PORTLAND DEVELOPMENT COMMISSION:
Financial transaction review reveals areas warranting management attention

February 2012

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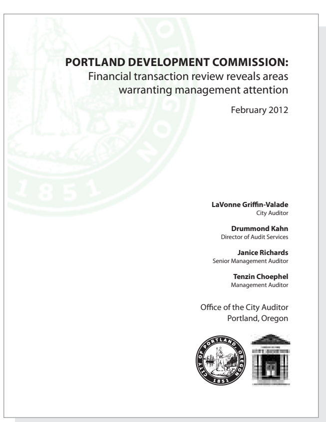
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TO: Mayor Sam Adams
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Commissioner Amanda Fritz
Commissioner Randy Leonard
Commissioner Dan Saltzman
Scott Andrews, PDC Commission Chair
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Charles A. Wilhoite, PDC Commissioner
Steven Straus, PDC Commissioner
Aneshka Dickson, PDC Commissioner
Patrick Quinton, PDC Executive Director

SUBJECT: Audit Report – *Portland Development Commission: Financial transaction review reveals areas warranting management attention* (Report #406B)

The attached report contains the results of our audit of financial transactions at the Portland Development Commission (PDC). We conducted a similar review of the City of Portland's financial transactions, and we will issue those results in a separate report.

Audits of a government entity's business activities provide important assessments of financial transparency, relevant safeguards, and the quality of public stewardship. In this case, our diagnostic tests revealed mixed results, and we identified nine areas that warrant management attention. These nine areas represent a diverse range of PDC processes – from payments to unregistered businesses to inconsistent treatment of employment incentives and fringe benefits. We have developed specific recommendations to prevent, detect and correct such activities in the future. PDC has already initiated corrective action in five of these areas, as noted in our report.

We ask the Portland Development Commission to provide us with a status report in one year, through the Office of the Mayor, detailing steps taken to address our recommendations in this report.

We very much appreciate the cooperation and assistance we received from Portland Development Commission staff as we conducted this audit.

L. Griffin-Valade

LaVonne Griffin-Valade
City Auditor

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Attachment

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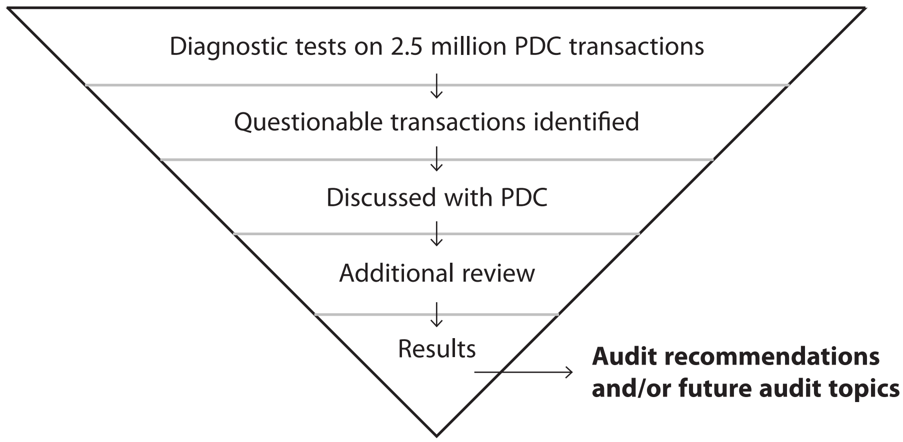
Summary

Just as the human body is susceptible to germs that can cause sickness, an organization is susceptible to risks that can cause errors, frauds or inefficiencies. Without adequate defenses, possible risks to an organization include fraudulent financial reporting, misappropriation of assets, corruption, regulatory and legal misconduct, and public mistrust.

We conducted an audit "check-up" on the financial transactions of the Portland Development Commission (PDC). Similar to a check-up by a doctor to assess patient health, a transaction audit uses a series of diagnostic tests to identify areas within an organization that may warrant management attention. Since an organization's financial transactions represent its business activities, transaction audits also serve as an important part of financial transparency and stewardship over public funds. Our objective was to review transactions – business activities that record the actual flow and use of funds – to identify irregularities, anomalies, risks and potential fraud, and investigate the underlying causes of any questionable transactions.

We selected a variety of diagnostic tests commonly applied to organizations' transactions, and after analyzing about 2.5 million transactions, we identified seventeen areas worth discussing with PDC. We discussed the results of these tests with PDC officials to interpret them within PDC's organizational context. We performed additional reviews and assessments. We found that eight of the seventeen identified areas appeared reasonable based on additional information provided, and require no further action by PDC.

Figure 1 Transaction testing audit process



Source: Audit Services Division

Ultimately, our diagnostic tests revealed mixed results and we identified nine remaining areas that warrant management attention. While the results of our review demonstrated that PDC has established some defenses, there were specific areas where the organization was either unaware of or not adhering to what was expected, allowed or accepted by its requirements. These nine areas represent a diverse range of PDC business processes – from payments to unregistered businesses to inconsistent treatment of employment incentives and fringe benefits. Management attention to the areas noted in this report will assist PDC's efforts to reduce risk and ensure compliance with applicable laws, regulations and accounting practices as intended.

Figure 2 **Issues warranting management attention**

Area	Issue	PDC Action
1	Payments to some unregistered businesses	
2	Weaknesses with conflicts of interest and related party transactions	
3	Overtime amounts mixed with regular salary	
4	Oregon Ethics Law compliance concerns for employee awards	Initiated
5	Information systems access needs better management	Initiated
6	Vendor records sometimes incomplete	Initiated
7	PDC issues checks payable to itself	
8	Some undetected duplicates and gaps in payment sequences	Initiated
9	Better guidance and documentation needed for employment incentives and fringe benefits	Initiated

Source: Audit Services Division

Every day, transactional activities in government require proper management and oversight. However, these activities often do not come to the public's attention unless there is a high profile issue, or if management failures escalate to significant error, fraud or scandal. In an effort to strengthen oversight at PDC, we have developed recommendations to fortify PDC's defenses to prevent, detect and correct such activities in the future. PDC has already initiated corrective action in five of these areas, as noted in this report.

Objectives, scope and methodology

The first objective of our work was to review transactions at the Portland Development Commission (PDC) to identify irregularities, anomalies, and risks. For any questionable transactions identified, a second objective was to investigate the underlying cause or refer the issue to management for resolution.

Our 2006 audit, *Financial Transaction Review: Few results identified for further study* (Report #334), analyzed the City of Portland's financial transactions for irregularities. This performance audit expands upon the work of that prior audit by including activities at PDC and adding more diagnostic tests. While this is the first PDC transaction audit conducted by our office, PDC's Internal Auditor recently completed reviews of travel, meals, membership and sponsorship payments, and made recommendations in each of these areas.

To prepare for our review, we interviewed staff and examined a variety of documents to gain an understanding of PDC's core business activities. The documents included policies, procedures, budgets and financial statements. In order to become familiar with the data, we reviewed available system documentation, record layouts, field definitions and sample extracts of data sets. We also researched best practices and audit reports issued by other jurisdictions related to transaction testing and fraud detection. We used this information to identify a series of diagnostic tests to perform for this review, as described in the Audit Results section.

We analyzed PDC data and applied the transaction tests using ACL, a software application widely used in the auditing profession for data analysis. The advantage of using ACL is that we were not limited to a small sample of transactions but analyzed full populations of data. We were able to quickly convert, match and join data to make information uniform and comparable for our test purposes.

We analyzed about 2.5 million transactions from the PDC accounts payable, payroll register, vendor master, employee master and information system user data sets. PDC provided all available data for the July 1, 2008, to September 30, 2010 period. We did not perform all planned payroll tests due to questions identified in our initial payroll analysis that were not resolved until after our fieldwork was completed. We describe the reason in the *Overtime amounts mixed with regular salary* section of this report. We may focus on that particular data set in a future audit.

While we identified nine areas that require further management attention in the Audit Results section, we shared an additional eight areas with PDC. We discussed the results of all tests to interpret them within PDC's organizational context, and received responses from PDC officials throughout fieldwork. We used an iterative process – we performed a set of tests, reviewed results and then used this information to perform additional tests as needed. Since some areas appeared reasonable based on additional information provided, no further action is needed by PDC officials. We describe these lower risk areas and their resolutions in the *Other transactions identified by auditors and referred to PDC* section of this report, starting on page 28.

We relied on management's representations about the data from its information systems. We did not perform tests of data reliability as part of our review, but we did verify and review the data for reasonableness. While we did not audit source documents, we checked management representations with our knowledge of programs. We requested and received additional information from PDC officials when warranted, as cited in the Audit Results section. Our reviews and results are not intended to provide absolute assurance that all data elements provided by management are free from error, or fraud, waste and abuse.

We conducted this performance audit in accordance with generally accepted 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.

AUDIT RESULTS

Payments to Some Unregistered Businesses

Requirements

Businesses are required to register with applicable government entities, and information in these registries is available to the public. Anyone doing business in Portland is required to register for a license through the City Revenue Bureau. In addition, many businesses also need to register with the state, and obtain any licenses, permits or certifications specific to their industry – for example, construction contractors must be licensed by the Oregon Construction Contractors Board. Requiring businesses to register provides the means for government to monitor business activity, collect fees and taxes, and allow the public to research and file any complaints about their interactions with these business entities. At PDC, procurement and financial assistance decisions originate in various work units, each responsible for assessing business compliance.

Audit steps

We used publicly available information to determine whether entities doing business with PDC complied with specific requirements. We examined whether businesses were registered with the City Revenue Bureau and Oregon Corporations Division. While PDC had close to 7,800 vendor, borrower and grant recipient records for the audit period, we focused our examination on the 185 entities that each conducted at least $100,000 in business with PDC during the audit period and were not exempt from registration requirements (i.e. not governments or sole proprietors).

Findings

From our review of the 185 PDC vendors, borrowers and grant recipients that met our criteria for the two business registries, we found the following:

- Five entities were not registered with either the state or the City.
- An additional twelve entities were not registered with the City.
- An additional five entities were not registered with the state.

We calculated that these 22 entities conducted about $12.8 million in business with PDC during the audit period. Our estimates represent the lower end of the actual range since we did not include businesses that registered once but may not have been current during the audit period. This estimate also does not include taxes these businesses would have paid if they were registered with the City.

While PDC educates businesses about registration requirements, the Purchasing and Contracting Manual for PDC employees is not as comprehensive. PDC's *Portland Business Handbook* targets business owners looking to start or expand a business in Portland and describes new business registration requirements. The *Doing Business with PDC* publication affirms the City business registration requirement and that vendors must have a legal capacity to transact business in Oregon. However, we found that PDC's internal purchasing policies and procedures do not include the Oregon state registration and licensing requirements. In addition, PDC does not apply any of the state or City requirements to its borrowers or grant recipients. Therefore, PDC has not directed its staff to verify business registration for all required situations.

Conclusions

PDC officials did not consistently make businesses follow its own requirements for doing business with PDC. Ultimately, by not verifying business registry, PDC is providing City funds to businesses that may not be operating in the City legally and paying applicable City business taxes.

Recommendations

We recommend PDC management:

- Revise its manual to include state and City registration requirements for all entities doing business with PDC, including borrowers and grant recipients.
- Develop new and strengthen existing procedures to assure entities are current with registration requirements prior to and while doing business with PDC.

Weaknesses with conflicts of interest and related party transactions

Requirements

Oregon public officials are expected to work in accordance with Oregon Government Ethics Law and PDC instructs its employees of these requirements. PDC's Commission adopted a "Conflict of Interest and Related Party Transactions" policy in 2009, which requires annual training. An internal audit report released in the same year also recommended PDC be aware of its employees who serve on outside boards and commissions that receive PDC funds because of possible related party concerns. Like many other governments, PDC relies on individuals to self-disclose any potential or actual conflicts of interests and related party relationships.

In addition to these policies, PDC includes similar requirements as part of its personnel and purchasing policies. PDC is not allowed to make purchases from a business or organization related to a PDC employee unless there is written authorization by the Executive Director. PDC also prohibits its former employees from serving as a PDC contractor for a period of one year after their separation date unless waived by the Executive Director.

Audit steps

We identified questionable relationships and then determined if PDC management identified or addressed these relationships. These included PDC employee-to-employee relationships, as well as relationships between PDC employees to PDC vendors, borrowers or grant recipients. To accomplish this, we used address, phone and social security or taxpayer identification number fields in the PDC employee, vendor, borrower and grant recipient files to find instances when a PDC employee matched another record in the PDC data sets.

Findings

The Oregon Ethics Law applies to a broad definition of "public officials," but we noted PDC's policies about conflicts of interest and related party transactions only address relationships between its "employees" and other organizations. City Councilors, PDC Commissioners, Urban Renewal Area Committee members and other volunteers are still subject to the Oregon Ethics Law, but PDC policies do not address these non-employees. In addition, unlike the City of Portland that has adopted a specific policy on nepotism, PDC policies do not address employee-to-employee relationships.

We focused on those individuals that PDC employed during the audit period because the information systems we used did not have information readily available for all PDC public officials. However, a PDC internal audit, which included PDC Commissioners and employees in its review, demonstrated the existence of numerous related party transactions in the normal course of PDC business activities. It found PDC officials served on the boards of directors for nine nonprofit organizations that received a total of nearly $1.4 million from PDC over 16 months within our audit period. The Internal Auditor concluded over half of this amount involved related party transactions.

Since relationship building and collaboration are among PDC's core values, we were also interested in the extent of PDC employee relationships to Oregon businesses and nonprofits generally. We obtained business registries for the City of Portland and State of Oregon to identify instances when an employee's home address matched another record in the data set.

When comparing the list of employees to the business registries, we found 162 PDC employees (45 percent) had their home address in one or both of the business registries, indicating a possible affiliation between someone at that address and an Oregon business. Since occupants at an address may change over time, we further examined how many of these addresses also matched employee names and found that 42 PDC employees (16 percent) appear to have a personal stake in a business.

We also identified a few relationships between PDC employees and its vendors, borrowers or grant recipients from our address match tests that were not identified in the internal audit. From the 262 employees reviewed, we questioned the following relationships:

- One PDC employee is the spouse of a PDC vendor who works out of their household. Over the course of the audit period, the vendor provided PDC with about $3,500 in advertising. PDC officials stated there was no authorization from the

Executive Director, but the employee had no responsibility in placing the advertisements.

- Three PDC employees were listed as both employees and as vendors. PDC officials reported it was common for former employees to become consultants, and we found all three provided consulting services immediately after separation from PDC. One served as a consultant and was paid $5,000 during the audit period but there was no waiver documented from the Executive Director. The other two former employees received waivers to consult, and initiated contracts in the audit period each not to exceed $25,000.

Not all of these businesses have the potential to be a PDC vendor, borrower or grant recipient, and not all PDC employees have decision-making authority that would result in a financial benefit that could lead to a potential conflict of interest. However, we believe the results of these collective tests reveal the possible relationships that may exist through PDC employees and their affiliations that are worth monitoring, as well as some of the actual relationships that are worth addressing.

Conclusions

PDC has several weaknesses in its conflicts of interest and related party practices. PDC existing policies are not inclusive enough to meet the Oregon Ethics Law definition for "public officials," and are silent about relationships between employees. In addition, there is compelling evidence that employee relationships warrant additional work in identifying and monitoring potential conflicts of interest and related parties. Lastly, PDC has not consistently followed its own requirements related to purchasing from businesses where employees may have a personal interest or hiring former employees.

Recommendations

We recommend PDC management:

- Ensure its "Conflict of Interest and Related Party Transactions" policy applies to all public officials as defined in Oregon Ethics Law, and include a nepotism policy.
- At a minimum, regularly advise all public officials how to disclose potential conflict of interest, including financial interest and related party relationships, in accordance with PDC's policies.
- Strengthen Executive Director authorization and waiver practices to align with existing policy and procedure requirements.

Overtime amounts mixed with regular salary

Requirements

Effective overtime management requires tracking data about work performed to control overtime costs, evaluate whether it is cost-effective to perform work on overtime as opposed to regular time, and prevent waste or abuse. PDC has adopted a standardized accounting system, in accordance with state laws and generally accepted accounting principles, which includes separate classifications for regular and overtime wages. The appropriate classification of accounting information is important to make sure users of financial and budget reports are receiving accurate information about PDC activities.

Audit steps

Since payroll is a significant expenditure for PDC, we performed various analytical tests on PDC's payroll data. One of the tests we conducted was to assess whether employee wages were for the appropriate salary or hourly rate. We compared gross wages and timesheet hours reported in the payroll data sets to the salary rates listed in the employee master file. We worked with PDC officials using a sample walkthrough to make sure our methodology for the analysis was reasonable.

Findings

We assessed whether PDC paid its employees at the appropriate salary or hourly rate. We first attempted to analyze the payroll data for the full audit period but then focused on payroll for one fiscal quarter because our calculations did not match expected salary amounts.

Our calculations for one fiscal quarter showed 27.7 percent of payroll records with rates that were greater or less than the rate listed in the employee master file. PDC indicated that the differences could be due to overtime. We found 82 employees (47.7 percent) in the quarter reported more hours on their timesheet than is typical in a business day (i.e. over 10 hours) or weekend activity. PDC officials explained that these results were reasonable because of employee job responsibilities or vacation payouts upon separation. Some employees were not eligible for overtime and additional hours worked would have been unpaid. However, others were eligible and paid at overtime pay rates.

PDC officials explained that PDC adds overtime to the regular wages account, which is why we could not isolate the impact of overtime in the payroll data provided. PDC officials did not know why the designated overtime account was not used. PDC project reports also mix hours together. Supervisors are responsible for approving overtime and reviewing timesheets for each pay period. They also have access to time reports that include separate overtime hours by employee for anyone they supervise.

Conclusions

PDC is not adhering to its own accounting system due to the combined reporting of regular and overtime wages in the regular wages account. Combining these significant expenditures makes the specific wage types less transparent for the public and PDC decision-makers.

Recommendations

We recommend PDC management:

- Separately record and track its regular and overtime wages in the designated general ledger accounts in accordance with PDC's accounting system.

Oregon Ethics Law compliance concerns for employee awards

Requirements

The Oregon Ethics Law specifically restricts when public officials are allowed to receive gifts, awards and other items of economic value because of their public position. The restrictions include gifts or awards given to employees by their public employers but does not discourage the use of employee award programs to recognize performance. If public employers use public funds to purchase these awards, they must meet certain requirements – generally, employees may be recognized based on job performance but, if not performance-based, any awards are restricted to less than $25 in value. The Oregon Government Ethics Commission may impose civil penalties for violations of the law.

Audit steps

We performed various tests on the PDC payroll register. One test was to identify when PDC employees received more than one check per pay period. We joined the resulting data sets to the employee master records, using employee identification numbers, to isolate the specific employees related to these instances.

Findings

In our review of PDC payroll transactions, we found 99 instances of employees receiving more than one check per pay period and PDC explained this was due to the processing of awards for PDC's Employee Recognition Program. While not in PDC policy, the Human Resources Division manages two types of awards and distributes framed award certificates and gift cards to select employees. The "Hats Off Award" is distributed quarterly to employees nominated and selected by their peers for exemplary job performance. The "Service Award" is distributed at particular job anniversary dates starting at 10 years of service.

PDC pays all applicable payroll taxes so that the net payment equals the gift card's face value (e.g. PDC paid $85.68 to include taxes for a $50 gift card awarded to an employee). In total, we identified 65 transactions totaling about $5,500 that were related to employee awards. The pre-tax award amounts ranged from $17.13 to $257.08 per instance.

Awards may be appropriate under the Oregon Ethics Law if considered part of an official compensation package approved by the entity's governing body. We examined applicable labor agreements and found no information about employee awards. PDC officials reviewed their records and found no documentation that the Board of Commissioners had approved the awards.

Conclusions

After consulting with the Oregon Government Ethics Commission, we do not believe the Service Awards are consistent with the Oregon Ethics Law. PDC discontinued the practice of distributing Service Awards to its employees after hearing our concerns about these awards. We conclude the Hats Off Award complied with the Oregon Ethics Law but PDC could formalize the information available on the awards.

Recommendations

We recommend PDC management:

- Assure Human Resources Division, Legal Division and other applicable staff receive training on the Oregon Ethics Law requirements so they can advise PDC on compliance issues in the future.
- Develop and approve a policy for its current Hats Off Awards.

Information systems access needs better management

Requirements

Information system security protects data from theft or loss, and must be managed and aligned with business requirements. PDC policy requires it establish and maintain procedures to restrict access to data and information processing resources to authorized users only. It also outlines responsibilities to ensure data access privileges are current, accurate and appropriate.

PDC uses two information system applications to disburse funds: the Lawson system includes accounting and human resource information; and the Mitas system included loan and grant information during the audit period. The PDC Accounting Manager approves employee access requests for these two applications. Various employees may have access to read information in the systems, but only specific employees in Accounting and Budgeting can enter transactional information into the financial system. The Information Technology Division generates user reports twice a year to manage existing user profiles and also receives alerts from the Human Resources Division to identify recently separated employees.

Audit steps

We compared user profile information to employee master information to identify any individuals with inappropriate access. Specifically, we combined data sets to include employee name, position, department and separation date fields. In addition, Lawson transactions include a field identifying the user who created the transaction, so we also reviewed the appropriateness of Lawson general ledger activities based on the user's job responsibilities at PDC.

Findings

We found instances when PDC did not terminate user access in a timely manner. Specifically, our test revealed the following:

- Three of the 149 Lawson user records were for individuals no longer working at PDC, including an individual who had permission for system-wide access. Two of the users were consultants hired for the system upgrade project conducted in June 2009, but the profiles were still active in March 2011.

- Three of the 51 Mitas user records were also inappropriate. We found two profiles were for temporary employees who had since separated from PDC, and we found duplicate profiles for one current employee who changed departments within PDC.

While PDC officials did not find any inappropriate postings to the system by these users, the data access weaknesses leave PDC vulnerable to potential misappropriation of funds or fraud.

PDC officials reported that it was taking steps to delete the profiles identified in our review. PDC officials also stated that Information Technology Division has recently updated the distribution of its user reports to include the Accounting Manager and senior staff from both Information Technology and Finance Divisions.

Conclusions

PDC did not follow its own policy to restrict access to data and information processing resources to authorized users only. While PDC has taken some corrective measures, it should take additional steps and perform reviews on a regular basis to make sure similar security lapses do not occur in the future.

Recommendations

We recommend PDC management:

- Strengthen existing procedures designed to restrict system access timely and according to PDC policy.
- Require the Information Technology Division regularly review the communication of user access information and monitor coordination across the Finance Division, Human Resources Division and other applicable staff.

Vendor records sometimes incomplete

Requirements

Data is often the most significant and valuable asset for a business. The way an organization collects and enters its data into their system impacts the reliability, completeness and usefulness of the data for management needs. PDC policy outlines staff responsibilities to ensure data integrity and quality by requiring business rules for data definitions, specifications and collection.

An entity's vendor master file is a critical resource that sits at the heart of payment operations. Since a business must be entered in PDC's vendor master file prior to payment, the file serves as PDC's centralized list of vendors, borrowers and grant recipients. Well-maintained vendor master records serve as a key defense in preventing duplicate payments, errors or fraud. PDC recently implemented an annual review to improve the integrity of these records.

Audit steps

We selected the vendor master files to assess the integrity and completeness of the data maintained in PDC's two systems, Lawson and Mitas. As part of our review, we examined the business name, address, tax identification number or social security number, and record type.

Findings

We reviewed a combined 7,781 vendor master records to assess the integrity and completeness of the data maintained by PDC. We found 230 questionable records in these files.

- We identified 65 records where key vendor fields were blank. PDC officials stated most of these vendors received a refund or reimbursement and the vendor either delivered or picked up the check. PDC officials stated it started requiring Internal Revenue Service (IRS) W-9 documentation with taxpayer identification numbers about four years ago, but did not start enforcing its collection and entry of this information into the information systems until recently.

- We identified 150 potential duplicate records. Of these, PDC officials confirmed and removed one duplicate. PDC officials stated the other 149 records were not duplicates – these records reflect PDC activity with multiple business entities that operate out of the same address, or when it needs to issue separate checks for an individual owner and his/her business.
- We identified 15 vendors incorrectly classified as employees and, as a result, PDC did not have complete data records for these vendors. PDC's practice is to maintain employee data in its employee master file and, when reimbursed for travel and other expenditures, only include minimal information on the employee in the vendor file. PDC officials stated the identified records are a mix of former and present staff of the Mayor's Office, and former and prospective PDC employees.
- We also identified differences in data field entries for non-employees requiring IRS Form 1099 informational returns. PDC officials could not explain why the differences existed, but stated the there was no impact in its reporting to the IRS since PDC does not rely solely on this field to generate the annual reports.

Conclusions

PDC's current practice of data management does not consistently produce complete records in the vendor master as required by policy. By using incomplete records, PDC has also missed an opportunity to verify, update and scrutinize information in its vendor master to add reasonable assurances against errors and fraud.

Recommendations

We recommend PDC management:

- Strengthen data entry procedures to maintain a complete record – with no redundancies or gaps in information – in the appropriate master files.
- Develop regular verification procedures to assure records are current and accurately reflect PDC activity with its vendors.

PDC issues checks payable to itself

Requirements

Checks issued from an entity made payable to itself are unusual. Generally, accounting entries are used to record these transactions between accounts and, if transferring funds between different bank accounts, wire transfers would be more secure than issuing paper checks for large dollar amounts.

Audit steps

As part of our review of the vendor master files, we found PDC listed itself as a vendor once in the accounting information system and twice in the loan and grant information system. We examined the accounts payable and disbursement data sets to identify the transactions associated with the PDC vendor activity.

Findings

We found the following checks signed by and made payable to PDC:

- We identified two accounts payable transactions for significant amounts of about $181,500 and $3.5 million. PDC officials stated that, on occasion, it is necessary to issue checks to facilitate the movement of funds. PDC issued the first check in 2008 to establish a sequestered cash account at the City of Portland Treasurer's Office. The second check in 2010 was to record the Grove Hotel property received in lieu of loan payment by a borrower. Staff reported that the practice of issuing checks to record property received in lieu of payment has become more common, although for smaller dollar amounts.
- We identified 426 checks in the audit period for lending and grantmaking activity – payable to PDC – ranging from $5 to $600,000. Collectively, these payments total about $1.7 million for the two PDC vendor records in the disbursement system. PDC officials stated these checks were for loan origination fees or reimbursements for credit reports and appraisals. PDC officials said that it needed the two vendor records to distinguish between different activities.

Conclusions

PDC issues checks to itself on a regular basis but for different reasons. It is unclear whether this practice is appropriate, especially for all the reasons described. Fraud schemes use a similar practice to steal funds. PDC's practice presents the opportunity for the misappropriation of funds, especially when more secure methods – such as wire transfers or journal entries – are available alternatives.

Recommendations

We recommend PDC management:

- Consult with its financial auditors to determine when it should issue checks payable to itself.
- Assure suitable controls are in place when issuing, endorsing and depositing these checks to minimize risk of misappropriation.

Some undetected duplicates and gaps in payment sequences

Requirements

Since checks and other payment methods are numbered, any duplicates or gaps in the number sequence are often examined as part of a transaction testing review. There should be no duplicates in the sequence. Any gaps – often the result of voided checks or printing errors – should be accounted for. Otherwise, unexplained duplicates and gaps could be due to fraud schemes using copied, forged or stolen checks.

PDC issues checks or wire transfers for payments to its employees, vendors, borrowers and grant recipients. PDC has different number sequences for each of these types of payments. PDC uses a log separate from the information systems to record the release of funds and account for any gaps in payment number sequence.

Audit steps

We examined the payroll, accounts payable and disbursement files to identify any duplicates or gaps in payment number sequences. We then reviewed the log to determine if PDC officials explained the reasons for the duplicates or gaps.

Findings

While reviewing the payroll, accounts payable and disbursement files, we found the following duplicate or gap sequence issues:

- We identified 95 out of 12,410 payroll checks issued were for duplicate check numbers. Some of these were for reversals but others were payroll payments for employee awards described previously in this report. PDC officials explained that the duplicates resulted from the payroll system incorrectly assigning the previously used check numbers to net zero checks. PDC officials stated they were investigating this issue of payroll check number assignment.
- We identified three sequence gaps in the 12,410 payroll checks. Since this payment sequence is not tracked in the log, PDC investigated the gaps and explained these were for voided paychecks.

- We identified 73 sequence gaps in the 23,047 accounts payable checks, yet there was no explanation in the log. PDC officials investigated the gaps and discovered they occurred when PDC paid a vendor for multiple invoices during a printing of checks. While there is a number on all checks, the system issues one check to the vendor to represent the total payment for all invoices and does not use the other checks.
- We identified 53 out of 3,883 disbursement checks issued were for duplicate check numbers. These were all for reversals or corrected disbursements to borrowers but there were no comments in the log.

PDC officials stated these transactions were accurate in the system and the lack of information in the log did not have any impact in its operations.

We also examined the wire transfers and identified six payments in the log that did not initially correspond with information in the financial system. Upon investigation, PDC officials explained five of these transfers were later cancelled and resulted in no transfer of funds. The remaining transfer was an automatic withdrawal that had been incorrectly recorded in the log as a wire transfer.

Conclusions

A number of payment sequence gaps and duplicates went undetected by PDC. In addition, the log used to monitor and explain any gaps and duplicates was not always accurate or complete, which impacted its effectiveness as a tracking tool. While PDC officials were able to explain most of the sequence issues, regular and timely reviews of gaps and duplicates can prevent errors or potential misuse of funds.

Recommendations

We recommend PDC management:

- Resolve the assignment errors for payroll check numbers.
- Strengthen the use of the log or develop an alternative means for reconciling and accounting for any gaps or duplicates in payment sequences.

Better guidance and documentation needed for employment incentives and fringe benefits

Requirements

Recruitment processes are developed and used to attract, evaluate and select the most qualified candidates to fill vacant positions. The PDC Commission has authorized the Executive Director to hire employees. The Human Resources Manager and Division Directors are responsible for developing offer letters for the Executive Director's approval. Recruitment processes should be job related, and in accordance with applicable legal requirements.

Audit steps

We examined payroll and accounts payable disbursements to identify any questionable payments made by PDC to its employees. We linked payments to PDC employees using employee name, employee number or social security number, and identified payments that were not regular paychecks.

Findings

While we found various types of employee payments (see *Other transactions identified by auditors and referred to PDC* section, page 30) consistent with PDC policies, we found instances where PDC offered employment incentives or fringe benefits not allowed in its policies:

- Two employees received relocation benefits as part of their compensation agreement at the time of hire. Both agreements stipulated a one-year minimum employment term, maximum relocation benefit amounts based upon allowable receipts ($5,000 for one and $10,000 for the other), and were signed by the Executive Director. Employees provided receipts and PDC reimbursed a total of $13,865. PDC officials stated it reported these benefits to the IRS.
- One employee received employer-provided parking that PDC officials said was based on the compensation agreement. However, PDC could not find the 2002 compensation agreement that authorized the parking incentive. While

reviewing this practice, PDC paid the employee about $1,800 for the 2009 undisclosed tax liability but a 2011 tax advice letter from a Certified Public Accountant disagreed with PDC's decision.

- One employee received an employer-provided vehicle. An internal memo from 2005 referenced a facilities van and revised job description stipulating the employee had on-call responsibilities for emergencies. PDC paid the employee about $700 for the 2009 undisclosed tax liability but the 2011 tax advice letter stated PDC needs additional documentation for this tax treatment.

PDC officials stated that it does not have policies about employment incentives and vehicle fringe benefits. The incentive items are available for negotiation at the time of hire for certain management level positions. In comparison, the City of Portland has a human resource policy that identifies interview travel, relocation and vacation accrual as possible employment incentives available at the discretion of its bureaus.

Conclusions

PDC should formalize the guidance and improve its record retention for employment incentives and fringe benefits. Including these items in policy will assure these practices are consistent and are in accordance with applicable legal requirements. PDC informed us it has stopped providing assigned parking for any employees or Commissioners, and made improvements to its record retention of personnel files.

Recommendations

We recommend PDC management:

- Establish policies regarding employment incentives and employee fringe benefits to assure consistency in application, record keeping and tax reporting.

Other transactions identified by auditors and referred to PDC

In addition to the nine areas described in the report, we also questioned transactions because of other tests we performed on the data sets. We shared and discussed these transactions with PDC officials. We referred these items to PDC officials and they concluded that the transactions were appropriate. We summarize these results below but require no further action by PDC.

Figure 3 Issues referred to PDC

Area	Issue	PDC Action
10	Duplicate payments	Resolved
11	Suspicious payments	Resolved
12	Weekend activity	Resolved
13	Activity with prohibited federal vendors	Resolved
14	Activity with deceased individuals	Resolved
15	Payments to employees	Resolved
16	Employee benefit periods	Resolved
17	Late bill payments	Resolved

Source: Audit Services Division

Duplicate payments

We used the vendor, check date, amount and invoice number fields to identify 1,033 potential duplicate payments (4.5 percent) out of the total 23,047 accounts payable transactions. PDC reviewed these payments and stated these were recurring property and utility expenditures that are often paid using the same primary invoice number. PDC officials stated it prevents duplicate payments through its authorization, review and reconciliation processes.

Suspicious payments

We analyzed PDC accounts payable transactions and found that payment amounts did not conform to the expected distribution under "Benford's Law," a simple theory regarding the naturally occurring frequency of numbers. We reviewed the ten categories with the most significant deviations since they were indications of possible suspicious or fraudulent transactions. Our investigation showed the deviations appear to be due to a significant number of recurring transaction amounts. PDC officials reviewed the 34 vendors identified with these recurring transactions, and stated the payments related to its core business activities (e.g. property maintenance, pest control, security services, subscriptions, advertisements, bond administration fees, payroll withholding, etc.).

Weekend activity

We reviewed date fields for various transaction files to identify potential unauthorized activity outside of business hours, and found a large number of accounting records occurred on a weekend. PDC officials stated many of the system date fields are auto-filled based on the invoice due date or month end date, and other dates were in error. While accounting staff reviewed and approved the erroneous dates, PDC officials said it scrutinizes this field more at year-end when any errors could affect reporting in the proper financial period.

Activity with prohibited federal vendors

We compared the federal registry of businesses debarred, suspended or otherwise disqualified from federal contracts to PDC disbursement information. Using the name fields from the federal registry, we found potential matches to seven individuals from PDC files. Since the results included commonly occurring names, PDC officials reviewed the list and verified that none of these excluded entities were actual matches with businesses PDC paid.

Activity with deceased individuals

We compared PDC data with social security numbers from over twenty years of State of Oregon death records, and found one vendor and three borrowers died during the audit period. PDC officials verified the vendor provided services prior to dying, and verified the appropriate release of interest payment refunds to the estates or spouses of the deceased borrowers per their loan agreements.

Payments to employees

We used accounts payable disbursements to identify any questionable payments made by PDC to its employees. We found non-payroll payments to 171 employees (65 percent of all employees) that total about $315,600 for the audit period. There were various reasons for these payments and PDC officials stated these were supported by PDC policy (i.e. work-related travel reimbursement), labor agreement (i.e. tuition reimbursement), or legal settlement.

PDC had a reduction in force during the audit period. As a result, 16 employees received severance and retirement payments processed through payroll which total about $446,000. We requested supporting documentation since these amounts ranged from 12 to 58 percent of the employees' annual salaries. We found these amounts were in accordance with Human Resources Division documentation and an executive team member's individual agreement signed by the Executive Director.

Thirteen of 932 employee payments (1.4 percent) were made after the employees' departures. However, most were within a month of employee separation and PDC officials provided reasonable explanations for the remainder.

Employee benefit periods

We compared employee benefit data with hire and separation dates in the employee master file, and found three employees had benefits that did not align with their employment dates. PDC officials explained that these differences were from employees that separated and were later rehired.

Late bill payments

We compared the invoice due dates to the payment dates for 23,047 payments issued by PDC during the audit period. We found that 48 percent of payments were released on the invoice due date and an additional 14 percent were issued after that date. PDC officials stated that PDC does not pay late fees, interest or other charges for late payments even if these payments are late.

RESPONSES TO THE AUDIT

OFFICE OF MAYOR SAM ADAMS
CITY OF PORTLAND

February 7, 2012

Ms. LaVonne Griffin-Valade
Office of City Auditor
Audit Services Division
1221 S.W. 4th Avenue, Room 310
Portland, OR 97204

Dear Ms. Griffin-Valade,

My office thanks you and your staff for the time and energy put forth in preparing the recent audit of the Portland Development Commission (PDC). The report, *Portland Development Commission: Financial transaction review reveals areas warranting management attention*, Report #406B, provides insight regarding PDC's day-to-day business activity, and makes valuable recommendations for improved organizational success.

I have reviewed PDC's letter of February 1, 2012, detailing their management's response to the above-referenced audit. I find their response to be sufficient, and I concur with the steps they have outlined to implement corrective actions. Thank you again for all your efforts.

Sincerely,

Sam Adams
Mayor, City of Portland

SA:cam

Cc: Patrick Quinton
Executive Director, PDC

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February 6, 2012

Ms. LaVonne Griffin-Valade
Office of City Auditor
Audit Services Division
1221 S.W. 4th Avenue, Room 310
Portland, OR 97204

Dear Ms. Griffin-Valade,

We thank you for the opportunity to respond to your recent audit, *Portland Development Commission: Financial transaction review reveals areas warranting management attention*, Report #406B, and for the work put into this audit by your staff. It was a pleasure working with them and we appreciate their patience and dedication as they learned how the Portland Development Commission (PDC) does business.

The PDC management is gratified to know that out of 2.5 million transactions reviewed, the audit has identified a handful of items requiring some type of corrective action, and confirmed that these errors are primarily related to systems and process errors, rather than intentional action on the part of PDC management or staff.

This letter details management's response to the recommendations resulting from your recent audit and the steps we will be taking to implement corrective actions.

1. *Payments to Some Unregistered Business;*

- *Revise its manual to include state and City registration requirements for all entities doing business with PDC, including borrowers and grant recipients.*
- *Develop new and strengthen existing procedures to assure entities are current with registration requirements prior to and while doing business with PDC.*

The PDC is in the process of publishing of updating the Purchasing and Contracting Manual dated November 10, 2011. The new updated manual, expected to be published March 1, 2012 reads:

> **2.4.2 City of Portland Business License.** Vendors must obtain a Portland Business License. Application materials and an explanation of fees can be found at www.portlandonline.com/omf/index.cfm?c=29554. Search for licensed businesses at www.portlandonline.com/licenses/lookup.
>
> **2.4.3 Authority to Transact.** Corporations (for-profit and non-profit) and sole proprietors operating under an assumed business name (e.g., "John Coltrane d/b/a Coltrane Enterprises") must register with the Oregon Secretary of State's Corporation Division. Sole Proprietors operating under their legal name are not required to register with the Secretary of State. Application forms and an explanation of fees can be found at: www.filinginoregon.com/pages/business_registry. Search the Oregon business registry at: http://egov.sos.state.or.us/br/pkg_web_name_srch_inq.login.

The Purchasing and Contracting Manual does not cover borrowers and grant recipients. Urban Development Department business processes for loans and grants include the collection and verification of business registration information, as well as assisting new businesses with the requirements of doing business in the City of Portland. Urban Development Department previously recorded City license and State registration information in a separate CRM database; that database has recently been merged into PDC's financial assistance system. Accounting processes will be revised to include the collection, verification, and retention of the registration information in the vendor record in the Lawson Financial System.

The PDC agrees that it is good practice to check the City of Portland Business License and the Oregon Secretary of State's Corporation Division registry when PDC enters into a contractual relationship with a business. But periodically re-checking for compliance during the agreement term would be administratively burdensome given the large number of businesses with which PDC has contractual relationships, and of less practical value, given the lack of an appealing remedy (short of default) for non-compliance. However, re-verification of the City Business License and State Registry at contract amendment adds value and is currently the PDC practice as outlined in Section 7.73 of the updated Purchasing and Contracting Manual dated November 10, 2011. As noted above, the revision of Accounting processes to include the collection of registration information will also include appropriate steps for re-validation.

2. *Weaknesses with conflicts of interest and related party transactions;*

- *Ensure its "Conflict of Interest and Related Party Transactions" policy applies to all public officials as defined in Oregon Ethics Law, and included a nepotism policy.*
- *At a minimum, regularly advise all public officials how to disclose potential conflict of interest, including financial interest and related party relationships, in accordance with PDC's policies.*
- *Strengthen Executive Director authorization and waiver practices to align with existing policy and procedure requirements.*

The PDC recognizes the value in having a single conflict of interest policy, incorporating the requirements of applicable law, that applies both to employees and volunteers who serve on PDC committees. Accordingly, PDC will revise its existing Conflict of Interest and Related Party Transactions Policy to extend to both groups, which should make the policy applicable to all public officials associated with PDC other than members of PDC's Board of Commissioners. As you know, the Oregon Government Ethics Law applies in a different way to members of Boards and Commissions than it does to other public officials. And the typical practice for a Board or Commission that acts as the governing body of a local government, is to look directly to the Oregon Government Ethics Law (rather than to an intervening policy) for the applicable ethics rules both because the Oregon Government Ethics Law is, by itself, a comprehensive regulatory scheme (including implementing administrative rules and an enforcement mechanism in the form of civil penalties for violations) and because it is not clear what the enforcement mechanism would be if a Board or Commission member violated a Board adopted policy. Accordingly, PDC believes the public is best served by having the members of the Board of Commissioners look directly to the Oregon Government Ethics Law for the applicable ethics rules governing their actions as commissioners.

Although PDC believes that much of what would otherwise be covered by a nepotism policy is addressed implicitly in PDC's existing Conflict of Interest and Related Party Transactions Policy, PDC will make the nepotism provisions explicit either through revision of that policy or adoption of a new policy.

The PDC trains new staff, on or near the first day of employment, and existing staff, annually, on the requirements of PDC's Conflict of Interest and Related Party Transactions Policy. And PDC provides information on the Oregon Government Ethics Law in Board packets and regularly advises members of its Board of Commissioners on the requirements of that law. PDC will continue those practices and develop a process for advising volunteers on PDC committees of the requirements of the policy. Training will include appropriate Executive Director authorization and waiver requirements to meet PDC's existing policy and procedure requirements.

3. *Overtime amounts mixed with regular salary;*

   - *Separately record and track its regular and overtime wages in the designated general ledger accounts in accordance with PDC's accounting system.*

The recording of overtime wages combined with regular wages is a legacy from a former time sheet system. Steps are already being taken to record wages paid as overtime in the appropriate general ledger account. Once system changes are tested, the change will be implemented with the start of the next fiscal year.

It is also important to note here that approximately 80% of PDC's employees are exempt from overtime. Salaried employees' record all hours worked and wages are prorated to the applicable projects costs based on the hours recorded for each project.

4. *Oregon Ethics Law compliance concerns for employee awards;*

   - *Assure Human Resources Division, Legal Division, and other applicable staff receive training on the Oregon Ethics Law requirements so they can advise PDC on compliance issues in the future.*
   - *Develop and approve a policy for its current Hats Off Awards.*

The PDC agrees with the need for training of applicable staff on the requirements of the Oregon Ethics Law and will ensure that appropriate training needs are met. Additionally, steps will be taken to formalize and approve the Hats Off Award program.

5. *Information systems access needs better management;*
   - *Strengthen existing procedures designed to restrict system access timely and according to PDC policy.*
   - *Require Information Technology Division regularly review the communication of user access information and monitor coordination across the Finance Division, Human Resources Division and other applicable staff.*

The PDC will strengthen existing procedures designed to restrict system access according to policy and in a timely manner. Additionally, the IT Division will provide user access information to the Finance Division and HR Division no less than quarterly to ensure only currently authorized users have access to appropriate systems.

6. *Vendor records sometimes incomplete;*
   - *Strengthen data entry procedures to maintain a complete record – with no redundancies or gaps in information – in the appropriate master files.*
   - *Develop regular verification procedures to assure records are current and accurately reflect PDC activity with its vendors.*

The PDC has amended vendor requirements to include the collection of W-9's on all vendors regardless of payment class and will further include business registration information as previously noted in response to recommendation #1. Additionally, all employee vendor records will include all required information.

The PDC annually, as part of its financial audit procedures, reviews vendor records for duplicates. With the inclusion of financial assistance vendors in Lawson, PDC will be assessing the review and frequency of this step. Year End procedures also include the inactivation of vendors not used in the preceding two years. To reactivate a vendor, procedures require a new W-9 form signed by the vendor.

7. *PDC issues checks payable to itself;*
   - *Consult with its financial auditors to determine when it should issue checks payable to itself.*
   - *Assure suitable controls are in place when issuing, endorsing, and depositing these checks to minimize risk of to minimize risk of misappropriation.*

The PDC will consult with its financial auditors regarding this practice. We will also review our procedures and evaluate alternatives in light of the new financial assistance system recently implemented.

The PDC is acutely aware of the risk surrounding this practice and for that reason the responsibility for issuing, coding for deposit, endorsing and preparing the deposit, and actually depositing these checks reside in separate positions. As a further safeguard, the position responsible for reconciling the bank statement is completely separate from the deposit transactions. PDC will review existing controls to determine if any changes are required to comply with this recommendation.

8. *Some undetected duplicates and gaps in payment sequences.*
   - *Resolve the assignment errors for payroll check numbers.*
   - *Strengthen the use of the log or develop an alternative means for reconciling and accounting for any gaps or duplicates in payment sequences.*

The recommendation regarding the assignment errors for payroll check numbers results from the payroll processing of earnings gross-ups for taxable awards which result in a net zero check. A net zero check happens when the earnings less withholdings equal zero not creating a disbursement record. The system does not create a check but the last check number used is carried forward on the transaction. PDC is investigating the system assignment of carrying the last check number through on net zero transactions and will implement any corrective measures necessary to resolve assignment errors.

The PDC has also enhanced the use of the check log to include voided checks and skipped numbers, the result of remittance overflow. We have also added a tab in the check log for payroll checks; accounting for all three types of payments issued through the payroll system.

9. *Better guidance and record retention needed for employment incentives and fringe benefits.*
   - *Establish policies regarding employment incentives and employee fringe benefits to assure consistency in application, record keeping, and tax reporting.*

The PDC's new Human Resources Division Manager will be reviewing and updating PDC's Personnel policies and procedures in the near term to ensure consistency in application, record keeping and tax reporting. PDC agrees with the findings and, as noted in the audit, has discontinued providing assigned parking for employees and Commissioners and has made improvements to its record retention of personnel files. PDC will request the City's policies that cover "interview travel, relocation and vacation accrual as possible employment incentives available at the discretion of its bureaus" to become familiar with the City's guidelines in these areas.

On behalf of the PDC Audit Committee, please extend our appreciation to the Audit Services staff for their effort on this audit and considering our feedback during the process.

Sincerely,

Patrick Quinton
Executive Director

PQ:crk

Cc: Mayor Sam Adams
PDC Audit Committee

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Portland Development Commission: Financial transaction review reveals areas warranting management attention

Report #406B, Febraury 2012

Audit Team Members: Janice Richards
Tenzin Choephel

LaVonne Griffin-Valade, City Auditor
Drummond Kahn, Director of Audit Services

Other recent audit reports:

DNA Testing: Turnaround time must improve to meet national guidelines (#427, January 2012)

City of Portland 21st Annual Community Survey Results (#409, December 2011)

Span of Control: Although numbers are reported, bureaus lack organizational structure goals (#397, August 2011)

Portland's Fiscal Sustainability and Financial Condition: Actions now can reduce risk of future problems (#399, July 2011)