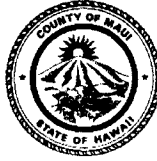


County Auditor
Lance T. Taguchi



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OFFICE OF THE COUNTY AUDITOR

COUNTY OF MAUI
2145 WELLS STREET, SUITE 106
WAILUKU, MAUI, HAWAII 96793
<http://www.maui-county.gov/auditor>

OFFICE OF THE
COUNTY CLERK

June 14, 2017

Honorable Mike White, Chair
and Members of the Council
200 South High Street
Wailuku, Hawaii 96793

Dear Chair White and Members:

**SUBJECT: AUDIT REPORT NO. 16-01, AUDIT OF COUNTY
PROCUREMENTS (pCARD)**

Pursuant to Section 3-9.2(2) of the Revised Charter of the County of Maui (1983), as amended, transmitted are 19 bound copies and 2 unbound copies of Audit Report No. 16-01, relating to the Audit of County Procurements (pCard).

Sincerely,

LANCE T. TAGUCHI
County Auditor

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Enclosure

cc w/o enc: Alan M. Arakawa, Mayor
Keith Regan, Managing Director

cc w/enc: Robert Carroll, Council Vice-Chair
Stacy Crivello, Presiding Officer Pro Tempore
Alika Atay, Councilmember
Elle Cochran, Councilmember
Don S. Guzman, Councilmember
Kelly T. King, Councilmember
Riki Hokama, Councilmember
Yuki Lei Sugimura, Councilmember

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OFFICE OF THE
COUNTY COUNCIL

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Audit of County Procurements (pCard)

Report No. 16-01
June 2017



Office of the County Auditor
County of Maui

Table of Contents

Office of the County Auditor	iii
Preface	v
Executive Summary	vii
Chapter 1 Introduction	
Background	1
Audit Objectives	3
Audit Scope and Methodology.....	3
Chapter 2 Audit Findings	
Finding 1: Fraud, waste, or abuse may have occurred	7
Finding 2: Cardholders used County pCards to make multiple back-to-back purchases to avoid purchase limits meant to safeguard taxpayer funds.....	7
Parceling	8
Structuring/payment plans.....	9
Finding 3: Cardholders are not required to disclose when the purchases they make could be used in their personal businesses or in doing “side job” type work.....	11
Finding 4: Individual pCard credit limits are more than 16 times higher than actual use	12
Finding 5: Employees obtained pCards without first receiving training.....	13
Finding 6: The ability for certain pCards to be used at restaurants creates a loophole which could allow those cards to be used at bars (i.e., hostess bars.....	14
Subsequent Event	17

List of Exhibits

Exhibit 1-1	The top 25 Vendors (by total dollars spent) fell into these categories and made up approximately 50% or \$2.2 million total pCard spending	2
Management's Response	Attachment 1

Office of the County Auditor

The mission of the Office of the County Auditor is to:

- Serve as a catalyst for positive change in County government through focused independent audits and examination.
- Advocate for the efficient and appropriate use of public resources.
- Increase government transparency for the purpose of bringing a higher quality of life to the citizens of Maui County.

The Office of the County Auditor consists of a County Auditor and necessary staff, and is responsible for promoting economy, efficiency, and improved service in the transaction of the public business in both the legislative and executive branches.

To ensure the objectivity of the Office of the County Auditor, the Revised Charter of the County of Maui (1983), as amended, requires that the County Auditor be independent of the Mayor and the County Council. As such, the County Auditor is appointed to a six-year term.

We adhere to very rigorous and demanding professional auditing requirements described in Generally Accepted Government Auditing Standards, or more commonly referred to as *GAGAS* or the Yellow Book. These standards include requirements for planning our work, ensuring that our staff is properly trained and supervised; determining our rationale for the objectives, scope, and methodology; selecting the criteria we use to evaluate the audit subject; and ensuring that our evidence is sufficient, relevant, and competent.



Office of the County Auditor County of Maui

2145 Wells Street, Suite 106
Wailuku, Hawaii 96793

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Preface

This audit was initiated by the Office of the County Auditor pursuant to Section 3-9.1 of the Revised Charter of the County of Maui (1983), as amended, and the Plan of Audits for Fiscal Year 2016 issued by the Office of the County Auditor. This audit was selected due to the high dollar volume of purchases made with pCards and the inherent risks related to the issuance of credit cards to employees. Public interests and prior audit findings were also considered. The audit was conducted from September 2015 through May 2017.

We wish to express our appreciation for the cooperation and assistance extended by the Managing Director and various County employees, as well as others who assisted us throughout the course of the audit.

Lance T. Taguchi, CPA
County Auditor

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EXECUTIVE SUMMARY

Audit of County Procurements (pCard)

Report No. 16-01, June 2017

Key ideas found in full report:

The County spends a lot on travel pg. 1

Fraud, Waste, or Abuse may have occurred..... pg. 7

How \$500 pCard limits were bypassed pg. 7

Want a pCard? Better disclose your outside interests pg. 11

Credits limits are 16 times more than what's needed..... pg. 12

Training is key pg. 13

Can County pCards be used at hostess bars? pg. 14

Personal use of taxpayer funds by someone entrusted to protect it..... pg. 17

A procurement card or “pCard” is a County-issued credit card that can be used by County employees to buy the goods and services needed to perform their job. Over the 13-month period which was audited, 369 pCards were used by all levels of County employees to make \$4.38 million of purchases.

While using pCards inherently improved efficiency and brought in just under \$80,000 of cash rebates to the County, we found that some of the County’s pCard use may have been fraudulent, wasteful, or abusive.

The Office of the County Auditor set out to determine if Maui County’s pCards were exposed to similar issues like those reported by local news agencies which claimed that Hawaii County pCards were used to pay for a tab at a hostess bar in Honolulu, an expensive bicycle, surfboard, and other personal use.

Of the nearly 25,000 separate transactions, we observed no instances of pCards being used at hostess bars. However, testing revealed that some hostess bars are categorized as “restaurants”. This creates a loophole that would allow some pCards to be used at hostess or other types of bars. As such, we recommend that this loophole be addressed by finding alternative ways to pay for authorized meals.

We also observed that some pCard purchases were parceled--or broken up into multiple smaller transactions--to avoid the \$500 single purchase limits, obtaining price quotes, or other rules meant to safeguard taxpayer funds. To remedy this, we recommend the County make pCard training a priority, monitor and document instances where parceling continues to occur, and when appropriate discipline employees who do not comply. In addition, we also made recommendations relating to improving transparency by requiring Cardholders to disclose personal businesses or “side job” work performed outside of their employment with the County and controlling pCard credit limits in order to reduce financial exposure to the County.

Subsequent Event - personal use of taxpayer funds by someone entrusted to protect it.

Near the completion of our audit, we observed an instance where a County pCard was used to purchase round-trip airline tickets to the mainland for the wife and college-aged child of the Director of Finance. Although the Director reimbursed the County, using a County pCard to pay for family members' travel is personal use. Personal use of a County pCard is explicitly prohibited. County taxpayers deserve better.

This personal use begs the question: can the County realistically expect its employees to follow rules meant to safeguard taxpayer money when those rules are being broken by the person making them?

Because of the serious nature of this matter, we brought this to the attention of the Managing Director on May 5, 2017.

Chapter 1

Introduction

This audit was initiated by the Office of the County Auditor pursuant to Section 3-9.1 of the Revised Charter of the County of Maui (1983), as amended, and the Plan of Audits for Fiscal Year (“FY”) 2016 issued by the Office of the County Auditor on June 12, 2015. This audit was selected due the high dollar volume of purchases made with pCards and the inherent risks related to the issuance of credit cards to employees. Public interests and prior audit findings were also considered.

BACKGROUND

The County of Maui Purchasing Card Program & Procedures (“Program”) was established in 2003 to streamline the processes related to the purchase of goods and services needed by County employees in the performance of their official duties.

The County’s Program is made possible through a contract between the State of Hawaii and First Hawaiian Bank.

While the County is a participant of the State’s contract, ultimate authority for the County’s Program resides with the County’s Director of the Department of Finance (“Director of Finance”); day-to-day operation of the Program is handled by the Purchasing Division of the Department of Finance (“Purchasing Division”).

Over the 13-month period which was audited, 369 pCards were used by all levels of County employees to make nearly 25,000 separate transactions, totaling \$4.38 million in purchases spread across approximately 890 vendors.

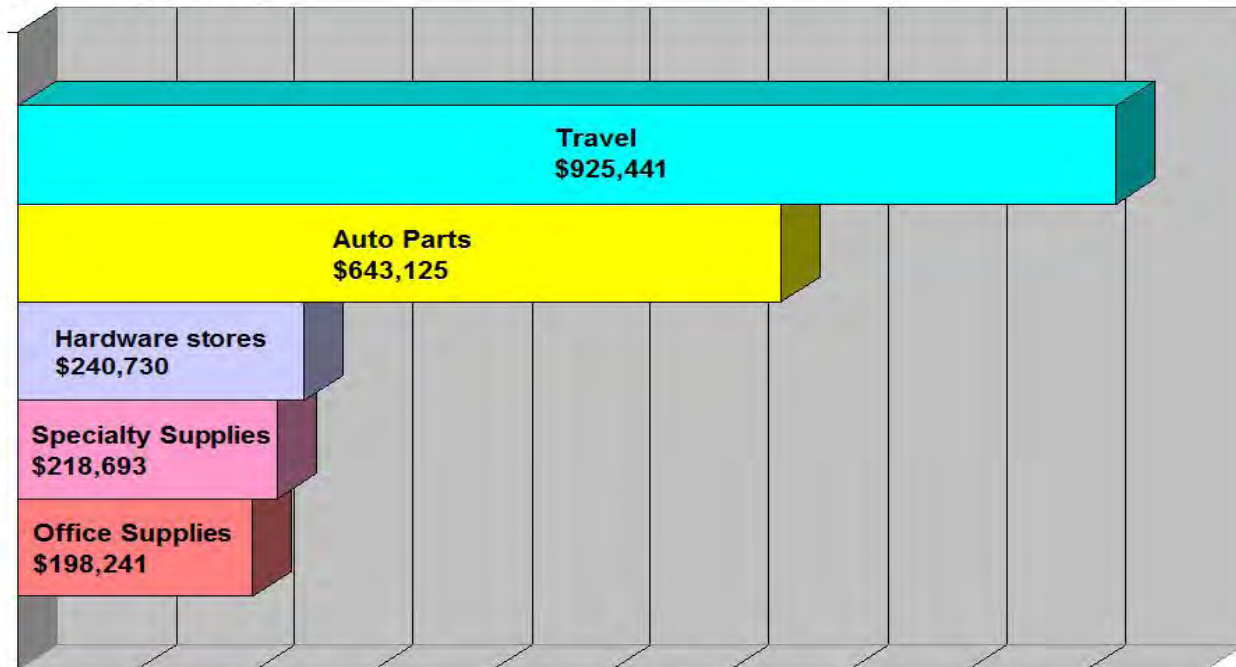
The largest cumulative total paid to a single vendor during that period was Hawaiian Airlines at \$491,129.

The top 25 vendors in terms of total pCard spending accounted for \$2.2 million, or approximately 50 percent of the County’s total pCard spending.

Four of the top 10 vendors were airline carriers (i.e., Hawaiian, Mokulele, American, and United) and represented \$808,445 or nearly 20 percent of the County’s total pCard spending.

Exhibit 1-1

The top 25 Vendors (by total dollars spent) fell into these categories and made up approximately 50% or \$2.2 million total pCard spending



Source: Office of the County Auditor data from Department of Finance Purchasing Division

Generally limited to \$500 per transaction, the pCard can be an effective alternative to the sometimes more cumbersome purchase order. According to the Purchasing Division, the per transaction savings to the County for using a pCard versus the traditional purchase order is estimated to be approximately \$50. While we did not verify this claim, similar claims of savings are frequently made by other local and federal government entities which utilize pCards.

The pCard also offers a benefit to the County in the form of a cash rebate. During the 13-month period under review, the County received just under \$80,000 in cash rebates for the \$4.38 million of purchases made by 369 pCards.

The pCard system has the ability to:

- block pCards from being used at certain types of businesses (e.g., liquor stores, drinking places);
- establish individual card credit limits; and
- allow the County to deactivate pCards where abuse or misuse is suspected.

These system controls are supplemented by the requirement for a designated manager to review and approve the purchases made by Cardholders each month. If properly functioning, these controls can be effective tools in managing spending and safeguarding taxpayer funds.

However, as with any convenience, the pCard does not come without risks. An example of this point was made very public after the media reported that the Hawaii County Mayor used a Hawaii County pCard to pay for a tab at a hostess bar in Honolulu, an expensive bicycle and surfboard.

While the Hawaii County Mayor was ultimately found not guilty of the theft charges, the public still questioned how something like that could happen. How was it that a government employee was able to use taxpayer funds for seemingly personal use? Could something like that happen in Maui County?

This audit hoped to answer such questions.

AUDIT OBJECTIVES

1. Determine if purchases made with County-issued pCards are in compliance with the County's pCard Program and Small Purchase threshold guidance; and
2. Make recommendations as appropriate.

AUDIT SCOPE AND METHODOLOGY

The scope of our audit covered pCard purchases made from September 29, 2014 through October 30, 2015. For the purposes of comparison and quantification of recommendations, information from adjacent periods was used when appropriate.

This audit is the first of its kind since the County established the Program in 2003. As such, the audit focused on individual pCard transactions. This "triage" approach would enable the County to focus and prioritize correcting the Program's most urgent issues first, leaving fine-tuning for a later date.

The evidence gathering and analysis techniques used to meet our audit objectives included, but were not limited to:

Interviews

- Personnel from the Purchasing Division;
- Miscellaneous County personnel, and when appropriate, those tasked with law enforcement; and

- Personnel from other counties in the State of Hawaii, and private accounting and finance industry professionals with direct knowledge of pCards and the issuance of consumer credit.

Document review

- The Constitution of the State of Hawaii; Hawaii Revised Statutes; the Revised Charter of the County of Maui (1983), as amended; the Maui County Code; and resolutions adopted by the Maui County Council;
- Business registration information from the State of Hawaii Department of Commerce and Consumer Affairs;
- General Excise Tax information from the State of Hawaii Department of Taxation;
- Maui County Council Committee documents, including meeting minutes and presentation materials;
- Audit guidance issued by government audit agencies, including the United States General Accounting Office (“GAO”) and the Office of Management and Budget (“OMB”);
- Best practices and guidance issued by the Government Finance Officers Association (“GFOA”)
- Guidance and articles published by the Association of Certified Fraud Examiners (“ACFE”);
- State of Hawaii Purchasing Card Program and Procedures, including Addenda;
- Purchasing Card Agreement between the County of Maui and First Hawaiian Bank;
- County of Maui Purchasing Card Program and Procedures, including the Cardholder Agreement;
- Small Purchase Threshold Guidance issued by the Director of Finance;
- Presentations prepared by the Purchasing Division and submitted to the Maui County Council;
- pCard transaction reports generated by the Purchasing Division;
- Hardcopies of pCard logs submitted by Cardholders, including signatures, receipts, and other supporting documentation.
- Departmental communications, reports, and other related documents;
- Previous audit reports related to the County of Maui; and
- Audit reports issued by other local government agencies.

Analysis

- Utilization of data analytics and extraction software to review the over 25,000 pCard transactions which took place within the scope of the audit;

- Walk-throughs of pCard processing procedures with the Purchasing Division;
- Stratified sampling of transactions which display irregularities;
- Application of multiple layer filters to detect high-risk purchases;
- Calculation of the County of Maui's financial exposure as it relates to credit limits and actual usage;
- Velocity analysis of transactions to detect non-compliance; and
- Scatter plot and other graphical tools to review transaction patterns or other associations;

Our audit was performed from September 2015 through May 2017 and was conducted in accordance with generally accepted government auditing standards. These standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our audit findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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Chapter 2

Audit Findings

FINDING 1

Fraud, waste, or abuse may have occurred

During the course of our audit, we observed irregularities in some of the pCard transactions which may indicate fraud, waste, or abuse may have occurred. We have been in contact with law enforcement and have provided them with certain summaries and analyses related to these matters. As such, it is our understanding that the transactions of one employee were under active criminal investigation and the transactions of another employee were being investigated internally by the employing department.

In order to avoid interfering with active investigations, we relied on guidance issued by the Comptroller General of the United States. Government Auditing Standards, 2011 Revision, paragraph 6.35 states:

“Avoiding interference with investigations or legal proceedings is important in pursuing indications of fraud, noncompliance with provisions of laws, regulations, contracts or grant agreements, or abuse...In some cases, it may be appropriate for the auditors to work with investigators or legal authorities, or withdraw from or defer further work on the audit or a portion of the audit to avoid interfering with an ongoing investigation or legal proceeding.”

As such, we did not directly pursue these matters at this time and remain on standby as a resource should the need for assistance arise.

FINDING 2

Cardholders used County pCards to make multiple back-to-back purchases to avoid purchase limits meant to safeguard taxpayer funds

The pCard can be a useful tool to allow County employees to quickly purchase items needed to do their jobs without having to spend time getting prior approval through the more cumbersome and time-consuming processes for purchase orders or County check requests.

The tradeoff for this operational flexibility is the establishment of the \$500 purchase limit for most transactions.

Purchase limits are best practices to control spending and ensure that pCards are not used to make larger value purchases that

would require obtaining written quotes or require using other methods which encourages competition, such as the request for proposals (RFP) or invitation for bids (IFB).

These practices are in direct violation of the Program and go against the intent of good government procurement.

Parceling

Unfortunately, we observed instances where the \$500 limit was avoided by “parceling” or the breaking up of larger dollar valued purchases into smaller parts. While some degree of flexibility should be given to the Cardholders, in virtually all instances reviewed the same pCard was swiped two, three, and up to five times within minutes of each other. The result was essentially a single larger value purchase over the \$500 limit.

An example of how parceling would be carried out is as follows:

The Cardholder fills a shopping cart with \$2,500 worth of items. Normally, this single larger value purchase would require a minimum of three verbal price quotes in order to ensure the County is getting the lowest prices.

1. Knowing that purchases cannot exceed \$500 at a time, the Cardholder asks the cashier to break the \$2,500 into six purchases at \$416.66 for each individual transaction ($\$2,500 / 6 = \416.66).
2. When prompted, the Cardholder then swipes the pCard six times at \$416.66 each. The transactions occur within minutes of each other.
3. The Cardholder leaves the store with \$2,500 worth of items **without:**
 - a. Ensuring the County paid the lowest prices for those items by getting three verbal price quotes; and
 - b. Complying with the intent of the \$500 transaction limit.

Structuring/payment plans

We also observed instances where it appeared Cardholders “structured” payments with vendors by entering into revolving accounts or payment plans to purchase larger dollar valued equipment.

In these instances, invoices showed that Cardholders had beginning and end balances--sometimes in the thousands of dollars--on their revolving accounts, indicating that larger items may have been previously purchased.

Then, on a monthly or sometimes weekly basis, the Cardholder would make a “purchase” against the balance. The “purchase” was almost always just under the \$500 limit.

An example of how structuring would be carried out is as follows:

1. The Cardholder sees a new piece of desired equipment that costs \$7,000. Normally, this single larger value purchase would require a minimum of three written price quotes in order to ensure the County is getting the lowest prices.
2. Knowing that purchases cannot exceed \$500 at a time, the Cardholder asks the vendor to allow scheduled payments (e.g., weekly or monthly) against the \$7,000 equipment.
3. The vendor allows the Cardholder to swipe the pCard for \$499.99 once or twice a week for the next few months until the \$7,000 is paid.
4. After repeating this 14 times ($14 \times \$499.99 = \$7,000$), the Cardholder receives delivery of the \$7,000 equipment **without**:
 - a. Ensuring the County paid the lowest prices for the equipment by getting three written quotes;
 - b. Complying with the intent of the \$500 transaction limit; and
 - c. Possibly having to log the equipment into the County’s asset inventory.

These practices are in direct violation of the Program and go against the intent of good government procurement that requires stewards of public funds to seek best value and encourage competitive bidding from vendors wishing to sell goods and services to the County.

While not in the scope of the audit, the practice of parceling and structuring/entering into payment plans can lead to larger dollar valued equipment being purchased without being added to the County's asset inventory. That would essentially make the equipment invisible to County management. Further, those equipment tend to be "theft sensitive" (i.e., small and attractive items that easily convert to personal use outside of County employment); determining the whereabouts of items purchased in these manners may be difficult.

Failure of the County to ensure compliance with the Program or Small Purchase threshold guidance, could result in loss of public trust and increase the chances of fraud, waste, or abuse.

We recommend the following:

1. Make pCard training mandatory for all involved with the Program;
2. Provide resources so the Purchasing Division can actively identify transactions which indicate parceling or other noncompliance with the Program. The Purchasing Division should:
 - a. transmit those identified transactions by written correspondence to the Cardholder's department/division head for follow-up;
 - b. transmit a copy of the written correspondence to the Managing Director for oversight; and
 - c. transmit a copy of the written correspondence to the County Clerk to allow for public inspection; and
3. Actively and consistently suspend pCards and discipline employees for noncompliance with the Program; and
4. Require requests be approved on a case-by-case basis if it is determined that a larger individual transaction limit above \$500 is warranted. The rationale for the request and approval should be documented and made available for future audits or investigations.

FINDING 3

Cardholders are not required to disclose when the purchases they make could be used in their personal businesses or in doing “side job” type work

During the course of the audit, we observed instances where Cardholders appeared to be registrants of--or affiliated with--outside businesses. While the extent of these relationships is not known at this time, the fact that many of the items purchased by pCards are theft sensitive and Cardholders could readily use the items in their personal businesses or on “side job” type work, is cause for concern.

When County employees are given public resources, they need to operate in the County’s best interests and not their own.

To be clear, we are not recommending prohibiting employees from conducting business outside of their County employment. Rather, when County employees are given public resources, it is reasonable to expect a heightened level of transparency. Further, use of County property or personnel for other than public activity or purpose is prohibited by the Revised Charter of the County of Maui (1983), as amended.

There are currently no requirements in the Program to disclose whether a Cardholder owns a personal business or performs “side job” type work. However, the spirit of such a requirement can be seen in Section 3-131-1.02(4), Hawaii Administrative Rules, which require government employees to “*Identify* and eliminate any conflicts of interests;”. [emphasis added] As stewards of public funds, Cardholders should seek best value and purchase ethically, fairly, and without conflict of interests.

Not knowing the Cardholders’ outside businesses or “side jobs” leaves the County’s approving managers underprepared to fully scrutinize purchases. As a result, if fraud, waste, or abuse were to occur there could be a loss of public trust. Additionally, this breakdown in scrutiny could make it difficult for upper-level County management to discipline approving managers.

If it is found that the Cardholders they supervise have been inappropriately using the pCards, those managers could plausibly deny any knowledge of the Cardholders’ outside business interests.

We recommend the following:

1. The Cardholder Agreement should be revised to require Cardholders to disclose when the purchases they make can be used in their personal businesses or in doing “side job” type work (e.g., the County plumber with a pCard who also does “side job” plumbing work);
2. Approving managers should be made aware of a Cardholder’s personal business or performance of “side job” type work by signing the Cardholder Agreement;
3. Cardholder Agreements should be updated every year or as soon as a Cardholder establishes a personal business or performs “side job” type work; and
4. Cancel pCards that do not have an updated Cardholder Agreement.

FINDING 4

Individual pCard credit limits are more than 16 times higher than actual use

During the 13-month period which was audited, 369 employees made 24,659 pCard transactions, totaling \$4.38 million. Individual Cardholder usage for the same period ranged from a high of \$238,350 to a low of \$27.11, with an average monthly charge of approximately \$914 per month.

Unfortunately, the average monthly credit used (\$914) is disproportionate to the average monthly credit limit of pCards (\$15,858). The difference between the “credit used” and the “credit limit” is considered “excess financial exposure”, which is approximately \$14,944 per pCard, per month.

High pCard credit limits unnecessarily increase the County’s financial exposure.

Failure of the County to reduce excess financial exposure could increase the risk of fraud, waste, or abuse. Further, pCards that remain inactive or underutilized for extended periods of time needlessly add to an approving manager’s administrative burden, especially when tasked with approving multiple Cardholders’ purchases.

We recommend the following:

1. Set pCard credit limits to match actual use; and
2. Cancel inactive or rarely used pCards to reduce administrative burden and the possibility of risk for fraud, waste, or abuse.

FINDING 5

Employees obtained pCards without first receiving training

Employees obtained pCards without first receiving training on its proper use. Because there is no system in place to ensure proper training is completed by employees prior to the issuance of a pCard or assignment of review/approval responsibilities, employees may not be ready to fulfill their responsibilities.

Additionally, the County may find it difficult to fully hold employees accountable for any misuse that may occur as a result.

Employees obtained pCards without first receiving training on its proper use.

Best practices issued by the United States Government Accountability Office (GAO), the United States Office of Management and Budget (OMB), and the National Association of Purchasing Card Professionals recommend that training be required both for potential Cardholders as well as reviewers/approvers of pCard purchases.

These trainings should take place prior to the issuance of pCards or assignment of review/approval responsibilities. Further, mandatory refresher trainings help ensure that all employees involved in the pCard process are kept up to date with current Program rules.

However, if Cardholders choose to not do the right thing with their pCards, no amount of training will prevent that misuse from happening. A tool that may help Cardholders do the right thing when no one is looking could be to incorporate elements from the "Reasonableness Test" found within Stanford University's expense guidelines into the County's training program.

In general, this reasonableness test makes Cardholders ask themselves a series of questions before making pCard purchases.

The pertinent questions are as follows:

Could the purchase/amount be comfortably defended under public scrutiny?

- Would I be free from worry if the purchase was audited?
- Would I be comfortable reading about it in the newspaper?
- Would I be comfortable explaining to a taxpayer that I used his/her money this way?

Using this test would enable Cardholders to “self police” purchases before they are made.

We recommend the following:

1. Establish a system to ensure pCard training is completed before an employee gets a pCard or is designated as a reviewer/approver; and
2. Require mandatory refresher trainings for all involved in the pCard process. Refresher trainings should occur at least every three years; sooner if significant changes to the Program are made.

FINDING 6

The ability for certain pCards to be used at restaurants creates a loophole which could allow those cards to be used at bars (i.e., hostess bars)

We observed no instances of exploitation of this loophole. However, testing revealed that two in four hostess bars fell within the “Eating places, Restaurants” Merchant Category Code (“MCC”), a category not currently blocked on pCards issued to the Department of Fire and Public Safety and the Department of Liquor Control. Further, in one instance, the business name shown on the charge was completely different from the name on the outside of the establishment; this could make detection even more difficult.

The use of pCards to make personal purchases or to purchase alcohol explicitly prohibited.

Unfortunately, the County does not have control over the MCC that a private business chooses to classify its business. As such, the County’s ability to block the use of pCards at businesses with certain MCC is diminished.

For example, if an establishment that is commonly known as a bar is identified by MCC 5813, “Drinking Places (alcoholic beverages)-bars, taverns”, County pCards will not work there because of an existing block put in place by the Purchasing Division.

However, if the same establishment reports its MCC as 5812, “Eating Places, Restaurants”, some County pCards will work and could be used to purchase alcohol or other services that are personal in nature.

Generally, purchasing meals is not allowed under the guiding principle that taxpayer funds should not pay for everyday personal expenses.

However, meals are allowed in certain instances relating to Board and Commission meetings or for “rehab meals” traditionally provided to firefighters during large-scale brush fires.

Failure of the County to detect and block the purchase of explicitly prohibited items by pCard could result in the loss of public trust and increase the chance of fraud, waste, or abuse.

We recommend the following:

1. The County should be aware of the limitations of MCC blocks and should begin compiling a listing of known instances where the colloquially known business names and products/services offered do not match the business names and MCC used by credit card companies to process payments. This list could then be used to more accurately scrutinize purchases; and
2. The County should strongly consider:
 - a. blocking restaurant or food-related MCCs on all pCards;
 - b. reimbursing approved restaurant or food-related expenses through existing processes outlined in Chapter 2.76, Maui County Code, and the “GUIDELINES FOR REIMBURSEMENT OF EXPENSES, REVISED MAY 2007”; and
 - c. implementing other preventative measures (e.g., Emergency pCards) to ensure purchases from restaurants or other food-related MCCs are limited, easily identified, and scrutinized.

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Subsequent Event

Use of public funds without a public purpose (i.e. for personal use) may violate the following:

1. Article 7, Section 4 of the Constitution of the State of Hawaii which mandates that public funds only be used for public purposes.
2. The Code of Ethics in Section 10-4.1.d of the Revised Charter of the County of Maui (1983), as amended, which prohibits the use of County property or personnel for other than a public activity or purpose.
3. State of Hawaii Purchasing Card Program and Procedures, which requires immediate closure of the account when a pCard is used for a personal purpose. Further, personal use may also require disciplinary action.
4. County of Maui Purchasing Card Program and Procedures, which restricts the use of a pCard to official purposes only. In addition, where personal use is suspected, termination of the account or other disciplinary action should be taken.
5. County of Maui Purchasing Card Cardholder Agreement, which explicitly states "...personal purchases is strictly prohibited and unauthorized...".
6. Item 4 of the Purchasing Card Agreement between First Hawaiian Bank and the County, which requires that pCards "...may be used for business purchases of goods or services...Company [the County of Maui] agrees that all Cards will be used solely for business use and not for consumer credit purposes."

Personal use of taxpayer funds by someone entrusted to protect it.

Near the completion of the audit, we observed an instance where a County pCard was used to purchase round-trip airline tickets to the mainland for the wife and college-aged child of the Director of Finance. The Director's travel was presumed to be to attend an Association of Certified Fraud Examiners in Nashville, TN, relating to "bribery and corruption". However, neither the Director's wife nor his college-aged daughter are County employees.

Although the Director of Finance reimbursed the County, using a County pCard to purchase airline tickets for family members is a personal use. Personal use of a County pCard is explicitly prohibited.

Because of the seriousness of this matter, we brought this to the attention of the Managing Director on May 5, 2017.

The actions of the Director of Finance are unfortunate because they present the County with some additional problems:

1. Loss of public trust. The person the public has entrusted with some of the County's highest level of responsibility, accountability, and trust...has violated that trust; and
2. Loss of respect by County employees for its Director of Finance. Specifically, can the County realistically expect its employees to follow rules when those rules are being broken by the person making them?
Short answer: no.

While we are hopeful that the County will make efforts to rebuild the public trust, County taxpayers deserve better. And, while we are confident that the County is capable of implementing many, if not all of our recommendations, the Director of Finance needs to regain employee trust by leading by example, not by exception.

ALAN M. ARAKAWA
MAYOR



KEITH A. REGAN
MANAGING DIRECTOR

DEPARTMENT OF MANAGEMENT

COUNTY OF MAUI

June 7, 2017

Lance T. Taguchi
County Auditor
2145 Wells St., Suite 2006
Wailuku, HI 96793

OFFICE OF THE
COUNTY AUDITOR

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RECEIVED

Dear Mr. Taguchi:

SUBJECT: AUDIT OF COUNTY PROCUREMENTS (pCard)

Thank you for your correspondence dated May 24, 2017, relating to the above-referenced subject and the opportunity to review the confidential draft report, *Audit of County Procurements (pCard)*. Pursuant to your request, please find our official comments to your findings and recommendations herein-below. Please note that our planned corrective actions are incorporated into our responses for each recommendation, and while we have already commenced review and assessment of the pCard program, policy and procedures, we intend to have all planned corrective actions implemented by January 1, 2018.

Oversight of the purchasing card program is the responsibility of the County Finance Department through its Purchasing Division. The Finance Department established and implemented the County of Maui Purchasing Card Program & Procedures in July 2008 to provide countywide management and direction of the pCard program and assigned the responsibility of overall program coordination to its Purchasing Division.

As mentioned in the draft audit report, the pCard can be an effective and cost-saving alternative to the more cumbersome purchase order. It is estimated that the County of Maui saves an average of \$50.00 per transaction in administrative costs, or an average \$850,000.00 per year based on a conservative estimate of \$50.00 saved per transaction multiplied by 17,000 transactions, when paying via a pCard versus a purchase order.¹

Unfortunately, while there are benefits to using pCards, there is also the potential for misuse and fraud. Accordingly, please know that the Department of Management ("Management") appreciates the audit and has already convened a working group that has been reviewing and assessing the pCard program and its policy and procedures to determine ways to effectively improve them.

¹ The Government Finance Officers Association (GFOA) recognizes the use of pCards as a *best practice* – providing "an efficient, cost-effective method of purchasing and paying for small-dollar as well as high-volume purchases." GFOA also notes that "this type of program is used as an alternative to the traditional purchasing process and can result in a significant reduction in the volume of purchase orders, invoices, and checks processed."

Lance T. Taguchi
June 7, 2017
Page 2 of 6

“Finding 1: Fraud, waste, or abuse may have occurred.”

It is our understanding that comments are not being required for this particular finding due to the nature of the irregularities and the ongoing investigation. Although not requested to provide comment on Finding 1, please know that we are very concerned about this matter and will fully cooperate and provide any assistance needed to facilitate the investigations.

“Finding 2: Cardholders used County pCards to make multiple back-to-back purchases to avoid purchase limits meant to safeguard taxpayer funds.”

Recommendation 1: “Make pCard training mandatory for all involved with the pCard program.”

Management Response: Agree. Adequate training for all employees involved with the pCard program is vital to ensuring that internal controls are clearly understood, effective, and properly adhered to for all pCard transactions. Management will work with the Department of Finance and the Purchasing Division to enhance existing training and include additional components that would address the concerns raised through this audit. We also intend to ensure that anyone involved with the pCard program has received training, and that no one is authorized to use a pCard without first receiving training.

Recommendation 2: “Provide resources so the Purchasing Division can actively identify transactions which indicate parceling or other noncompliance with the pCard Program. The Purchasing Division should:”

Management Response: Agree. Additional resources, in the form of manpower and operational funding, would better equip the County to conduct systematic reviews to better detect irregular pCard usage and take the appropriate steps to initiate investigations into possible violations of the policy. Management intends to explore the possibility of using data analysis, analytic software to better detect misuse, uncover program weaknesses and control deficiencies. Management will coordinate with the Budget Office to propose additional manpower and funding through a budget amendment to the Maui County Council (“Council”) for consideration. The amendment for additional manpower and resources to address this recommendation will require the Council to approve and fund the expansion request.

Recommendation 2a: “transmit those identified transactions by written correspondence to the Cardholder’s department/division head for follow-up;”

Management Response: Partially Agree. While we agree that there should be proper oversight, and that any transactions identified which may indicate parceling or other non-compliance with the pCard program should be documented and reviewed, we believe it would be advantageous for Management and the Purchasing Division to review this recommendation, along with the relevant provisions of the pCard policy and procedures, before making a final determination.

Lance T. Taguchi
June 7, 2017
Page 3 of 6

Recommendation 2b: “transmit a copy of the written correspondence to the Managing Director for oversight; and”

Management Response: Partially Agree. See, Response immediately above. Please know that Management has convened a working group that has already been reviewing and assessing the pCard program and its policy and procedures to determine ways to effectively improve them.

Recommendation 2c: “transmit a copy of the written correspondence to the County Clerk to allow for public inspection; and”

Management Response: Disagree. While we can appreciate the intent behind this recommendation, we are concerned that this recommendation may identify possible violations that have not been formally investigated. Formal investigations of alleged or potential violations can result in disciplinary actions against employees. As such, we are concerned that this recommendation could negatively impact the formal investigation process, potentially violate an employee’s right to due process, and expose the County to unnecessary liability.

Recommendation 3: “Actively and consistently suspend pCards and discipline employees for noncompliance with the pCard Program; and”

Management Response: Generally Agree. We agree that cardholders are responsible for the proper use of pCards and should be held responsible and accountable for violations of the pCard policy and procedures, or other noncompliance with the pCard Program. We also believe that there must be regular enforcement of the policy and procedures, as well as discipline, including the suspension of pCards, for those who violate the policy and procedures. However, for sake of clarity, we do not believe that every violation should result in an automatic suspension of pCard privileges. Instead, we believe that each violation or non-compliance should be evaluated on its own merits and appropriate disciplinary measures administered accordingly.

Recommendation 4: “Require requests be approved on a case-by-case basis if it is determined that a larger individual transaction limit above the \$500 is warranted. The rationale for the request and approval should be documented and made available for future audits or investigations.”

Management Response: Agree. Management will review this recommendation with the Finance Director and the Purchasing Agent to assess ways to incorporate this process into the current policy and procedures.

Lance T. Taguchi
June 7, 2017
Page 4 of 6

“Finding 3: Cardholders are not required to disclose when the purchases they make could be used in their personal business or in doing ‘side job’ type work.”

Recommendation 1: “The Cardholder Agreement should be revised to require Cardholders to disclose when the purchases they make can be used in their personal business or in doing ‘side job’ type work (e.g., the County plumber with a pCard who also does ‘side job’ plumbing work);”

Management Response: Partially agree. Management understands the concern, but will review this recommendation with the Finance Department, Department of Corporation Counsel and the Department of Personnel Services to assess the legal and operational feasibility of adding this recommendation to the pCard policy and procedures.

Moreover, we would respectfully suggest that this recommendation be revised to clarify that “personal business” means “personal work-related business” and that “purchases” means “purchases made with a County pCard.”

If appropriate and feasible, we will explore ways to incorporate language that captures the intent of this recommendation into the pCard policy and/or agreement.

Recommendation 2: “Approving managers should be made aware of a Cardholder’s personal business or performance of ‘side job’ type work by signing the Cardholder Agreement;”

Management Response: See, Response to Recommendation 1, immediately above.

Recommendation 3: “Cardholder Agreements should be updated every year or as soon as a Cardholder establishes a personal business or performs ‘side job’ type work;”

Management Response: See, Response to Finding 3, Recommendation 1, herein-above.

Recommendation 4: “Cancel pCards that do not have an updated Cardholder Agreement.”

Management Response: Agree. Management will review this audit recommendation with the Department of Finance and the Purchasing Division to assess the operational feasibility of incorporating this process in the pCard policy and procedures.

“Finding 4: Individual pCard credit limits are more than 16 times higher than actual use.”

Recommendation 1: “Set pCard credit limits to match actual use;”

Management Response: Agree. Management will review this audit recommendation with the Department of Finance and the Purchasing Division and discuss ways to effectively implement this recommendation.

Lance T. Taguchi
June 7, 2017
Page 5 of 6

Recommendation 2: *“Cancel inactive or rarely used pCards to reduce administrative burden and the possibility of risk for fraud, waste, or abuse.”*

Management Response: Agree. See, Response immediately above.

Finding 5: “Employees obtained County pCards without first receiving training.”

Recommendation 1: *“Establish a system to ensure pCard training is completed before an employee gets a pCard or is designated as a reviewer/approver;”*

Management Response: Agree. Adequate and relevant training for all employees before they assume responsibilities with the pCard program is vital to ensuring that internal controls are clearly understood, effective, and properly adhered to for all pCard transactions. Management will work with the Department of Finance and the Purchasing Division to enhance existing training and include additional components that would address the concerns raised through this audit.

Recommendation 2: *“Require mandatory refresher trainings for all involved in the pCard process. Refresher trainings should occur at least every three years; sooner if significant changes to the pCard Program are made.”*

Management Response: Agree. Management will work with the Department of Finance and the Purchasing Division to incorporate refresher trainings to ensure that all personnel involved with the pCard process stays current with policy requirements as well as to serve as an opportunity for the Department of Finance to be informed of issues, address concerns and obtain feedback from pCard administrators and cardholders.

“Finding 6: The ability for certain pCards to be used at restaurants creates a loophole which could allow those cards to be used at bars (i.e. hostess bars).”

Management Comment: Management appreciates the auditor’s observations and notes for clarity that the auditor’s recommendations did not arise from any specific instances of irregularities found in the performance of the audit. Management acknowledges that the recommendations are preventative controls that may be helpful in minimizing the potential risk for the misappropriation of funds.

Recommendation 1: *“The County should be aware of the limitations of MCC blocks and should begin compiling a listing of known instances where the colloquially known business names and products/services offered do not match the business names and MCC used by credit card companies to process payments. This list could then be used to more accurately scrutinize purchases;”*

Management Response: Agree. Management will review the audit recommendations with the Department of Finance and the Purchasing Division to assess the operational feasibility of incorporating this process effectively in the pCard policy and procedures.

Lance T. Taguchi
June 7, 2017
Page 6 of 6

Recommendation 2: “The County should strongly consider:

- a. blocking restaurant or food-related MCCs on all County pCards;
- b. reimbursing approved restaurant or food-related expenses through existing processes outlined in Chapter 2.76, Maui County Code, and the “GUIDELINES FOR REIMBURSEMENT OF EXPENSES, REVISED MAY 2007; and,
- c. implementing other preventative measures (e.g., Emergency pCards) to ensure purchases from restaurants or other food-related MCCs are limited, easily identified, and scrutinized.”

Management Response: Partially agree. Management generally agrees with this recommendation. See, Response to Finding 6, Recommendation 1 herein-above. However, it is our understanding that “Emergency pCards” will be introduced for use only during emergency situations (i.e. tsunami, hurricane etc.). Management believes that allowing reasonable food related purchases on “Emergency pCards” is necessary for employees asked or being required to work 24-48 hour (or longer) shifts.

We thank you for your hard work in the performance of your audit in assessing the internal controls of the County pCard program. We find your audit recommendations relevant and helpful, and our working group will carefully review and assess them to determine how we might best incorporate them into the County pCard program, policy and procedures.

Thank you for the opportunity to provide comments. Should you have any questions, please feel free to contact me, or Deputy Managing Director Jock Yamaguchi.

Sincerely,



KEITH A. REGAN
Managing Director

cc: Alan Arakawa, Mayor
Danny Agsalog, Finance Director

amh/jmy/kar



Lance T. Taguchi, CPA
County Auditor

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Audit of County Procurements (pCard)

Report No. 16-01, June 2017

The Office of the County Auditor is tasked with promoting economy, efficiency, and improved service in the transaction of public business in the legislative and executive branches of the County. Copies of this audit report can be obtained by contacting the Office of the County Auditor or visiting our website:

<http://www.mauicounty.gov/2032/Audit-Reports-Projects>.