



ACTION REQUIRED

Date: September 27, 2017
To: TTC Audit & Risk Management Committee
From: Auditor General
Subject: Auditor General's Report – Review of Toronto Transit Commission Accounts Payable Functions: Improving Invoice Verification and Vendor Account Management

Attached is the Subject Report.

The report is being forwarded to the TTC Audit and Risk Management Committee for review and consideration, and forwarding to the next TTC Board meeting.

Original signed by Kevin Lee

Head of Commission Services

Attachment: Auditor General's Report – Review of Toronto Transit Commission Accounts Payable Functions: Improving Invoice Verification and Vendor Account Management

Review of Toronto Transit Commission Accounts Payable Functions: Improving Invoice Verification and Vendor Account Management

Date: September 15, 2017

To: Toronto Transit Commission Audit and Risk Management Committee

From: Auditor General

Wards: All

SUMMARY

This is the Auditor General's first review of the Toronto Transit Commission's (TTC) accounts payable functions. TTC procures approximately \$1.2 billion worth of goods and services each year for day-to-day operations. The TTC's Accounts Payable Unit ("Accounts Payable") processes invoices and issues payments to vendors.

The objective of our audit was to assess whether there were adequate controls in the payment process. The audit included a review of vendor payments during the period from January 2014 to June 2016.

Overall, we found Accounts Payable ensured that invoices had proper user department authorization prior to processing payments. Our key concerns relate to invoice verification by user departments prior to payment, and the management of vendor accounts by Accounts Payable.

The TTC needs to put in place adequate controls and procedures to ensure invoices are adequately verified by user department staff prior to payment authorization. Based on a conservative estimate, ensuring adequate invoice verification could result in at least \$1 million in annual savings.

To minimize the risk of issuing payments to incorrect vendors or duplicating payments to the same vendors, the TTC needs to maintain an accurate Vendor Master File. As of June 30, 2016, there were 39,648 vendors in the Vendor Master File, 87 per cent of which were stale accounts with no business activity with the TTC over the past four years.

Our audit provides nine recommendations. The implementation of these recommendations will help improve invoice verification, management of vendor accounts, and access controls.

RECOMMENDATIONS

The Auditor General recommends that:

1. The Board request the Chief Executive Officer, Toronto Transit Commission, to review the results of the sampled invoices and potential overpayments identified by the Auditor General in this report, assess whether additional overpayments exist in other related invoices from the same vendors, and recover the overpayments from the vendors where appropriate.

2. The Board request the Chief Executive Officer, Toronto Transit Commission, to enhance the existing invoice verification processes to provide reasonable assurance that invoices are paid according to the contract terms and prices. Consideration should be given to:

a. Provide guidelines and training to user department approvers on the importance of invoice verification and the specific information that should be reviewed prior to invoice approval.

b. Incorporate monitoring measures to verify, at least on a sample basis, that the approved invoices by user departments have been adequately reviewed to be consistent with contract terms and prices.

3. The Board request the Chief Executive Officer, Toronto Transit Commission, to maintain a reasonably accurate and complete Vendor Master File to minimize the risk of duplicate or incorrect payments to vendors. Steps to be undertaken should include, but not be limited to:

a. Conduct a one-time comprehensive review of vendor accounts to purge the large number of duplicate and inactive accounts.

b. Implement adequate system functionalities to enable staff to update vendor account records in the system.

c. Periodically review the vendor account records to ensure the required information is obtained and accurately entered into the system.

d. Ensure staff responsible for creating vendor accounts or maintaining the Vendor Master File are provided with an updated and comprehensive procedure manual outlining the key information requirements and processes.

4. The Board request the Chief Executive Officer, Toronto Transit Commission, to ensure conflicts of interest are properly managed. Such steps should include, but not be limited to:

a. Ensure employee vendor match is conducted on an annual basis.

- b. Provide training and reminders to the appropriate staff to reinforce the importance of disclosing actual and perceived conflicts of interest.
 - c. Hold employees who fail to disclose potential conflicts of interest accountable.
5. The Board request the Chief Executive Officer, Toronto Transit Commission, to review the current payment process and identify opportunities to further reduce the number of late payments and to take advantage of early payment discounts.
6. The Board request the Chief Executive Officer, Toronto Transit Commission, to review and enhance current cheque request policies to ensure adequate use of cheque requests by staff. Steps should be taken, but not be limited, to:
- a. Clearly define the items that can be procured using cheque requests.
 - b. Regularly review and identify repeated cheque request purchases that should have been procured using Purchase Orders or Blanket Contracts.
 - c. Clarify the monitoring measures and responsible departments in the policy.
7. The Board request the Chief Executive Officer, Toronto Transit Commission, to review and update Supplier Information Management System (SIMS) and Industrial Financial System (IFS) user access rights and privileges periodically to ensure adequate segregation of duties and access controls.
8. The Board request the Chief Executive Officer, Toronto Transit Commission, to continue its effort to increase the use of Electronic Fund Transfer for vendor payments, in particular for vendors who receive multiple payments from the agency per month.
9. The Board request the Chief Executive Officer, Toronto Transit Commission, to identify opportunities to further improve the efficiency of the duplicate payment identification and verification process.
10. The Board forward this report to City Council for information through the City's Audit Committee.

FINANCIAL IMPACT

Based on a review of 41 randomly selected invoices, we identified potential overcharges on nine invoices totalling \$5,144. To determine whether the overcharges also existed in other invoices from the same vendors, we reviewed 14 additional invoices and identified potential overcharges in the range of \$17,000 from one vendor and \$1,000 from another vendor. These overpayments, potentially \$23,000 in total, should be immediately reviewed and recovered by the TTC where feasible.

Among the 41 randomly selected invoices (totalling \$143,375), nine invoices were found to contain billing errors or questionable charges that were not identified by staff prior to invoice approval. The potential overcharges from these nine invoices totalled \$5,144, representing 3.6 per cent of the total invoiced amount. Applying this error rate to the \$80

million yearly payments for invoices under \$50,000, the overcharged amount could be as high as \$2.8 million per year.

Based on the above analysis and using a conservative estimate, the TTC can potentially reduce its day-to-day purchase costs by at least \$1 million per year by ensuring an adequate and thorough review and verification of charges on invoices.

Furthermore, as the TTC's 2016 early payment discount capture rate was approximately 75 per cent, there is room for improvement. If the TTC can improve its capture rate to 90 per cent, it could potentially increase its early payment discount by \$100,000 per year.

We analysed payments processed between January 2014 and June 2016 and identified nine duplicate payments totalling approximately \$6,000 in overpayments to vendors.

Implementing other audit recommendations will help improve controls over vendor account management, system access controls, and electronic fund transfers. These will potentially result in future cost savings, but the amount is not determinable at this time.

DECISION HISTORY

In response to the additional funding from the City Council and consideration of risks and priorities in TTC operations, the Auditor General updated her 2016 and 2017 TTC audit work plan, and submitted an updated work plan report to the TTC Audit and Risk Management Committee and the TTC Board in May 2016. The report can be accessed at:

https://www.ttc.ca/About_the_TTC/Commission_reports_and_information/Commission_meetings/2016/May_31/Reports/7_AG_Report_-_TTCV_Updated_Audit_Work_Plan_for_2016_and_2017.pdf

The Auditor General's 2016 Audit Work Plan included a review of the TTC's Accounts Payable operations administered by the Finance department.

COMMENTS

The TTC's Accounts Payable Unit is responsible for processing invoices and issuing payments to vendors. During the past three years (2014-2016), Accounts Payable processed approximately 74,000 invoices totalling \$2 billion in vendor payments each year. The objective of our audit was to assess whether there were adequate controls in the payment process. We focused on a type of purchase that requires department staff verification. About \$279 million in payments were issued under this type of purchase.

Overall we found that Accounts Payable ensured that invoices had proper user department authorization prior to processing payments. Our key concerns relate to invoice verification by user departments prior to payment, and the management of vendor accounts by Accounts Payable.

We selected and reviewed a random sample of 41 invoices processed between January 2015 and June 2016. Among them, nine invoices were found to contain billing errors or questionable charges that were not identified by staff prior to invoice approval. By ensuring adequate and thorough review and verification of charges on invoices, TTC can potentially reduce its day-to-day purchase costs by at least \$1 million per year. Departmental staff responsible for invoice review should be provided with the necessary training and be held accountable for their work.

To ensure payments are sent to the correct vendors, TTC needs to maintain an accurate Vendor Master File that contains important information such as vendor names, addresses, contact information, GST/HST and business registration numbers. As of June 30, 2016, there were 39,648 vendors in the Vendor Master File, 87 per cent of which were stale accounts with no business activity with the TTC over the past four years. As well, a considerable number of the accounts had missing information such as phone numbers, specific addresses, or GST/HST numbers.

The audit report is attached as Attachment 1. Management responses to audit recommendations are also included in the Attachment.

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SIGNATURE



Beverly Romeo-Beehler
Auditor General

ATTACHMENTS

Attachment 1: Auditor General's Report, Review of Toronto Transit Commission Accounts Payable Functions: Improving Invoice Verification and Vendor Account Management

**AUDIT
AT A GLANCE****WHY THIS AUDIT MATTERS**

The TTC's Accounts Payable Unit processed approximately 74,000 invoices totalling \$2 billion each year. Of the \$2 billion in payments in 2016, \$1.2 billion were for day-to-day operations. The objective of this audit was to assess whether there were adequate controls in the payment process. We focused on a type of purchase that requires department staff verification. About \$279 million in payments were issued under this type of purchase.

BACKGROUND

TTC Accounts Payable processes invoices and pays vendors. Vendors send their invoices to Accounts Payable, where staff identify the user department, indicate the purchase order number on the invoice, and forward the invoice to the appropriate department for approval. Departmental staff should ensure that the items received and the invoiced amounts match those set out in the Purchase Orders prior to payment authorization.

BY THE NUMBERS

- \$2 billion in payments are processed by TTC Accounts Payable each year
- 9 of the 41 sampled invoices contain incorrect charges or prices higher than the agreed prices
- \$23,000 in potential overpayments identified in 9 original samples, and additional samples from the same vendors also had problematic invoices
- \$2.8 million – estimated annual overcharged amount based on an analysis of sample results
- Projected savings of at least \$1 million annually if staff adequately verify invoices
- \$100,000 in annual savings by increasing early payment discount capture rate from 75% to 90%

Review of Toronto Transit Commission (TTC) Accounts Payable Functions - Improving Invoice Verification and Vendor Account Management**What we found****Areas where Accounts Payable performed well:**

- Ensured invoices had proper user department authorization prior to processing payments.
- Made efforts to increase payments via Electronic Fund Transfer, which is a more efficient payment method than cheques.
- Have put in place a process to identify duplicate payments, but there could be room to improve the efficiency of the manual process used to verify duplicate payments.

Areas that need improvement:

- Invoices were not thoroughly reviewed by departmental staff to identify questionable charges and billing errors.
 - In a random sample of 41 invoices, we found that nine had billing errors or questionable charges that were not identified by departmental staff prior to approving the invoices. For example:
 - TTC was billed for the weight of motor oil plus the container, but it should only pay for the net weight of the motor oil (potential \$1,460 overcharge).
 - A vendor erroneously sent a wheelchair monthly rental invoice belonging to another customer to TTC, but the invoice was approved by TTC staff (\$426 incorrect charge).
 - Other invoices submitted by vendors had similar billing errors or overpayments.
- Inactive vendor accounts were not deactivated in a timely manner. As of June 30, 2016, there were 39,648 vendors in TTC's Vendor Master File, 87 per cent of which were stale accounts with no business activity with the TTC over the past four years.
- As of June 2016, approximately 1,600 invoices totalling \$18 million were overdue for more than 30 days. Among them, 559 were overdue for over 90 days. Aside from missing opportunity to benefit from early payment discounts, delays in payments may inadvertently deter potential vendors.
- Lack of adequate access controls to payment and vendor account systems:
 - 12 staff members' system access had potential issues in the segregation of duties.
 - 9 student interns or temporary workers who had left the TTC continued to have system access.
 - 3 staff members continued to have system access even though they had left the department 12 months before.

How Recommendations will Benefit the City

Implementing the nine audit recommendations will help improve invoice verification, management of vendor accounts, and access controls. Ensuring adequate invoice verification by department staff can potentially result in at least \$1 million in annual savings. Maximizing early payment discounts could save about \$100,000 per year.

AUDITOR GENERAL'S REPORT

Review of Toronto Transit Commission Accounts Payable Functions:

Improving Invoice Verification and Vendor Account Management

September 15, 2017

Beverly Romeo-Beehler, CPA, CMA, B.B.A., JD, ICD.D, CFF
Auditor General



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EXECUTIVE SUMMARY

\$2 billion dollars in annual spending on goods and services

The Toronto Transit Commission (TTC) pays over two billion dollars annually through its Accounts Payable Unit for goods and services for operating and capital needs. Of the two billion in payments made in 2016, \$0.8 billion was for payments for capital projects, and the remaining \$1.2 billion in payments were for day-to-day operations.

The objective of our audit was to assess whether there were adequate controls in the payment process. The audit included a review of vendor payments during the period from January 2014 to June 2016.

Payments processed through progress billings relating to construction projects, purchasing cards (PCards), and employee reimbursements were not included in the scope of this audit.

Accounts Payable staff ensured invoices were properly authorized prior to processing payments

Overall we found that Accounts Payable ensured that invoices had proper user department authorization prior to processing payments. Accounts Payable has made efforts to increase payments via Electronic Fund Transfer, which is a more efficient means of payment method than cheques. Our analysis identified very few duplicate payments, but there could be room for improving the efficiency of the manual process used to verify duplicate payments.

Our key concerns relate to invoice verification by user departments prior to payment, and the management of vendor accounts by Accounts Payable.

Ensuring Adequate Invoice Verification Prior to Payment

Audit focused on payments made under Purchase Orders with an Upset Limit; \$279 million in payments in 2016

To assess whether invoices were adequately verified before payments, we focused our review on a type of purchase order called "Purchase Orders with an Upset Limit". Approximately \$279 million in payments were issued under this type of Purchase Order in 2016.

User department staff are responsible for invoice verification prior to payment processing by Accounts Payable

Goods/services procured using this type of Purchase Order are usually non-stock items delivered directly to user departments. User department staff are responsible for invoice verification to ensure the items received and the invoice amounts conform to the terms in the Purchase Order. The approved invoices are then forwarded to Accounts Payable for processing payments.

We reviewed a random sample of 41 invoices

We selected and reviewed a random sample of 41 invoices processed between January 2015 and June 2016. Among them, nine invoices were found to contain billing errors or questionable charges that were not identified by staff prior to invoice approval. For example:

- TTC was billed for the weight of motor oil plus the container, but it should only pay for the net weight of the motor oil, according to the Purchase Order (potential \$1,460 overcharge).
- TTC was billed for a replacement part for a rental forklift even though the monthly rental fee included insurance for damage (potential \$2,687 overcharge).
- A vendor erroneously sent a wheelchair monthly rental invoice belonging to another customer to TTC, but the invoice was approved by TTC staff (\$426 incorrect charge).
- In three cases, the vendors included shipping fees in their invoices even though the sellers should be responsible for such charges, according to the Purchase Orders (potential \$95 in overcharges).

Based on the 41 randomly sampled invoices, the potential overcharged amount could be as high as \$2.8 million per year

The overcharges from the nine invoices amount to \$5,144, representing 3.6 per cent of the total \$143,375 invoice value from the 41 samples. The dollar value of each individual overcharge is small, but multiplying the payment verification error rate by hundreds and thousands of invoices paid by TTC each year makes the impact of the overcharges significant. Based on our analysis, the potential overcharged amount could be as high as \$2.8 million per year.

TTC could save at least \$1 million by adequately verifying invoices

Based on the above analysis, it is safe to say that TTC can potentially reduce its day-to-day purchase costs by at least \$1 million per year by ensuring an adequate and thorough review and verification of charges on invoices. Departmental staff responsible for invoice review should be provided with the necessary training and be held accountable for their work.

5 sampled invoices included purchases outside of the Purchase Orders

In addition, in five of the sampled invoices (one of which also has an overcharge issue, as discussed above) the billing items were similar to, but not exactly, the specific items listed in the Purchase Orders. For instance, the Purchase Order was for purchasing refurbished electric motors, but the purchase on the invoice was for a new motor. These instances might be due to last-minute operational needs where staff found it easier to use an existing Purchase Order instead of making a new purchasing request.

Increased risks of inappropriate purchases and non-competitive pricing when procuring goods without proper purchasing documents

Nonetheless, purchasing goods or services that are not specified in Purchase Orders exposes the TTC to risks including:

- The quantity and specific items purchased may not be appropriate, and
- TTC may not be obtaining the best prices.

Improving Management of Vendor Accounts

An accurate Vendor File minimizes duplicate and incorrect payments to vendors

To ensure payments are sent to the correct vendors, TTC needs to maintain an accurate Vendor Master File that contains important information such as vendor names, addresses, contact information, GST/HST and business registration numbers.

87% of vendor accounts were inactive

As of June 30, 2016, there were 39,648 vendors in the Vendor Master File, 87 per cent of which were stale accounts with no business activity with the TTC over the past four years. Of the remaining 13 per cent (5,181) of active accounts, 248 appeared to be duplications with similar addresses or business names. As well, a considerable number of the accounts had missing information such as phone numbers, specific addresses, or GST/HST numbers.

Many accounts were missing basic contact information and GST/HST numbers

It is important for TTC to maintain a reasonably accurate Vendor File to minimize the risk of issuing payments to incorrect vendors or duplicating payments to the same vendors.

Managing Potential Conflicts of Interest

Important to identify potential conflicts of interest between employees and vendors

TTC policy requires employees and vendors to make a timely and full disclosure of any actual or potential conflicts of interest prior to, or during, the course of employment or business. All vendors have to sign a conflict of interest form during the bidding process. Accounts Payable staff are required to conduct an employee and vendor match on an annual basis. However, staff did not conduct the required match in 2015 and conducted a match in December 2016 during our audit.

Based on our review, we identified two instances of potential conflicts of interest arising from family relationships between the employees and vendors. TTC staff replied that both instances had been identified in their December 2016 match and none of them constituted any potential conflict. In our view, these employees should at the very least have declared their potential conflicts with the vendors, particularly as both employees were in director or acting director positions.

Maximizing Early Payment Discounts and Ensuring Timely Payments

1,600 invoices totalling \$18 million in payments were overdue for more than 30 days

Some vendors offer early payment discounts between one and three per cent if they receive payment less than 30 days from the invoice issuance date (i.e. 'net 30'). According to TTC's Invoice Aging Report, as of June 2016, approximately 1,600 invoices totalling \$18 million have been overdue for more than 30 days. Among the 1,600 overdue payments, 559 (34 per cent) had been overdue for over 90 days.

While TTC has not paid any interest on the overdue payments, delayed payments result in the loss of the early payment discount. Aside from the financial loss, delays in payments may affect TTC's reputation and inadvertently deter potential vendors from conducting business with the agency.

Currently 75% early payment discount capture rate

As TTC's 2016 early payment discount capture rate was approximately 75 per cent, there is room for improvement. If the TTC can improve its capture rate to 90 per cent, it could potentially increase its early payment discount by \$100,000 per year.

Ensuring Adequate Segregation of Duties and Access Controls

The TTC relies on two information systems to manage its vendor accounts and payments to vendors. Sound segregation of duties and access controls are key to minimizing the risk of making payments to fictitious, ineligible or inactive vendors.

12 staff members were found to have potential issues in segregation of duties

From our review of staff duties and access controls, we identified potential issues in the segregation of duties among 12 staff members. Moreover, we noted 14 inactive users whose system access should be re-assessed or terminated. In response to our findings, staff reported they have made the necessary changes.

Tightening Controls over Cheque Requests

\$700 million in cheque payments in 2016

According to TTC's policies, certain goods or services can be procured without a Purchase Order using Cheque Requests. These are normally payments for external training, utilities, government payments, and petty cash replenishment. In 2016, payments approved through Cheque Requests amounted to \$700 million.

Some cheque payments do not fall under TTC policies and should have been procured through purchase orders

About 95 per cent of \$700 million in cheque requests were for regular cheque items listed in the Policies. Based on a review of the cheque payments from January 2014 to June 2016, a number of cheque payments appeared to be for repetitive purchases from the same vendors when they should have been procured through Purchase Orders. These include repeated payments to law firms and doctors, and forensic and advertising companies.

Cheque requests are essentially sole-sourced purchases without the need for justification. As such, the use of Cheque Requests should be limited to the types of purchases specified in the TTC Cheque Request policies. There was no competitive process (such as requests for quotes from more than one vendor) involved in Cheque Requests to ensure TTC is getting the best prices.

Conclusion

TTC procures approximately \$1.2 billion worth of goods and services each year for day-to-day operations. TTC needs to put in place adequate controls and procedures to ensure invoices are properly verified and payments are processed in a timely manner.

9 recommendations to help improve the payment and vendor management process

Our audit provides nine recommendations to help improve invoice verification, management of vendor accounts, and access controls. Ensuring adequate invoice verification by department staff can potentially result in at least \$1 million in annual savings. Maximizing early payment discounts could save about \$100,000 per year.

We express our appreciation for the co-operation and assistance we received from management and staff of the TTC Finance Department and the Materials and Procurement Department.

BACKGROUND

The TTC's Accounts Payable Unit ("Accounts Payable") within the Finance Department is responsible for processing invoices and issuing payments to vendors. Accounts Payable has 17 staff members and one supervisor who reports to a Finance Department Director.

Over \$2 billion in payments were processed by Accounts Payable each year

As shown in Table 1, during the past three years (2014-2016), Accounts Payable processed approximately 74,000 invoices totalling \$2 billion in vendor payments each year.

Table 1: Number of Payments and Total Yearly Payment Amount Processed by TTC Accounts Payable, 2014-2016

Year	Number of Payments Processed	Payment Amount (in millions)
2014	74,578	\$2,033
2015	75,223	\$2,193
2016	73,158	\$2,040

Over 40 per cent of the yearly payments were for capital projects. For instance, of the \$2 billion in payments in 2016, \$0.8 billion was for progress billings for capital projects, and the remaining \$1.2 billion in payments were for day-to-day operations.

This audit focused on the day-to-day operational payments. Payments processed through progress billings relating to construction projects, purchasing cards (PCards), and employee reimbursements were not included in the scope of this audit.

Table 2 provides a breakdown of the various types of day-to-day operational payments in 2015 and 2016 and the payment verification method (either Three-Way or Two-Way Match).

Table 2: Breakdown of 2016 and 2015 payments by contract type, excluding progress payments (in millions)

Contract type	2016	2015
Purchase order with upset limit (2-way match)	\$279 (24%)	\$249 (20%)
Blank order (3-way match)	\$188 (16%)	\$191 (15%)
Purchase order (2-way match)	\$19 (2%)	\$20 (2%)
Non-Purchase order (2-way match)	\$674 (58%)	\$810 (63%)
Total	\$1,160 (100%)	\$1,270 100%

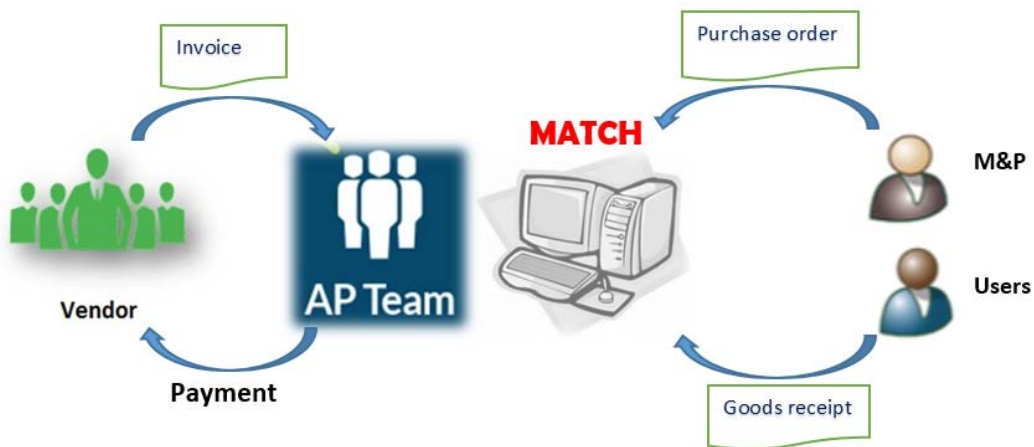
Both Two-Way and Three-Way match are used in the payment process

Prior to payment approval, invoices should be verified by TTC staff using either the Three-Way Match or the Two-Way Match process as illustrated below:

Three-Way Match

Figure 1 depicts a Three-Way Match payment verification process whereby the purchase information (e.g. prices and quantities ordered) is entered into a payment system. This allows staff to compare the invoice amount against the purchase order and goods receipt. If there is any discrepancy, payment will not be processed until it has been resolved. Invoices for goods procured using Blanket Contracts are verified by staff using the Three-Way Match process. The majority of these goods are shipped directly to the Materials and Procurement Department (M&P) for payment verification.

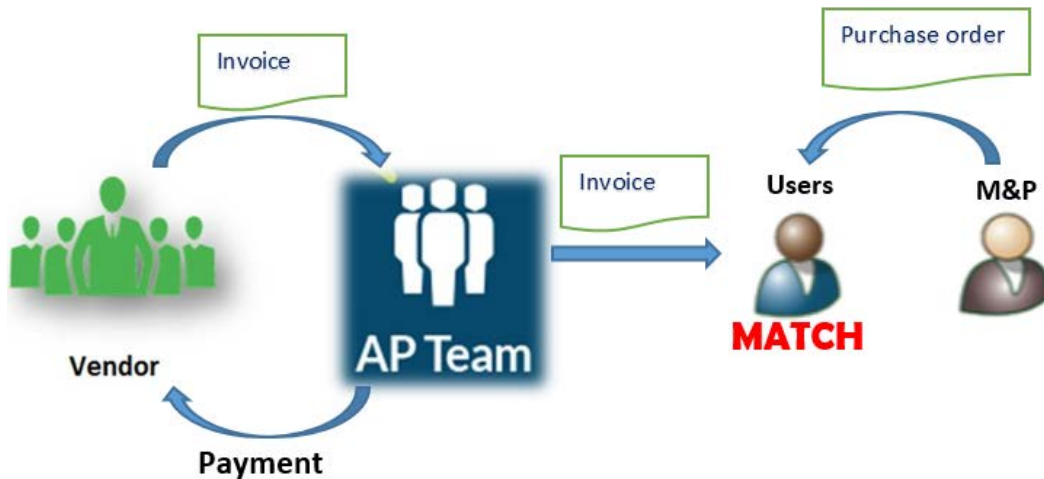
Figure 1: Three-Way Match Payment Verification Process



Two-Way Match

In a Two-Way Match process (Figure 2), user department staff match the information on an invoice with the purchase order before payment is authorized. A review of the goods receipt is not required. Most of these are recurring purchases for office supplies, internet fee, synthetic oil and other regular vehicle replacement parts. The products are delivered directly to the user departments. A designated staff member is responsible for verifying the charges on invoices. Cheque Requests for non-Purchase Order payments are also paid through the Two-Way matching process.

Figure 2: Two-Way Match Payment Verification Process



Payment controls audit by TTC's Audit Department

TTC's own internal audit report on payment controls

The TTC's own Audit Department conducted an audit on payment controls in 2015. In its May 2016 Quarterly Update public report to the TTC Audit and Risk Management Committee, TTC Audit staff highlighted "Some Actions Required" pertaining to the areas of Master Vendor Files, Invoice Processing, and Process Efficiency. During our 2017 audit, we noted that a number of the internal audit recommendations had not been fully implemented and the issues continued to exist.

AUDIT RESULTS

A. ENSURING INVOICES ARE FULLY VERIFIED PRIOR TO PAYMENT

All TTC vendors are directed to send their invoices to Accounts Payable where staff identify the user department, indicate the purchase order number on the invoice, and forward the invoice to the appropriate department for approval.

User department staff are responsible for reviewing invoices

Departmental staff are responsible for ensuring that the items received and the invoiced amounts conform to those set out in the Purchase Orders. The staff should:

- confirm the receipt of goods and services,
- verify that the price and items on the invoice are correct,
- sign the invoice, and
- send the approved invoice to Accounts Payable for processing payment.

Accounts Payable staff, after receiving the approved invoice, are responsible for ensuring that the invoice has not been previously paid and the approving staff has the appropriate level of authority.

A.1. Overcharges Were Noted in Sampled Invoices

41 randomly selected invoices were reviewed and used to project potential savings

To assess whether the invoices were adequately reviewed and verified prior to payments, we selected and reviewed a total of 55 invoices for goods or services procured using Purchase Orders with an Upset Limit over an 18-month period (January 1, 2015 to June 30, 2016). These invoices should undergo the Two-Way match verification process before payment, and are mostly for small dollar and recurring purchases.

Of these 55 invoices, 41 were randomly selected and 14 were judgmentally selected to determine if the same billing error occurred in other invoices from the same vendor. Our extrapolation on potential savings is based on our review results of the 41 randomly selected invoices.

All of the sampled invoices were approved for payment by various TTC departments. The value of the 41 sampled invoices totalled \$143,375.

13 out of 41 samples were not accurately verified before payment

Our review found that 13 of the 41 approved invoices were not accurately verified before payment:

- In nine invoices, the amounts billed by vendors were either incorrect or higher than the agreed prices in the Purchase Orders. A brief explanation of our findings is provided in Table 3, followed by further explanations for four invoices as examples.
- One of the nine invoices and four additional invoices (total 5 invoices) contain billing items that were not included in the Purchase Orders, but the invoices were approved by user department staff without question. Table 4 lists the purchase information of these 5 invoices.

Table 3: Sampled Invoices Showing Incorrect Billing or Potential Overcharges

No	What should be charged according to the Purchase Order (PO)	PO amount	What was charged on the invoice	Invoice amount	Potential Over-charges
1	Synthetic oil based on net volume	\$6,441	Weight of synthetic oil including the weight of the container	\$7,901	\$1,460
2	Cost of a replacement part for a rental forklift should be waived as the monthly rental fee included insurance on damage and theft	\$0	Charge for replacement cost of a damaged fork bar	\$2,687	\$2,687
3	No additional shipping charge for annual magazine subscription	\$0	Additional shipping charge	\$14	\$14
4	Invoice for a wheelchair monthly rental fee was incorrectly billed to TTC	\$0	Charge for wheelchair and accessories rental	\$426	\$426
5	Monthly Internet fee	\$1,600	Overcharged on monthly fee	\$1,925	\$325
6	Monthly support charges for a copy machine	\$70	Overcharged on monthly fee	\$75	\$5
7	Supply of different shop tools charged at cost plus percentage including shipping charge	\$4,348 \$0 (shipping)	Scissor lift overcharged on mark-up price and additional shipping charge	\$4,448 \$50 (shipping)	\$100 \$50 (shipping)
8	Professional photography service including mileage fee	\$0	Additional mileage fee	\$31	\$31
9	Supply of different vehicle parts from a specific OEM brand charged at cost plus percentage	\$171	Vehicle parts overcharged on mark-up price	\$217	\$46
	Subtotal	\$12,630	Subtotal	\$17,774	\$5,144

A more detailed explanation of sample invoice No.1 to 4 and additional sample test results are provided below:

Sample Invoice No.1

Product weight was incorrectly calculated and added to the invoice

The vendor included the weight of a container in the billing amount, but according to the contract, TTC should only pay for the net weight of motor oil. As a result, the invoice amount was 23 per cent higher than the contract amount (\$7,901 instead of 6,441).

To determine whether the same billing error occurred in other invoices from the same vendor, we reviewed five additional invoices issued in 2015 and 2016 from the same vendor, and found the same billing error on two of the five invoices. Of the remaining three invoices, two included products that were not specified in the Purchase Order.

All of the five additional sampled invoices were approved for payment by user department staff without question.

Potential overcharges from previous invoices could be in the range of \$17,000

Over the past 3.5 years (January 2013-June 2016), TTC paid approximately \$175,000 to this vendor. Based on the billing error rate (approximately 10 per cent) in the total six invoices reviewed, the potential overpayment to this vendor could be in the range of \$17,000.

TTC staff have contacted the vendor and are in the process of reviewing all the invoices to determine the exact overpayment amount to be recovered.

Sample Invoice No. 2

No clarification with vendor to assess whether the charge was consistent with the purchase order

Under a Purchase Order for a forklift rental, the monthly rental fee included an insurance fee to cover theft, damage and collision during the rental period. Yet in 2016, the vendor billed the TTC for \$2,687 for replacing a damaged part. Staff approved payment for the invoice without question.

In response to our inquiry about this invoice, TTC Accounts Payable staff indicated that the staff originally involved in setting up the rental was no longer with the project, and that the replacement cost was likely due to long-term use of the equipment and would not be eligible as "an insurable event".

In our view, since the Purchase Order and monthly invoice clearly include a monthly insurance fee paid by the TTC, staff should have at least clarified with the vendor the rationale for the charge prior to payment approval.

Sample Invoice No.3

Freight charges were incorrectly added to the invoice

In a Purchase Order for legal publications, the terms of delivery specified as "Freight incl. in Price – FOB Dest", means the shipping cost should be included in the price charged. However, we noted in a 2014 invoice (paid in 2015) that the vendor billed the TTC a separate shipping fee of \$13.50. We reviewed an additional 2016 invoice and found similar shipping fee charge for \$14. Based on the total invoice amounts between 2014 and 2016, the overcharges for shipping fees are estimated in the range of \$1,000. We have advised staff to review all the invoices from this vendor to determine and recover the total overcharged amount.

Sample Invoice No.4

Paid for invoices that did not belong to TTC

TTC paid for an invoice of \$426 for a monthly rental fee for a wheelchair and accessories in 2015. We noted on the invoice that the wheelchair was to be delivered to a non-TTC address. In response to our query, TTC staff replied that they paid for an invoice that was meant for another customer, and were in the process of requesting a credit from the vendor. It would appear that the vendor incorrectly billed the TTC for a wheelchair rental ordered by another customer, and TTC staff approved the invoice and processed the payment without noticing the incorrect billing.

Among the above nine sampled invoices with billing issues, we noted that in three instances (Sample No. 3, 7 and 8), shipping or mileage charges were added to the invoices even though the Purchase Orders clearly indicate that sellers are responsible for such charges.

5 out of 41 samples included items not listed in the purchase orders

In addition to charging prices higher than the contract prices, we noted in five sampled invoices, the billing items were similar to, but not exactly, the specific items listed in the Purchase Orders. One of the five invoices also had the billing issue that was discussed in the previous section.

Table 4 lists the five sampled invoices.

Table 4: Sampled Invoices with Unauthorized Purchases

	What should be purchased under the Purchase Order	What was purchased and billed on the invoice	Invoice amount
1	Refurbished electric motor	New motor	\$299
2	Supply of a list of specific occupational hygiene tests	Rare hygiene test not on the list	\$885
3	Supply of specific lawn mower and snow blower parts	Starter rope not on the Purchase Order list	\$73
4	Supply of vehicle parts and accessories from a specific OEM brand (same invoice as Table 3 Sample 9)	Vehicle part not from the same brand	\$530
5	Three consultants hired to develop a program	Different consultant hired	\$95
		Subtotal	\$1,882

We recognize that these could be due to last-minute operational needs where staff found it easier to use an existing Purchase Order instead of making a new purchase request.

Nonetheless, purchasing goods or services that are not specified in Purchase Orders exposes the TTC to risks such as:

- The quantity and specific items purchased may not be appropriate, and
- TTC may not be getting the best prices.

Immediate cost recovery from overcharges

Total \$23,000 in potential overpayments were identified from a sample review

Based on a review of 41 randomly selected invoices, we identified potential overcharges on nine invoices totalling \$5,144 (Table 3). To determine whether the overcharges also existed in other invoices from the same vendors, we reviewed 14 additional invoices and identified potential overcharges in the range of \$17,000 from one vendor and \$1,000 from another vendor. These overpayments, potentially \$23,000 in total, should be immediately reviewed and recovered by TTC where feasible.

Potential future cost savings from adequate payment verification

Since 95 per cent of yearly invoices to the TTC are less than \$50,000 in purchase value, all of our 41 original samples were expectedly less than \$50,000 each. In 2016, payments for invoices under \$50,000 totalled approximately \$80 million (29 per cent of total \$279 million in purchases through Purchase Orders with Upset Limit in 2016).

Based on the 41 randomly sampled invoices, the annual overcharged amount could be as high as \$2.8 million

Among the 41 randomly selected invoices (totalling \$143,375), nine invoices were found to contain billing errors or questionable charges that were not identified by staff prior to invoice approval. The potential overcharges from the nine invoices totalled \$5,144, representing 3.6 per cent of the total invoiced amount. Extending this to the \$80 million yearly payments for invoices under \$50,000, the overcharged amount could be as high as \$2.8 million per year.

At least \$1 million annual savings by adequately verifying invoices

Based on the above analysis, it is safe to say that TTC can potentially reduce its day-to-day purchase costs by at least \$1 million per year by ensuring adequate and thorough review and verification of charges on invoices.

Recommendation:

- 1. The Board request the Chief Executive Officer, Toronto Transit Commission, to review the results of the sampled invoices and potential overpayments identified by the Auditor General in this report, assess whether additional overpayments exist in other related invoices from the same vendors, and recover the overpayments from the vendors where appropriate.**

A.2. Areas Where TTC Can Strengthen its Payment Verification Process

Of the invoices we reviewed, the lack of adequate payment verification appeared to be across all departments rather than in only a few isolated departments.

Invoice verification was not considered by staff as a work priority

In our review of payment approval process and discussion with staff, it appeared that many user department staff did not consider the function of invoice verification a work priority. In a few instances, staff did not even have the contract documents on hand when we requested a copy of the contracts.

Our review identified improvement needs in staff training and monitoring

Moreover, one of the invoice verification problems may stem from the lack of training to user department approvers to ensure they understand the importance of their roles in invoice verification and that they have the accurate understanding of the different terms and conditions in contracts.

Additional monitoring controls, such as spot checking a number of approved invoices by Accounts Payable staff, should also be in place to detect potential overpayments and identify training needs.

2015 internal audit report also identified invoice verification issues

The 2015 TTC internal audit report identified similar invoice verification issues, and recommended that management automate key controls where practical.

In response to the internal audit report, staff modified the Invoice Stamp as an interim measure to improve controls

TTC Finance staff, in response to the internal audit recommendation, indicated that they were working on automating invoice approvals, but it would take a couple of years to fully design and implement the automation. As an interim corrective measure, Finance staff would modify the Invoice Verification Stamp to add a statement asserting the invoice has been verified by a user department approver that the charged price is correct.

Audit staff continued to observe verification issues in an invoice with the new Stamp

Among the sampled invoices we reviewed, we found one invoice with the new Stamp but the charges were not adequately verified by staff to identify the excess mark-up percentage and the extra shipping fee that are inconsistent with the Purchase Order.

Recommendation:

- 2. The Board request the Chief Executive Officer, Toronto Transit Commission, to enhance the existing invoice verification processes to provide reasonable assurance that invoices are paid according to the contract terms and prices. Consideration should be given to:**
 - a. Provide guidelines and training to user department approvers on the importance of invoice verification and the specific information that should be reviewed prior to invoice approval.**
 - b. Incorporate monitoring measures to verify, at least on a sample basis, that the approved invoices by user departments have been adequately reviewed to be consistent with contract terms and prices.**

B. VENDOR ACCOUNT MANAGEMENT REQUIRES IMPROVEMENT

An accurate Vendor File minimizes duplicate and incorrect payments to vendors

In order to ensure payments are sent to the correct vendors, TTC needs to maintain an accurate Vendor Master File that contains important information such as the vendor's name, address, contact information, GST/HST and business registration number.

Materials and Procurement (M&P) staff are responsible for maintaining an up-to-date Vendor Master File in the Supplier Information Management System (SIMS). When a M&P System Administrator receives a request for creating or changing vendor records, the Administrator would review the supporting documents and enter the information into the System. The data is then uploaded to the IFS on a daily basis.

Nearly 40,000 vendor accounts were on the Master File

While the M&P staff are primarily responsible for maintaining the Vendor Master File, Accounts Payable staff can set up and amend vendor records directly in the system for vendors receiving one-time payment or payments for purchases without a purchase order.

As of June 30, 2016, there were 39,648 vendors in TTC's Vendor Master File.

Our review identified two key issues in the management of the Vendor Master File:

- a. Inactive vendor accounts were not deactivated
- b. Information was missing from vendor accounts

A brief discussion of the above issues is provided below.

B.1. Inactive Vendor Accounts Were Not Deactivated in a Timely Manner

87% of vendor accounts were inactive

In our review of the Vendor Master data, we noted that it contained many stale vendor accounts dating back to the 1990s and early 2000s, and had no recent business activities with TTC. As of June 30, 2016, there were 39,648 vendors in the Vendor Master File, 87 per cent of which were stale accounts with no business activity with the TTC over the past four years.

Of the remaining 13 per cent (5,181) of active vendor accounts, 248 vendor accounts appeared to be duplications with similar addresses or business names.

Procedures require staff to regularly review and purge inactive accounts

According to the Accounts Payable's Accounting Procedures Statement, Accounts Payable and M&P staff are required to jointly review and purge inactive vendor accounts on a regular basis.

System does not enable staff to deactivate vendor accounts when needed

In practice, the Vendor File System (i.e. SIMS) does not have functionalities to enable M&P staff to deactivate inactive vendor accounts. Nor are staff able to create different codes in the System to delineate active or inactive accounts.

The lack of system capability to routinely purge inactive or duplicate records has, over the years, resulted in an accumulation of inactive vendor records from mergers and acquisitions, inclusion of potential bidders, and migration of legacy data.

Faced with the restraint in the Vendor File System, TTC staff put in place a temporary control in the IFS payment system in 2016 to alert Accounts Payable staff of inactive or duplicate vendor accounts.

However, this function is managed by Accounts Payable staff who are also responsible for processing payments. As such, there is inadequate segregation of duties between vendor account management and payment process.

Inaccurate vendor master file increases the risk of issuing incorrect or duplicate payments to vendors

A Vendor Master File consisting of a large percentage of inactive accounts increases the risk of issuing payments to incorrect vendors or duplicating payments to the same vendor. To reduce the risk of duplicating payments, the Accounts Payable Department runs a duplicated payment report on a yearly basis. This yearly report on average identifies approximately 4,000 potential duplicate payments which are then manually verified and validated by staff.

Current compensating control is time-consuming and inefficient

While the duplicated payment report serves as a compensating control, it is a time-consuming and labour-intensive process that should not be needed in a properly designed system.

TTC should undertake an immediate one-time purge and develop a way to allow staff to deactivate accounts when needed

Given the large percentage of inactive vendor accounts currently in the system, TTC should immediately undertake a one-time comprehensive review of its Vendor Master File (SIMS), to identify and purge all inactive and duplicate accounts.

As TTC is in the process of implementing SAP to replace SIMS, the large percentage of inactive accounts need to be removed prior to data migration to SAP. As an interim measure prior to SAP implementation, TTC should explore ways to develop ongoing processes that will enable appropriate staff to deactivate vendor accounts as needed.

B.2. Missing Information in Vendor Accounts

Vendor information needs to be collected and input into the system

Prospective vendors interested in supplying goods or services to TTC are required to complete a Company Questionnaire available on TTC's public tender website. M&P staff are responsible for entering the vendor information on the questionnaire into the Vendor Master File to create a vendor account. Once an account is created in the system, the vendor can start conducting business with TTC.

In creating a vendor account in the system, staff should make sure basic information such as business name, address, phone number, and GST/HST information is provided by the vendor and entered into the system.

A considerable number of vendor accounts had missing information

Our review of the vendor account system records noted that:

- 24,756 (62 per cent) of vendor accounts did not have phone numbers.
- 825 vendor accounts only have a P.O. Box address while the business address, city and province information is missing. Management informed us that they were not aware that a P.O. Box is not an acceptable address.

- Over 95 per cent of the vendor accounts did not have GST/HST information. This could be due to the fact that prior to June 2016, M&P did not require supporting documents such as the Ontario Business Name Report or the Canada Revenue Agency's GST/HST registry report from vendors to ascertain accuracy of vendor provided information.

In addition, we noted in a number of TTC Company Questionnaires, vendors did not provide the required information such as GST/HST number or full address. It would appear that staff did not obtain the required information from the vendors prior to creating the accounts.

Missing vendor information can increase the risk of duplicate or incorrect payments

Incomplete information in the vendor master file could increase the potential for duplicating vendor accounts and processing incorrect or duplicate payments. Staff responsible for creating or maintaining vendor accounts should make sure vendor account information is accurate and complete.

Similar issues identified by TTC internal audit, but additional areas should be strengthened

The 2015 TTC Audit Department report identified similar issues in the management of the vendor master file and provided a number of recommendations.

We reviewed the internal audit recommendations and management action plans (noted in the 2015 report) and found that the recommended actions would not effectively address the issues.

During our audit fieldwork period (September 2016 to April 2017), we noted the issues highlighted in the internal audit (as described earlier) still existed. For instance, we found a number of inactive vendors and newly set-up vendor accounts with missing information in the Vendor Master File. Apart from the system constraints mentioned above, relying on Accounts Payable staff to control the vendor status is not appropriate as it poses an issue in segregation of duties.

B.3. Vendor Policies and Procedures Have Not Been Updated

AP Procedure Manual on vendor account management has not been updated since 2000

The existing Accounting Procedures were established by the Finance Department prior to the year 2000 (the exact year is unknown). Although the Procedures include a section on vendor account management, it has not been updated since 2000. The Manual requires Accounts Payable and M&P to purge the Vendor Master File on a regular basis.

The two-page M&P Procedures do not outline all pertinent requirements in vendor accounts management

The M&P Department issued a two-page Vendor File Maintenance Procedures in 2015, which describes how to set up a new vendor in the system and staff responsibilities. The Procedures, however, do not outline critical requirements or processes such as:

- What documents and steps are required in creating and validating a new Canadian or US vendor
- What type of documents should be required before making changes to vendor account information
- Purging frequency of the vendor file
- Vendor naming convention
- The need to generate periodic reports that can identify changes made to vendor records

The Procedures have not been distributed to AP staff who are also responsible for entering non-purchase order vendors into the system.

B.4. Employee Vendor Match not Performed Frequently

TTC Policy requires annual employee vendor match

TTC policy requires employees and vendors to make a timely and full disclosure of any actual or potential conflict of interest prior to or during the course of employment or business. All vendors have to sign a conflict of interest form during the bidding process. Accounts Payable staff are required to conduct an employee and vendor match on an annual basis. However, staff did not conduct the required match in 2015, but conducted a match in December 2016 during our audit.

Three instances of potential conflicts of interest were identified

Based on our review, we identified three instances of potential conflicts of interest between employees and vendors. Two have been recently reviewed by Accounts Payable following the 2016 match. We were advised by staff that no conflict of interest was found, even though there were family relationships between the employees and the vendors.

For the remaining one pair that was identified by our review (but not identified by Accounts Payable), we could not ascertain whether there was any family relationship between the employee and the vendor based on the information provided by TTC staff. Staff subsequently conducted a review and confirmed no conflict of interest.

Important for staff to declare potential conflicts

While TTC staff asserted that none of the instances constituted a conflict of interest, in our view, the employees and the vendors should at the very least have declared the potential conflicts arising from family relationships. In particular, two of the employees were in director or acting director positions, and one of them was with the Materials and Procurement Department.

The TTC Internal Audit, in its 2016 Quarterly update report, also identified that an employee match was not performed in 2015.

Recommendations:

- 3. The Board request the Chief Executive Officer, Toronto Transit Commission, to maintain a reasonably accurate and complete Vendor Master File to minimize the risk of duplicate or incorrect payments to vendors. Steps to be undertaken should include, but not be limited to:**
 - a. Conduct a one-time comprehensive review of vendor accounts to purge the large number of duplicate and inactive accounts.**
 - b. Implement adequate system functionalities to enable staff to update vendor account records in the system.**
 - c. Periodically review the vendor account records to ensure the required information is obtained and accurately entered into the system.**
 - d. Ensure staff responsible for creating vendor accounts or maintaining the Vendor Master File are provided with an updated and comprehensive procedure manual outlining the key information requirements and processes.**

- 4. The Board request the Chief Executive Officer, Toronto Transit Commission, to ensure conflicts of interest are properly managed. Such steps should include, but not be limited to:**
 - a. Ensure employee vendor match is conducted on an annual basis.**
 - b. Provide training and reminders to the appropriate staff to reinforce the importance of disclosing actual and perceived conflicts of interest.**
 - c. Hold employees who fail to disclose potential conflicts of interest accountable.**

C. MAXIMIZING EARLY PAYMENT DISCOUNTS AND ENSURING TIMELY PAYMENTS

Some vendors offer early payment discounts between one and three per cent if they receive payment less than 30 days from the invoice issuance date ('net 30'). TTC Accounts Payable staff in general aim to process payments within the early payment discount period. The Industrial Financial System (IFS) generates a Discounts Expiring Within 10 Days report to notify Accounts Payable staff to take speedier action when the discount period will expire in 10 days.

\$18 million delayed payments over 30 days

According to the Department's Invoice Aging Report, as of June 2016, there were approximately 1,600 invoices (\$18 million) that were overdue for more than 30 days.

Table 5 summarizes our analysis from Accounts Payable's June 2016 Aging Report.

Table 5: Number of delayed invoices for outstanding periods over 30 days, as of June 2016

Category	31 to 60 days	61 to 90 days	Over 90 days	Total	Per cent
No Explanation	715	174	198	1,087	66%
Authorization Required	40	63	156	259	16%
Pending department confirmation on goods receipt or invoice information	46	16	117	179	11%
Pending vendor credit or clarification on invoice information	14	12	88	114	7%
Total	815	265	559	1,639	100%

66% of delayed payments did not have a clear explanation

The majority of the delayed payments had no explanation, or were pending the appropriate staff to approve the invoices. About 34 per cent (559 invoices) were overdue more than 90 days.

Currently 75% early payment discount capture rate

While TTC has not paid interest on any overdue payments, delayed payment means the loss of the early payment discount offered by certain vendors. Aside from the financial loss, delays in payments may affect TTC's reputation and inadvertently deter potential vendors.

The City of Toronto currently sets its early payment discount capture rate at 90 per cent, and it reached 88 per cent in 2016. By comparison, TTC's 2016 early payment discount capture rate was approximately 75 per cent. There is room for improvement. If the TTC can improve its capture rate to 90 per cent, it could potentially increase its early payment discount by \$100,000 per year.

Staff advised that many of the delayed payments were due to the following reasons:

- User departments require excessive time to verify the goods delivered from the vendor.
- Information on the invoice is unclear and it is difficult for staff to identify the right department for approval.

While Accounts Payable staff review the Discounts Expiring Within 10 Days Report and the Invoice Aging Report on a regular basis, they are not forwarded to senior management or department heads for review. Provision of these reports to department heads may help expedite the invoice verification process by user department staff.

The 2015 TTC Audit Department report did not include any findings on early payment discounts or delayed payments. However, in its 2016 Quarterly Update report, the internal audit commented that staff should improve the process to identify vendors offering early payment discounts.

Recommendation:

- 5. The Board request the Chief Executive Officer, Toronto Transit Commission, to review the current payment process and identify opportunities to further reduce the number of late payments and to take advantage of early payment discounts.**

D. TIGHTENING CONTROLS OVER CHEQUE REQUESTS

About \$700 million in cheque requests without purchase order were issued each year

Cheque Requests allow department staff to order certain goods or services directly from vendors without purchase orders. Staff can request cheque payments from Accounts Payable as long as the requests are authorized by departmental supervisory staff. In 2016, approximately \$700 million in cheque requests were approved by departments.

Cheque requests are intended for items such as utilities or government payments

According to Accounting Payable's Cheque Request Policy and the M&P's Procurement Policy, examples of items that are procured using regular cheque requests are:

- External training
- Utilities and telecommunications
- Police paid duties
- Government payments such as WSIB, building permits, licences, etc.
- Petty cash replenishment

About 95 per cent of \$700 million in cheque requests were for regular cheque items listed in the Policies. Based on a review of the cheque payments from January 2014 to June 2016, a number of cheque payments appeared to be for repetitive purchases from the same vendors that should have been procured through Purchase Orders. These include repeated payments to law firms and doctors, and forensic and advertising companies.

No competitive process required for cheque requests

When procuring items using cheque requests, staff are not required to undertake any competitive process such as obtaining quotes from more than one vendor to ensure the best price. Cheque requests are essentially sole-sourced purchases without the need for justifying the non-competitive purchase. As such, the use of cheque requests should be limited to limited types of purchases.

City's cheque requisitions are governed by Schedule A in the Municipal Code

In the City of Toronto, payment requisitions are governed by Schedule A in the Municipal Code which lists the specific items that can be procured using cheque requisitions.

TTC's cheque request policies do not specify whether the M&P, Accounts Payable, or departmental staff should be responsible for identifying or addressing questionable cheque requests.

Recommendation:

- 6. The Board request the Chief Executive Officer, Toronto Transit Commission, to review and enhance current cheque request policies to ensure adequate use of cheque requests by staff. Steps should be taken, but not be limited, to:**
 - a. Clearly define the items that can be procured using cheque requests.**
 - b. Regularly review and identify repeated cheque request purchases that should have been procured using Purchase Orders or Blanket Contracts.**
 - c. Clarify the monitoring measures and responsible departments in the policy.**

E. LACK OF ADEQUATE ACCESS CONTROL

TTC relies on the Supplier Information Management System (SIMS) and the Industrial Financial System (IFS) to manage the Vendor Master File and payments to vendors. It is imperative for TTC to put in place sound access controls to minimize the risks of making payments to fictitious, ineligible or inactive vendors.

According to the M&P's Vendor File Maintenance Policy and Finance Department's Accounting Procedures Statement, only certain staff in M&P Purchasing and Sales, Project Procurement or Accounts Payable are allowed to have access to the SIMS or IFS. The staff duties and access restrictions are specified in the two Policies to avoid:

- the same person who can set up and approve vendor accounts
- the same person who can enter and approve payments
- the same person who can approve vendor accounts and authorize payments

As of March 2017, a total of 14 staff members had access to the SIMS and 30 staff members had access to IFS.

12 out of 44 staff members have potential segregation of duties to the systems

From our review of staff duties and access controls, we identified potential issues in the segregation of duties among 12 staff members. Specifically:

- Five had both vendor input and approval authority in the SIMS
- Two had access to SIMS but they were not listed in the Policy for system access
- Three could enter invoices and release payments in IFS
- Two could approve vendor accounts and enter invoices in IFS

14 out of 44 are staff members that should be deactivated from the systems due to inactivity

In addition, we noted 14 inactive users whose system access should be re-assessed or terminated:

- Two staff members with SIMS access did not use the system for over a year
- Nine were student interns or temporary workers who had left the TTC but their IFS access was not de-activated
- Three staff members continued to have IFS access even though they had left the department 12 months before

After we raised our concerns, staff reported that they made the necessary changes to access controls.

In its 2015 report, the TTC Audit Department indicated that they observed adequate user access and segregation of duty controls. This is contrary to our findings, as we identified significant issues in segregation of duties among staff with system access and delays in deleting inactive users' system access.

Recommendation:

- 7. The Board request the Chief Executive Officer, Toronto Transit Commission, to review and update Supplier Information Management System (SIMS) and Industrial Financial System (IFS) user access rights and privileges periodically to ensure adequate segregation of duties and access controls.**

F. EXPANDING THE USE OF ELECTRONIC FUND TRANSFER

TTC relies on SIMS and IFS to manage the Vendor Master File and payments to vendors. It is imperative for TTC to put in place sound access controls to minimize the risks of making payments to fictitious, ineligible or inactive vendors.

Electronic Fund Transfer (EFT) is increasingly becoming a common method of processing and transferring payments. EFT can significantly reduce administration costs, payment processing time, as well as the risk of cheque errors, frauds, and cheques lost in the mail.

66% of payments were processed via EFT

Over the years, Accounts Payable has made efforts to invite vendors to enrol in EFT. At the end of 2016, about 47 per cent of TTC's active vendors were on EFT, and 66 per cent of payments were processed via EFT. The number of cheques issued by Accounts Payable has also decreased from approximately 25,000 in 2014 to 10,000 in 2016.

Further expansion of EFT to vendors receiving regular payments can result in further cost savings

According to staff, it costs on average \$2.60 to process and issue a cheque. In our review of vendor payments, we noted that Accounts Payable continued to send 360 vendors an average of six or more cheques a month per year. Continued efforts should be made to encourage these vendors to enrol in EFT.

In its 2016 Quarterly Update report, TTC's internal audit commented that management should continue to *"redesign processes and improve efficiencies, including actively moving vendors to e-payment options and working with M&P Receiving to secure cash discounts for early payments."*

Recommendation:

- 8. The Board request the Chief Executive Officer, Toronto Transit Commission, to continue its effort to increase the use of Electronic Fund Transfer for vendor payments, in particular for vendors who receive multiple payments from the agency per month.**

G. PREVENTION AND IDENTIFICATION OF DUPLICATE PAYMENTS

TTC's own process verified 24 duplicate payments were made over an 18-month period

Accounts Payable currently relies on a "Duplicate Invoice Report" to identify potential duplicate payments. For the 18-month period from January 2015 to July 2016, approximately 4,000 sets of potential duplicate payments were identified in the report. Of the 4,000 potential duplicates, after manual reviews by Accounts Payable staff, only 24 sets were verified as duplicate payments.

Audit identified an additional 9 duplicate payments over 2.5 years

As part of our audit, we used an audit software program to analyze payments between January 2014 and June 2016. We identified and verified with staff nine additional duplicate payments totalling approximately \$6,000 in overpayments.

17 returned cheques as a result of duplicate payments

Over the same period (January 2014 to June 2016), TTC received 17 cheques that were voluntarily returned by vendors for reasons including invoice entry errors or duplicate vendor accounts in the Vendor Master File.

Number of duplicate payments identified by audit is small

Given the large volume of payments processed by Accounts Payable each year, the number of duplicates we identified is small and not material. While the current payment controls may be effective in preventing and detecting the majority of duplicate payments, there could be room to further improve the efficiency of the duplicate payment identification and verification process.

As TTC is in the process of migrating to SAP, staff should consider adding more specific fields to the database and more criteria testing to the system report that will improve the effectiveness of the system report.

The 2015 TTC internal audit report did not identify any duplicate payments. In its 2016 Quarterly Update report, it made a comment for staff to improve the existing duplicate payment report.

Recommendation:

- 9. The Board request the Chief Executive Officer, Toronto Transit Commission, to identify opportunities to further improve the efficiency of the duplicate payment identification and verification process.**

CONCLUSION

9 recommendations to help improve controls over invoice verification and vendor account management

This is the Auditor General's first review of TTC's accounts payable functions. TTC procured approximately \$1.2 billion worth of goods and services each year for day-to-day operations. TTC needs to put in place adequate controls and procedures to ensure invoices are adequately verified and payments are processed in a timely manner.

TTC could save at least \$1 million annually by adequately verifying invoices

Our audit provides nine recommendations to help improve invoice verification, management of vendor accounts, and access controls. Based on a conservative estimate, ensuring adequate invoice verification prior to payment could result in at least \$1 million annual savings. Maximizing early payment discounts can save about \$100,000 per year.

AUDIT OBJECTIVES, SCOPE AND METHODOLOGY

The Auditor General's 2016 Audit Work Plan included a review of TTC's Accounts Payable operations administered by the Finance department.

The objective of this review was to determine whether the key controls over TTC's payment process and vendor account management are effective to ensure that vendor invoices are processed accurately, timely and efficiently.

This audit covered the period from January 2014 to June 2016.

Our audit methodology included the following:

- Review of Accounts Payable policies and procedures
- Interview with key management and operational staff
- Analysis of payment data and records
- Analysis of vendor data and records
- Site visits for walkthroughs and file review
- Perform a financial and cost savings analysis
- Review of previous Auditor General's reports on TTC's procurement and payment operations

Compliance with generally accepted government auditing standards

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

APPENDIX 1: Management’s Response to the Auditor General’s Report Entitled: “Review of Toronto Transit Commission Accounts Payable Functions: Improving Invoice Verification and Vendor Account Management”

Recommendation 1: The Board request the Chief Executive Officer, Toronto Transit Commission, to review the results of the sampled invoices and potential overpayments identified by the Auditor General in this report, assess whether additional overpayments exist in other related invoices from the same vendors, and recover the overpayments from the vendors where appropriate.

Management Response: Agree Disagree

Comments/Action Plan/Time Frame:

Management will review all invoices issued by the vendors that overcharged the TTC to determine if further overpayments occurred and efforts will be made to recover any potential overpayments.

Timeline – Q1 2018

Recommendation 2: The Board request the Chief Executive Officer, Toronto Transit Commission, to enhance the existing invoice verification processes to provide reasonable assurance that invoices are paid according to the contract terms and prices. Consideration should be given to:

- a. Provide guidelines and training to user department approvers on the importance of invoice verification and the specific information that should be reviewed prior to invoice approval.
- b. Incorporate monitoring measures to verify, at least on a sample basis, that the approved invoices by user departments have been adequately reviewed to be consistent with contract terms and prices.

Management Response: Agree Disagree

Comments/Action Plan/Time Frame:

- a. Part of the SAP Wave 1, Accounts Payable includes a “How to process and code an Invoice” which will be provided to all users.

Timeline – Q1 2018

- b. The Finance Department will undertake to add a new A/P position dedicated to review approved invoices to ensure consistency with contract terms and process. This position will also be responsible for tracking compliance rates by department, vendor, type of good or service and focus future reviews and training measures based on results.

Timeline – Q1 2018, subject to position approval

Recommendation 3: The Board request the Chief Executive Officer, Toronto Transit Commission, to maintain a reasonably accurate and complete Vendor Master File to minimize the risk of duplicate or incorrect payments to vendors. Steps to be undertaken should include, but not be limited to:

- a. Conduct a one-time comprehensive review of vendor accounts to purge the large number of duplicate and inactive accounts.
- b. Implement adequate system functionalities to enable staff to update vendor account records in the system.

- c. Periodically review the vendor account records to ensure the required information is obtained and accurately entered into the system.
- d. Ensure staff responsible for creating vendor accounts or maintaining the Vendor Master File are provided with an updated and comprehensive procedure manual outlining the key information requirements and processes.

Management Response: Agree Disagree

Comments/Action Plan/Time Frame:

Following the completion of an internal TTC audit, the number of active vendor accounts was reduced from 39,648 to 4,324 accounts in the AP system (IFS). These same expired vendors accounts cannot be deactivated in SIMS due to system constraints.

Management will continue with efforts to review the Vendor Master File on a periodic basis until the implementation of SAP (Wave 3).

Timeline –SAP Wave 3 implementation (2019)

Recommendation 4: The Board request the Chief Executive Officer, Toronto Transit Commission, to ensure conflicts of interest are properly managed. Such steps should include, but not be limited to:

- a. Ensure employee vendor match is conducted on an annual basis.
- b. Provide training and reminders to the appropriate staff to reinforce the importance of disclosing actual and perceived conflicts of interest.
- c. Hold employees who fail to disclose potential conflicts of interest accountable.

Management Response: Agree Disagree

Comments/Action Plan/Time Frame:

- a. TTC will continue to ensure that an employee vendor match is conducted on an annual basis as has been standard practice in past years, with the exception of 2015.
- b. The TTC processes approximately 75,000 invoices annually, of which 3 potential conflicts were identified but found to be without merit. The TTC ensures appropriate training to all staff of the City's Public Service Bylaw, which includes information to staff on the potential for actual and/or perceived conflict of interests.
- c. The TTC ensures appropriate disciplinary action for any employee that fails to comply with the City's Public Service Bylaw.

Timeline - Ongoing

Recommendation 5: The Board request the Chief Executive Officer, Toronto Transit Commission, to review the current payment process and identify opportunities to further reduce the number of late payments to take advantage of early payment discounts.

Management Response: Agree Disagree

Comments/Action Plan/Time Frame:

The TTC will continue to explore opportunities to improve early payment discount capture rates, with focus on increased capabilities that may be achieved through SAP Wave 3 implementation.

The TTC had a 90% capture rate as recently as 2014. The decline in recent years is mainly attributed to an increase in purchases of safety critical parts required for TTC's aging fleet. These parts require intensive quality control procedures that often hinders the TTC's ability to capture early payment discounts.

Timeline – SAP Wave 3 implementation (2019)

Recommendation 6: The Board request the Chief Executive Officer, Toronto Transit Commission, to review and enhance current cheque request policies to ensure adequate use of cheque requests by staff. Steps should be taken, but not be limited, to:

- a. Clearly define the items that can be procured using cheque requests.
- b. Regularly review and identify repeated cheque request purchases that should have been procured using Purchase Orders or Blanket Contracts.
- c. Clarify the monitoring measures and responsible departments in the policy.

Management Response: Agree Disagree

Comments/Action Plan/Time Frame:

The City of Toronto is currently undertaking a review of the Financial Management and Control Bylaw, which will include an update to Schedule A, which lists the specific items that can be procured using cheque requisitions.

The TTC Finance Department will consult with City Procurement and Accounting staff following Council adoption of the new Financial Management and Control Bylaw to create a TTC equivalent of the City's Schedule A that is consistent with Council's approval.

Timeline - Begin in Q2 2018

Recommendation 7: The Board request the Chief Executive Officer, Toronto Transit Commission, to review and update Supplier Information Management System (SIMS) and Industrial Financial System (IFS) user access rights and privileges periodically to ensure adequate segregation of duties and access controls.

Management Response: Agree Disagree

Comments/Action Plan/Time Frame:

The TTC will establish a process to review user access rights and privileges on an annual basis.

Timeline – Q2 2018

Recommendation 8: The Board request the Chief Executive Officer, Toronto Transit Commission, to continue its effort to increase the use of Electronic Fund Transfer for vendor payments, in particular for vendors who receive multiple payments from the agency per month.

Management Response: Agree Disagree

Comments/Action Plan/Time Frame:

TTC has improved the amount of vendors on EFT from 47% at the end of 2016 to 66% today. In addition, the number of cheques issued by A/P has also decreased from 25,000 in 2014 to 10,000 in 2016.

TTC will continue to reach out to vendors to encourage the use of EFT. However, due to current system constraints, a vendor with multiple bank accounts cannot move to EFT. It is expected that 90% of vendors will be on EFT once SAP is implemented and the current system constraint is addressed.

Timeline – SAP Wave 3 implementation (2019)

Recommendation 9: The Board request the Chief Executive Officer, Toronto Transit Commission, to identify opportunities to further improve the efficiency of the duplicate payment identification and verification process.

Management Response: Agree Disagree

Comments/Action Plan/Time Frame:

The TTC's review identified 24 duplicate payments based on Report parameters of Jan 1, 2015 to July 31, 2016 and payments greater than \$1,000. The AG was able to find an additional 9 duplicate payments (with a total value of \$6,000) by refining the Report parameters to include all of fiscal 2014 and no payment threshold.

The TTC will continue to examine opportunities to further reduce the potential for duplicate payments, including more preventive type measures. In the interim, the 'Duplicate Invoice Report', with the AGs refined criteria will be used to capture and investigate potential duplicate payments.

Timeline – SAP Wave 3 implementation (2019)
