Prompt Payment Act Follow-Up Review

November 2015

Prepared by the Audit Division

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EXECUTIVE SUMMARY

The California High-Speed Rail Authority's (Authority), Audit Division has completed a follow-up review to our 2012 review of the Authority's compliance with the California Prompt Payment Act (Act), which requires that state agencies pay invoices for goods and services within 45 days of receipt or be subject to late payment penalties. Our follow-up review evaluated the Authority's compliance with the Act during fiscal years 2013/14 and 2014/15.

During our follow up review we found that the Authority continued to pay invoices late during fiscal years 2013/14 and 2014/15, primarily due to its cash flow situation. As the Authority's cash flow situation improved, the decision was made to make payments to vendors and contractors for valid amounts invoiced to bring the accounts current. In fall 2014, the Office of Accounting conducted a review of invoices paid in fiscal years 2012/13 and 2013/14. Penalty amounts were calculated and paid in accordance with the Act.

Our follow-up looked at the completeness of the review performed by the Office of Accounting in 2014, as well as a sample of penalty calculations for payments made in fiscal year 2014/15.

We reviewed eight invoices from fiscal year 2013/14 to determine if payment was made in a timely manner, and found no supervisory review of the penalty calculations, two incorrectly completed penalty calculation forms and one miscalculated penalty amount. We also reviewed 9% (115 of 1,317) of the claim schedules submitted to the State Controller's Office for payment in fiscal years 2013/14 and 2014/15 to determine if the proper penalty amount was paid and found five invoice penalties were not identified to be paid and two penalty payments were calculated incorrectly. We recommend the Authority require that Office of Accounting supervisory staff carefully review all penalty calculations to ensure they are correct. In addition, the Office of Accounting should develop a process that accounts for prior period invoices paid in a subsequent period to ensure that penalty payments are paid when necessary.

Finally, although the Authority incurred over $230,000 in late payment penalties attributable to invoices received in fiscal year 2013/14 the Authority did not file required reports to the Department of General Services detailing the amount of penalties because no payments of penalties were made until fiscal year 2014/15. We recommend the Authority require that penalty payments are made when penalties are incurred.

BACKGROUND

This review is a follow-up to our 2012 review of invoices paid with federal funds to determine whether the Authority is in compliance with the California Prompt Payment Act (Act). Report number 12-01, Compliance Review of the Prompt Payment Act, found that 18 of the 23 sampled invoices (78%) were not paid within the 45-day statutory timeframe and were, therefore, subject to penalty payments to vendors. Our objective for this follow-up review was to gain reasonable assurance that the Authority has improved its procedures for paying invoices within the 45-day timeframe.

In July 2014, state Cap and Trade funds were appropriated for the Authority, which as a new revenue stream provided the Authority with the ability to pay invoices with state funds and subsequently submit those expenses for federal reimbursement.

The 2012 review found that the Authority's funding structure allocated state Proposition 1A funds to pay the federal portion of invoices on a reimbursement basis, but the allocations of funds were not always adequate to pay both the state and federal portions of invoices until federal funds were received to reimburse Proposition 1A funds. Further, the review found that the Federal Railroad Administration was not equipped to process reimbursements through a drawdown of funds resulting in the Authority not receiving reimbursements for several weeks. Other delays were due to insufficient encumbrance balances; delayed submission of invoices by the Authority to the Department of General Services, the entity performing the Authority's accounting function at the time; insufficient encumbrance balances due to mis-posting by the Department of General Services; and Authority staff not date-stamping invoices until they were received by the Authority from the Project Management Team when they should have been date stamped by the Project Management Team when they were originally received.

Government Code, section 927 et seq. the Act, and State Administrative Manual, section 8474 et seq. specify that state agencies are liable for penalties on the undisputed amount of an invoice if they fail to submit a correct claim schedule to the State Controller's Office within 30 days of receipt of an invoice and payment is not issued within 45 calendar days. State departments are to automatically calculate and pay appropriate late payment penalties when due.

Invoices are date stamped when received and sent to the Office of Accounting where they are logged and scanned into the Office of Accounting's incoming log and delivered to the accounts payable staff responsible for the vendor. Accounts payable staff forwards the invoices to the contract or project manager for review, approval and return to the accounts payable staff for final review to ensure that all supporting documents are included with the invoices and that they comply with the contract agreement.

The foregoing invoice payment process has been in use by Authority staff since December 2013 when the Authority took over responsibility for accounting functions that had previously been contracted to the Department of General Services. The payment process has been revised through continuous improvement to provide associated timelines that are intended to ensure that payments are made to vendors to avoid late payment penalties. According to Office of Accounting staff, late payments are typically the result of a lack of funds. Under previous grant drawdown procedures, the Authority forwarded invoices to the FRA for payment and did not pay invoices until receiving the funds drawn, which was 30 days or longer. Since

July 2014, the Authority can pay invoices using available state Cap and Trade funds while waiting for the FRA reimbursement, avoiding late payments and the need to pay late payment penalties.

In fiscal years 2012/13 and 2013/14, the Authority's limited cash flow caused by a lengthy federal reimbursement process, led to an accumulation of late payment penalties. As the Authority's cash flow situation improved, the decision was made to make payments to vendors and contractors for valid amounts invoiced to bring the accounts current. In the fall of 2014, the Office of Accounting conducted a review of invoices paid in fiscal years 2012/13 and 2013/14. Penalty amounts were calculated and paid in accordance with the Act.

SCOPE AND METHODOLOGY

The scope of this review was to determine if the Authority is in compliance with the Act. The review focused on invoices received during fiscal years 2013/14 and 2014/15, and paid with federal funds. This included invoices for the time period encompassed by the Authority's assumption of responsibility for all accounting services and invoices processed using the current invoice processing procedures. A review of data since December 2013 should provide reasonable assurance as to whether or not the Authority has improved its process with regard to paying invoices.

To ensure that the follow-up review included the relevant data from fiscal year 2013/14, the Authority's Office of Accounting provided a listing of all invoice payments and associated days to payment through fiscal year 2013/14. The information was obtained from CALSTARS and the State Controller's Office information. We checked the listing against the 2013/14 federal funds drawdown listing of payments with federal funds, also obtained from the Office of Accounting from grant documents, to ensure that all payments were included from both sources, that all matched, and that the receipt date of invoices as well as the dates of invoice approval, payment and transmittal to the State Controller were accurate on the CALSTARS listing of all invoices. We performed the comparison of the listings to validate the CALSTARS listing of invoice payments. The CALSTARS listing of all fiscal year 2013/14 invoices does generally correspond to the federal drawdown information providing assurance that all invoices are included on both sources.

In addition, for fiscal years 2013/14 and 2014/15, CALSTARS reports identifying invoice payment amounts and dates were compared to the Office of Accounting's worksheet used to identify and calculate penalty amounts due.

To determine whether the Authority has improved its payment of invoices to avoid late payment penalties, we judgmentally selected eight sample invoices for review from fiscal year 2013/14 from the Authority's largest contracts. We obtained supporting payment documentation for the selected invoices to the extent possible. In addition, we selected 9% (115 of 1,317 of the claim schedules sent to the State Controller's Office for payment to determine if applicable penalty payment was paid.

This review was not performed under the International Standards for the Professional Practice of Internal Auditing due to the nature of the review. The review took place at the Sacramento office. The results of the review were discussed with management. A response to the draft report was provided by the Fiscal Services Division, and is attached.

RESULTS AND RECOMMENDATIONS

Based on this follow-up review, we found that the Authority continued to pay invoices late, primarily due to an inadequate cash flow. The results of our review are discussed below along with recommendations for improvement.

Issue 1 Penalty calculation was not always accurate.

Based on our review of the eight sample invoices from fiscal year 13/14, we found:

Review and approval of Penalty Calculation forms: For five of the invoices we reviewed, we noted there was no approval of the Penalty Calculation forms (Std. 208) by a supervisor or manager. In all five cases, the "Approver Initial & Date" lines were blank. One form had been initialed by a staff member who reviewed the form but the reviewer was an accountant trainee. Our conclusion is that there was inadequate approval of the forms and, therefore, erroneous penalty calculations and penalty payments could have been prevented.

Incorrect information on Penalty Calculation forms: On two of the Penalty Calculation forms, there was conflicting or incorrect information. For example, on one form the date the claim schedule was sent to the State Controller was noted as April 28, 2014, two months after the date paid of February 28, 2014. Upon review, we found that the date the claim schedule was actually sent to the State Controller was February 26, 2014. The conflict in information did not have any effect on the calculation of penalties because the date the invoice was due to be paid was November 8, 2013, but the date paid was 112 days later. The Authority incurred a penalty of $5,814.45 for paying the invoice late. According to staff of the Office of Accounting, the Authority took 112 days to pay the invoice because the portion of the invoice associated with the payment was subject to an unavailability of funds.

Error in penalty assessments: One invoice payment penalty was in error due to incorrect information on the Penalty Calculation form that resulted in an overpayment of penalties to the vendor. The invoice, dated February 25, 2014, from the vendor, was received by the Authority on April 10, 2014. The Penalty Calculation form indicated that payment was due on February 25, 2012, and that it was paid by the State Controller on June 12, 2014, 748 days after the payment was due. The Authority paid a penalty to the vendor of $792.37 for the late payment. However, the actual date the payment was due was May 25, 2014, (45 days after receipt of the invoice). Accounting records indicate that the claim schedule was sent to the State Controller for payment on June 11, 2014. As a result, the invoice was paid 18 days after the payment was due, resulting in no penalty due since the amount of penalty calculated on the invoice amount of $31,156.54 was less than $100. The Authority will recover the overpayment from the contractor.

Errors on these forms could likely have been prevented. Supervisory review and approval of the Penalty Calculation forms should have been performed to ensure that these errors did not occur. If reviews had been performed, with a supervisor verifying the data used to make penalty calculations instead of relying on unverified data from other than original sources, these errors and inappropriate penalty payments could have been avoided.

Based on our review of 9% (115 of 1,317) of the claim schedules submitted to the State Controller's Office in fiscal years 13/14 and 14/15 we found five invoices where the penalty due was not paid. In these instances the invoices were received for a prior fiscal year billing period, and paid in the subsequent fiscal year.

In addition, we found two invoices in which the proper penalty was not paid. The two invoices were for a certified small business, which have different criteria for penalty payments. According to the Office of Accounting, the error was because the invoices did not identify that the vendor was a certified small business. The small business penalty rate is 10% above the United States Prime Rate on June 30 of the prior fiscal year and the penalty can only be waived if the amount of the penalty is less than ten dollars. In contrast, the penalty for all other businesses is 1% above the Pooled Money Investment Account daily rate on June 30 of the prior year and the penalty may be waived if less than one hundred dollars.

Recommendation: The Office of Accounting should:

- Ensure that penalty calculations are correct by requiring supervisory review and signoff on Penalty Calculation forms indicating that the calculations have been correctly performed and that appropriate data have been used to perform the calculations.
- Develop a process that accounts for prior period invoices paid in a subsequent period to ensure that penalty payments are paid when necessary.
- Require that Contract Managers identify when contractors are small businesses.

Issue 2 Reporting late penalty payments

The Act requires state agencies to provide the Department of General Services, on an annual basis within 90 days of the end of each fiscal year, a report on late payment penalties that were paid in accordance with the Act. The report should separately identify the total number and amount of penalties paid to small businesses, other businesses, and refunds or other payments to individuals. The Department of General Services compiles a report of all late payment penalties and makes the report available to the public.

The Authority did not submit a report of penalty payments for fiscal year 2013/14, when the Authority was liable for over $230,000 in penalties. The Authority did not file the reports because it had not made penalty payments to vendors until fiscal year 2014/15. Therefore, we conclude the required report for fiscal year 2014/15 will misstate the amount of penalties the Authority has paid because penalties attributable to prior years will be included on the report with 2014/15 payments. The Late Payment Penalties Paid Report for fiscal year 14/15 was filed with the Department of General Services on October 9, 2015.

We believe that the report is important inasmuch as it provides prospective vendors with information about the Authority's record in paying vendors late and thus incurring late payment penalties.

Recommendation: Management of the Office of Accounting should, in the future, ensure that penalty payments are paid in the fiscal year in which penalties are incurred and that staff prepares and timely files the Late Payment Penalties Paid Report with the Department of General Services identifying penalty payments only for the fiscal year to which those payments apply.

CALIFORNIA **High-Speed Rail Authority**

Memorandum

DATE: November 12, 2015

TO: Paula Rivera

FROM: Derek Boughton

CC:

SUBJECT: Prompt Payment Act Follow-Up Review – Financial Office Response

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Dear Ms. Rivera,

Attached you will find the California High-Speed Rail Authority (Authority) Financial Office's response to the 2015 Prompt Payment Act Follow-Up Review.

The review contained two recommendations that address the processing and payments of late payment penalties. The Financial Office has mitigation methods installed for the recommendations and we have updated the policies and procedures to address the issues.

Please contact Derek Boughton at (916) 384-1474 with any questions or concerns.

Sincerely,

Derek Boughton

Contracts Officer

cc: Jeff Morales, CEO
Dennis Trujillo, Chief Deputy Director
Russell Fong, Chief Financial Officer
Lisa Ortega, Accounting Officer

Enclosure (Response to 2015 Prompt Payment Act Follow-Up Review)

Issue 1 Penalty calculation was not always accurate.

Recommendation: The Office of Accounting should ensure that penalty calculations are correct by requiring supervisory review and signoff on Penalty Calculation forms indicating that the forms and calculations have been correctly performed and that appropriate data have been used to perform the calculations. In addition, the Office of Accounting should develop a process that accounts for prior period invoices paid in a subsequent period to ensure that penalty payments are paid when necessary.

Financial Office Response:

We concur that supervisor review and sign off on Penalty Calculation forms/claim schedule face sheets is vital. While management does review the forms and data, proof of review is required and is part of the current procedures. Also, additional and ongoing training has been provided to accounting staff to improve the accuracy of the Penalty Calculation forms. The errors identified in this issue occurred while the Financial Office underwent a large, complex exercise (Exercise) to ensure that all outstanding late payments were identified and calculated in the fall of 2014. This Exercise was an extensive effort that required the processing and completion of a magnitude of Penalty Calculation forms and that is where the missed signature of management review occurred on the Penalty Calculation form copies. The Financial Office has since implemented an automated late payment calculator on the Invoice Tracking Logs that calculate the penalty payments if applicable when the warrant issue date is entered. This helps to ensure that any late payment eligible invoice is automatically identified.

Issue 2 Reporting late penalty payments

Recommendation: Management of the Office of Accounting should, in the future, ensure that penalty payments are paid in the fiscal year in which penalties are incurred and that staff prepares and timely files the Late Payment Penalties Paid Report with the Department of General Services identifying penalty payments only for the fiscal year to which those payments apply.

Financial Office Response:

We concur with the recommendation. Per policy, the Financial Office will pay the late payment penalties in the fiscal year in which they incurred. In the fiscal years referenced above, numerous factors contributed toward the delay in paying the penalties, including limited availability of Proposition 1A funds, which was the only source of funds to pay the penalties.

Ultimately, the Financial Office has greatly improved in both paying penalties in accordance with the Act and with processing the invoices that require a late payment penalty. There is a monthly Aging Report that is provided to the Finance and Audit Committee of the Board that provides direct and effective feedback on the invoice payment process that would indicate any systemic problem the Authority would face in the payment of invoices. The reports corroborate the steady improvement the Financial Office has shown in the timeliness of paying invoices. Additionally, through the continuously appropriated Cap & Trade funds, we now have the ability to

strategically avoid penalties that might arise on an isolated basis and subsequently seek invoice reimbursement from the Federal Railroad Administration. When the Authority had limited state cash available prior to 2014/15, the option to pay first with state funds was not feasible.