

Misuse of Purchasing Cards

During the past year, I have been asked several times about the misuse of Purchasing Cards. This is a very real concern of directors and financial officers of State agencies, particularly when the news media reports on the misuse of charge cards.

There are three major card types in the commercial card-spending program in Arkansas. The cards are Purchasing, Travel, and Fleet. The State has the Purchasing Card and Travel Card programs. In addition, several other agencies have a Fleet Card program.

Although the media does not distinguish between the card programs, many of the reports I have reviewed show that the purchases listed as misuse or fraud occur primarily in the use of the Travel Card. There is typically little or no merchant blocking or spending limits on Travel Cards. Within the U.S. Bank's card portfolio, both misuse and true fraud are significantly lower on Purchasing Cards than Travel Cards. Misuse and fraud on Purchasing Cards is the result of no or very poor Purchasing Card program management. This mismanagement is typically a lack of audit and manager review of cardholder activity.

While the misuse of Purchasing Cards cannot be prevented any more than agencies can prevent some employee from buying small dollar purchases without a purchase order or adding an item to a purchase order, it can be effectively controlled by limiting how much and where a cardholder can purchase. In a traditional purchasing scenario, these purchases will not be detected until the vendor statement arrives 30 to 45 days after the purchase. In many cases, it is difficult to determine who made the purchase, but with the Purchasing Card, a person must sign the ticket. A feature that is important in the Purchasing Card program is its data collection and reporting capability. When a card is used, the agency knows the details of the purchase within 48 to 72 hours after the purchase. The opportunity to review these transactions (reporting functionality) can be given to cardholder, mid-level management, program management, audit, tax, AP, or senior management as needed.

The State has developed in the Purchasing Card program what I call the trinity requirements of the card program. These three standards are: 1) policy and procedures, 2) education of employees trained in the use and operation of the card program; and, 3) internal controls and audits. Without these standards, the Purchasing Card program will certainly not have sufficient means to prevent misuse of the card and, surely, a failure in the program will occur.

In a recent article published in *Treasury & Risk Management* entitled "The Plastic Revolution" by David Lindorff, Mr. Lindorff writes that fear of fraud is usually the concern expressed by most finance managers when asked why they oppose a

charge card program. According to the 2003 study of corporate card use published by RPMG Research Corporation, misuse averaged only 0.027% on Purchase Cards among those surveyed. The segment of this report detailing state and federal agencies shows the misuse of cards to be 0.017%. This is the lowest of all “industries” surveyed.

Recently, the University of Arkansas, Fayetteville, encountered a case of procurement card fraud imposed by a third party. This problem was quickly detected and dealt with effectively through appropriate employee and management oversight. This case illustrates how p-card management should be conducted.

Last month two university cardholders had unauthorized charges placed on their accounts by a company that was doing third party billing for another company. The fraudulent charges were identified immediately upon download of the daily feed of charges. A member of the university’s automation development team found one of the charges, and a cardholder found the other charge. Both instances were reported to the university’s procurement card administrator who in turn reported the situation to the Account Coordinator with US Bank. The accounts were immediately cancelled and new cards were issued within 48 hours. The merchant was also contacted and credits were issued.

Upon investigation, the Fraud Department of US Bank discovered that “Apparently, someone was trying random account numbers until they found numbers that worked, and then they were processing charges on those accounts.” He said, “The merchants have been reported to VISA, and VISA will conduct an investigation into what happened. It does not appear that anyone with the State of Arkansas was ordering merchandise or using these account numbers fraudulently.”

A follow up on the actions taken by the University of Arkansas, Fayetteville, and US Bank was conducted by Paul Erickson, Arkansas Account Executive from US Bank. He stated that there are some key points to be gained from this experience:

- 1) This was fraud from a third party, not a State cardholder.
- 2) The State agencies and higher education institutions will never be held responsible for fraud under these circumstances.
- 3) This did not occur because the cardholder did not protect the card. This was a counterfeit account created by a Macro-blaster designed to create large numbers of accounts and send transactions for authorization. Obviously, the merchant is involved in this because there is no card present and other authorization checks are not performed such as address verification or CVV matching.
- 4) With the internal controls established by UAF and the electronic tools made available to the State and its agencies, these transactions were

identified, the merchant contacted, credits were issued, and the Purchasing Card accounts were reissued new numbers.

The University of Arkansas Fayetteville is completing its first year in the program with over 13,000 transactions and charges exceeding two million dollars.

In the RPMG survey, the top two sources in detection of card misuse are Internal Controls 34% and Internal Audit 31%. While no misuse is the only acceptable plan in the Purchasing Card program, in reality, there will always be individuals or companies that will misuse the card. The internal controls established at UAF prevented any loss for the University.

If employees misuse the card intentionally and are terminated, the State can file for VISA Liability Waiver Insurance to waive liability up to \$50,000 per cardholder. The key here is the cardholder must be terminated. Again, misuse and fraud are different, and the State will never be held responsible for fraud propagated against it or its cardholders. Misuse is best dealt with thorough training, policy and procedures, and VISA Insurance.

The University of Arkansas, Arkansas State University, University of Central Arkansas, and Little Rock School District have implemented the Arkansas Purchasing Card Program. These programs have been successful because of the development of the three standards in the Purchasing Card program: 1) policy and procedures, 2) education of employees trained in the use and operation of the card program; and, 3) internal controls and audits.

Reference:

“The 2003 Purchasing Card Benchmark Survey Results,” published by Richard J. Palmer, Lumpkin distinguished Professor of Business, Eastern Illinois University and Mahendra Gupta, Professor, Washington University in St. Louis, RPMG Research Corporation.

Dr. Palmer is a Certified Public Accountant. He received a MBA, M.Acc, and PH.D. from Southern Illinois University. He has taught courses in financial and managerial accounting, accounting information systems, cost accounting, electronic commerce, strategic cost, management and corporate tax at Washington University in St. Louis, University of Tennessee, and Southern Illinois University. He is a frequent speaker at professional conferences on bank commercial card technology, cost management, and electronic commerce topics. He was the keynote speaker in 2003 on the topics “Governmental Use of Purchasing Cards,” at VISA USA Government Executive Conference, Washington DC, “Best Practices in Purchasing Card Use,” Bank of America’s “supply chain Management Roundtable,” Washington DC; and, “The 2003 Purchasing Card Benchmark Survey,” The National Association of Purchasing Card Professional, New Orleans.