</b>					
<b>Credit for Disputed Transaction Not Received:</b>					
Transaction were identified where the documentation indicated the Laboratory should have received a credit for a disputed transaction. However, there was no record or documentation to verify that the Laboratory actually received the credit.				32,852	32,852
<b>Transactions Lacking Complete Documentation:</b>					
Transactions were identified where documentation was incomplete and therefore the amounts were questioned as to allowability. Alternative procedures based on available documentation were performed to assess risk of inappropriate transactions with no additional amounts identified for referral to authorities.	7,511	664	96,146	42,942	147,263
<b>Costs Questioned as to Allowability--Unable to Determine Propriety</b>	<b>\$ 7,511</b>	<b>\$ 664</b>	<b>\$ 96,146</b>	<b>\$ 75,794</b>	<b>\$ 180,115</b>
<b>III Costs which appear improper</b>					
Internet sign-up fees by intern with access to cardholder's account number, and Pet store			65		65
<b>Total Costs Questioned as to Allowability</b>	<b>\$ 18,743</b>	<b>\$ 2,965</b>	<b>\$ 97,744</b>	<b>\$ 75,794</b>	<b>\$ 195,246</b>