
Performance Audit of the Purchasing and Contracting Department

THE CITY NEEDS TO CLARIFY PURCHASING LAWS TO ENSURE CITY
COUNCIL OVERSIGHT AND ENCOURAGE COMPETITION

MARCH 2012

Audit Report
Office of the City Auditor
City of San Diego



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THE CITY OF SAN DIEGO

March 1, 2012

Honorable Mayor, City Council, and Audit Committee Members
City of San Diego, California

Transmitted herewith is an audit report on the purchasing practices within the City of San Diego. This report is in accordance with City Charter Section 39.2. This audit found that there are purchasing practices in the City that reduce City Council's authority to review and approve expenditures of substantial public funds. Additionally, this audit found that there are situations in which City Departments have awarded contracts totaling millions of dollars to a single vendor without competition.

We had planned a comprehensive audit of the City's Purchasing and Contracting Department. However, due to these findings and the subsequent and ongoing reorganization of the Department, we are delaying the planned additional work until the reorganization is complete. We plan to add a comprehensive Purchasing and Contracting Department audit to a future Audit Work Plan.

We conducted this audit in accordance with the City Auditor's Fiscal Year 2012 Audit Work Plan. The Results in Brief is presented on page 1, and the Objectives, Scope, and Methodology is presented in Appendix A on page 18. The Administration's and the City Attorney's responses to our audit recommendations can be found after page 22 of the report.

If you need any further information please let me know. We would like to thank the management and staff of the Purchasing and Contracting Department (P&C), as well all other City Departments that participated to the report for their cooperation. All of their valuable time and efforts spent on providing us information is greatly appreciated. We would also like to thank the Office of the City Attorney for giving their time, information, insight, and cooperation during the audit process. The audit staff responsible for this audit report is Claudia Orsi, Edward Moreno, Andy Hanau, Chris Constantin, and Kyle Elser.

Respectfully submitted,

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Results in Brief

Purchasing laws and regulations exist to obtain services and goods of the best quality and price in an expeditious and fair manner. The City Council is the authority defining the purchasing process and has done so by establishing specific San Diego Municipal Code (SDMC) rules. Among other things, these rules define when certain type of services must undergo a competitive selection process and/or require City Council review and approval.

Ambiguity in some of the SDMC rules has led to situations in which the City Council has lost its ability to oversee contracts that involve sizable expenditures of City funds. We found several instances involving brush management, graffiti removal, and weed abatement services where lack of clarity, completeness and understanding led to the City awarding approximately \$7.4 million in services without the benefit of competition and/or City Council review and approval.

These ambiguities need to be clarified so that both the City Council and City departments can be clear about the degree of oversight that needs to be exercised over such contracts and the degree of flexibility that City departments have in matters such as splitting the work into smaller amounts and extending work beyond the time specified in contracts. Accordingly, we recommend that (1) the Office of the City Attorney review the issues described in this report and issue a written legal opinion clarifying the current applicable SDMC rules and (2) the City Council review the written legal opinion, once issued, to determine if changes are needed in these SDMC rules.¹

We made a total of four recommendations to clarify purchasing rules and practices in the City. The City Administration and the Office of the City Attorney agreed with the recommendations directed to them.

¹ See Appendix C for a detailed list of questions we believe should be addressed.

Background

City Council Has Oversight Role in the City's Purchasing Operations

The City of San Diego (City) processed approximately 6,200 purchase orders and contracts for a total value of approximately \$719 million in goods and services in fiscal year 2011.² The magnitude of the City's purchasing necessitates a process that ensures the City is receiving good value, and also to guard against fraud and abuse. This process is established in the City Charter, San Diego Municipal Code (SDMC), and several Council policies and administrative regulations. Although these rules and policies generally grant the Mayor or his/her designee authority to execute City contracts, they establish a role for the City Council in the purchasing process. This role includes the following:

- **Approval of large contracts.** The SDMC requires City Council approval for certain contracts depending on the type of contract and the dollar amount involved. Exhibit 1 outlines the current purchasing thresholds above which City Council review and approval is required. Nonprofit and agency service contracts for amounts above the threshold presented in Exhibit 1 also carry requirements for competitive bidding.³ To ensure that City departments meet these requirements, the SDMC prohibits subdividing similar activities that should logically be grouped into one contract into two or more purchases.⁴
- **Review of contracts exceeding five years.** City Charter section 99 requires City Council approval by a two-thirds vote for contracts exceeding five years. The City is not authorized to continue a contract in excess of five years, regardless of the dollar amount, without this review and approval.⁵

² City of San Diego fiscal year 2011 Adopted Budget, p. 261.

³ SDMC Sections 22.3212 (h), 22.3222 (c).

⁴ SDMC Section 22.3204. The subdividing of goods or services apply to expenditures of \$50,000 or more.

⁵ City Charter Section 99 and Memorandum of Law, Overview of City Charter and Municipal Code Requirements for City Contracts, Office of the City Attorney, City of San Diego, December 18, 2009, p. 8.

Exhibit 1

City Council Approval Thresholds by Contract Type⁶

Type of Contract	Purchasing Thresholds
Public Works Contracts	> \$1,000,000
Goods and Services Contracts	> \$1,000,000
Non-Profit and Agency Services Contracts	> \$500,000
Consultant Contracts	> \$250,000

Source: San Diego Municipal Code Sections 22.3102 (b); 22.3211 (d); 22.3222 (c) and 22.3223

Purchasing Activities Are Centralized in the Purchasing and Contracting Department

The Purchasing and Contracting Department (P&C) is responsible for the City’s centralized purchasing and materials management functions. P&C was created in response to a 2006 review effort that found the City lacked a comprehensive list of contracts, a consistent and centralized process to award contracts, and sufficient internal controls.⁷ To address these issues, the review team recommended establishing a centralized and consolidated purchasing department. P&C manages the awarding of contracts for professional and general services that are necessary to support the City’s operational and administrative functions.⁸ A description of the City’s purchasing process is found in Appendix E.

⁶ SDMC Sections 22.3102 (b); 22.3211 (d); 22.3222 (c) and 22.3223.

⁷ City of San Diego Final Report on Contracting Re-Engineering Study, issued March 2006.

⁸ During FY 2012, the Mayor streamlined part of the City’s contracting process in an attempt to reduce the time it takes to award public works contracts for projects such as street repairs and water-main replacements. Under the reorganization, the City Administration moved 14 positions and the associated contracting authority from P&C to the Public Works Department. However, P&C still remains responsible for overseeing purchasing for materials and other services, such as brush management, graffiti and weed abatement—the contracts covered in this report.

Audit Results

Finding 1: The City Needs to Clarify Purchasing Laws to Ensure City Council Oversight and Encourage Competition

We identified two issues affecting the amount of oversight the City Council was able to exercise on certain City purchases. First, certain provisions of the San Diego Municipal Code (SDMC) are written in such a way as to limit public scrutiny afforded by City Council review. For instance, SDMC established a threshold of \$500,000 for each nonprofit and agency service contract for City Council review.⁹ In fiscal years 2011-2012, the City awarded about \$7.4 million for brush management, graffiti, and weed abatement services to several nonprofit and agency entities. In procuring these services, City departments entered into various non-competitive contracts for the same type of work, with the same vendor, and in the same fiscal year. As a result, all of these contracts fell below the \$500,000 purchasing threshold established for City Council review for nonprofit and agency service contracts.

Second, City departments used purchase orders to extend several of these agreements beyond five years—the maximum period specified in the City Charter for contracts that do not receive specific City Council approval.¹⁰ For the brush management, graffiti, and weed abatement contracts, about \$1.3 million of the \$7.4 million was authorized in this way, without competition and without City Council review and approval. City departments considered these purchase orders new contracts, but they lacked signatures and specific terms and conditions specified in the City Charter.¹¹ We discussed these issues with the Office of the City Attorney and they agreed to review these transactions and provide a written legal opinion to guide the City in its purchasing practices.

⁹ SDMC Section 22.3222 (c). See Exhibit 1.

¹⁰ San Diego City Charter Section 99.

¹¹ The purchase orders we reviewed contained a website link to terms and conditions. However, when the link is followed, it only leads to the P&C website. No terms and conditions are readily accessible.

These activities create a situation in which City departments can award contracts noncompetitively totaling millions of dollars to a single vendor without City Council review and approval. We are recommending a series of steps designed to (1) clarify what agencies are allowed to do under current SDMC and City Charter provisions and (2) change these practices if the City Council deems it should exercise greater oversight of such contracts.

**Current San Diego
Municipal Code
Provisions Limit
Oversight for Some
Contracts**

In fiscal years 2011-2012, five City departments—Development Services, Park and Recreation, Environmental Services, Transportation and Storm Water, and General Services—authorized work totaling approximately \$7.4 million under contracts with nonprofit and agency vendors for brush management, graffiti, and weed abatement services. These contracts, all non-competitive agreements, were with four vendors—Alpha Project, Urban Corps, California Conservation Corps, and County of San Diego Probation Department.¹² While we only reviewed information for fiscal years 2011 and 2012, all of the contracts were executed either during fiscal years 2006 or 2007.¹³ Exhibit 2 below shows how much the City awarded cumulatively to each entity between July 2010 and November 2011.

¹² SDMC Section 22.3222 refers to the City Manager authority to enter into contracts for services with agencies and nonprofit organizations.

¹³ During our exit conference the Interim Director for P&C informed us that this situation is not unique and that it occurs in other contracting areas in the City where nonprofits are involved.

Exhibit 2

Cumulative Service Amounts Authorized Per Fiscal Year

Entity	Fiscal Year Totals	Service Amounts Authorized
Alpha Project	2011	\$1,273,295
	2012	<i>\$1,145,000</i>
Urban Corps	2011	\$1,355,209
	2012	<i>\$1,296,727</i>
California Conservation Corps	2011	\$781,310
	2012	<i>\$363,156</i>
County of San Diego Probation Department	2011	\$575,320
	2012	<i>\$628,760</i>
	Total	\$7,418,777

Source: City Accounting System-SAP.

Note: Italics reflect service amounts authorized from July 2011 through November 2011.

In procuring these services, these City departments entered into at least 11 non-competitive contracts, as permitted by the SDMC. In some cases contracts fell below the \$500,000 purchasing threshold for similar services awarded to one vendor; however, if the services had been aggregated into one contract between City departments, they would have exceeded the threshold – a condition possibly requiring competitive bidding and City Council approval.

Legal Interpretation of the San Diego Municipal Code

The Office of the City Attorney has agreed to provide a written legal opinion as to whether the current SDMC language allows City departments to enter into multiple contracts with the same vendor performing the same work without City Council review and approval, even if the combined total for all City departments annually exceed the \$500,000 purchasing threshold for similar services. This may be permitted by the SDMC as long as City departments separate work based on criteria such as timing of the work or geographic location, and as long as each individual project does not exceed \$500,000.

The Office of the City Attorney, however, indicates that in light of the concerns we raised in this report, it will provide a written legal interpretation of the SDMC.

Currently, the SDMC language does not specify an annual maximum limit for specific vendors providing a specific service before requiring competition and City Council approval. Further, the SDMC does not include a clear consideration for what type of activity is similar for the purpose of determining the purchasing threshold.¹⁴ Accordingly, this creates a situation in which a department(s) can potentially non-competitively award nonprofit and agency service contracts exceeding millions of dollars to a single vendor without City Council review and approval. Further, there is a second issue that City departments may not utilize competition to receive the best price and quality for the services. It is important to notice that the practice of hiring nonprofits and agencies has been in place without any significant changes for over twelve years, during a time when the City government operated under a City manager. Since then, there have been significant changes to the governance structures.¹⁵

In our opinion, it is important to raise this matter to the City Council's attention to ensure it does not conflict with the City Council's understanding of what should constitute open, fair competition that is subject to City Council review and approval. This is especially necessary for similar activities exceeding \$500,000 awarded to one vendor, when it is reasonably contemplated that certain services would result in an award in excess of \$500,000 to one vendor. As a necessary first step in this matter, it would be important for the Office of the City Attorney to formalize its interpretation of this part of the SDMC.

¹⁴ The SDMC Section 22.3223 establishes a \$250,000 maximum limit for consultant services before requiring competition and City Council approval.

¹⁵ In 2006 the City of San Diego form of government changed from a City Manager to a Strong Mayor.

Current Purchasing and Contracting Department Practices Do Not Produce Meaningful Oversight of Nonprofit and Agency Service Contracts

Although P&C is potentially in a unique position to monitor actions such as these to ensure they do not constitute abuse of good contracting practices, there is little indication that it is inclined to do so. P&C is in the unique position to notice purchasing patterns of City departments, and it is also responsible for ensuring compliance with applicable purchasing laws and regulations and, where consistent with the SDMC, maintaining open, fair competition to obtain services at the best price and quality. P&C agrees that they are in a unique position to notice these patterns, but according to P&C staff, they also feel they do not have the appropriate resources and tools to be able to provide effective oversight.

P&C processed and authorized the expenditures from these contracts in fiscal years 2011 and 2012, and our discussions with P&C officials indicated that they did not see it as their role to question these practices. We found that P&C was generally aware of the multiple requests for services and believed departments did not subdivide contracts. According to P&C officials, they did not combine multiple service contracts because they considered it the requesting departments' responsibility to determine the scope of the contracts for outside services. Additionally, P&C officials informed us that they were not clear on the interpretation of the SDMC pertaining to the thresholds for nonprofit and agency services.

Current Practices Could Potentially Place Federal Grant Monies at Risk

One additional reason to address this matter is that current practices may be insufficient to meet federal requirements—a source of the money used in these activities. In December 2007, the City received three grants for brush management fire mitigation from the Federal Emergency Management Agency (FEMA), which totaled about \$2.3 million in Federal funds and required competitive bidding. We found that the City possibly fell short of complying with Federal regulations related to the use of Federal funds. Specifically, Federal regulations related to procurement require local jurisdictions to establish formal contracts and competitively award public funds in excess of \$100,000 to ensure cost-effective use of grant money. A review of FEMA grant expenditures revealed that the City spent approximately \$205,000 for nonprofit service contracts that

were not competitively bid. We are asking the Office of the City Attorney to review this issue as well and determine whether current practices meet federal requirements.

Purchase Orders Used to Extend Services Beyond Maximum Allowed Contract Term Without City Council Review

During fiscal year 2012, City departments used purchase orders to extend five of the 11 contracts beyond the maximum five-year timeframe allowed for contracts. These contracts were extended without competitively awarding the funds and without obtaining City Council review and approval. In all, the City awarded approximately \$1.3 million through these purchase orders, of which about \$390,000 had been paid as of November 2011. Exhibit 3 shows the existing purchase orders authorized for work and the actual payments made from June through November 2011. Appendix D shows a sample purchase order that was used to extend one of the contracts.

Exhibit 3

Payments Authorized and Made via Purchase Orders After the Expiration of Original Contracts During Fiscal Year 2012

Contracts	Original Contract Expiration Date	Purchase Orders Authorized	Payment Amount
8364-07-P ¹⁶	June 30, 2011	\$90,000	\$29,142
8366-07-P ¹⁷	June 30, 2011	440,000	106,702
8365-07-P ¹⁸	June 30, 2011	250,000	59,281
8365-07-P ¹⁹	June 30, 2011	30,000	17,823
8367-07-P ²⁰	June 30, 2011	463,467	178,442
Total		\$1,273,467	\$391,391

Source: City Accounting System-SAP (rounded).

Note: These amounts reflect payments to nonprofits only between June 2011 through November 2011.

¹⁶ Bid Number 8364-07-P. Agreement Between the City of San Diego and Alpha Project For Labor Crew Services Mt. Hope Cemetery and Other Designated Areas.

¹⁷ Bid Number 8366-07-P Agreement Between the City of San Diego and Alpha Project For Labor Crew Services At Miramar Landfill and Other Designated Areas.

¹⁸ Bid Number 8365-07-P Agreement Between the City of San Diego and Alpha Project For Labor Crew Services For Services Along Roadways, Other Public-Right-Of Way, and Other Designated Areas.

¹⁹ Same as note 19.

²⁰ Bid Number 8367-07-P Agreement Between the City of San Diego and Urban Corps For Graffiti Abatement Services.

Extent to Which the Practice Meets City Requirements Is Unclear

The use of purchase orders as previously described appears to contradict City requirements. The City Charter requires that contracts, agreements or obligations exceeding five years be approved by the City Council by ordinance of a two-third vote.²¹ Additionally, the City Charter requires that for a contract to be properly executed, the Mayor or his designee, the contractor and the City Attorney must review and sign the contract.²² The purchase orders that extended the services beyond the five-year timeframe lacked the appropriate signatures, as well as the specific terms and conditions for authorizing services with the same vendor.

P&C apparently authorized and allowed the creation of these purchase orders after the contracts expired. According to P&C staff, they approved purchase orders for some of the services at the urgent request of departments in order to prevent the interruption of seasonal work that is funded by a time-sensitive FEMA grant to mitigate fire hazards. However, according to a December 18, 2009 Office of the City Attorney Memorandum of Law, if a City department requires continued work, goods, or services, but does not wish to extend a contract beyond five years, it should coordinate with P&C to ensure that a competitive process for a new contract is under way well in advance of contract expiration. The Memorandum also states:

*"We understand that in the past some City contracts have been extended on 'month-to-month' basis. To the extent these extensions have resulted in a total contract term of more than five years, and have not been approved by the City Council by ordinance by a two-thirds' vote, the extensions are void or at least unenforceable against the City...As such, the contractors performing under these purported extensions are doing so at the risk they will not be paid for their services...."*²³

However, City departments utilized purchase orders that lacked signatures and terms and conditions to continue these

²¹ City Charter Section 99.

²² San Diego City Charter Article V, Sections 28 and 40, Article XV, Sections 260 and 265 (a).

²³ Memorandum of Law, Overview of City Charter and Municipal Code Requirements for City Contracts, Office of the City Attorney, City of San Diego, December 18, 2009, p. 8.

services after the original contract terms expired.²⁴ City departments utilized these purchase orders without competitively bidding the work after the contract term expired and did not seek City Council review and approval. The Office of the City Attorney has agreed to review these contracts for compliance with City Charter.

Further, in its December 2009 Memorandum of Law, the Office of the City Attorney said it was already aware that not all contracts route through the Office of the City Attorney for approval and that it was working with P&C to develop procedures for low expenditure contracts, such as small purchase orders or “pre-approved form” contracts to ensure both compliance with Charter Section 40 and efficient contracts processing.²⁵ It appears, however, that the purchase orders in question were not approved by the Office of the City Attorney because the purchase orders lack signatures.

We are asking the Office of the City Attorney to review the purchase orders in question and advise whether they comply with City Charter and Municipal Code requirements, particularly whether a purchase order, which lacks signatures and terms and conditions, can be considered a stand-alone contract. Also, the Office of the City Attorney should clarify if a City department can use these purchase orders to engage in services without the competitive process or without City Council review and approval once the original contract term has expired. Without City Council review and approval, and without competitively awarding services once contract terms have expired, the City is at risk of awarding funds without the necessary oversight.²⁶

The practice of extending contracts through purchase orders also creates a potential labor relations problem. When City departments initiate service requests, the requests are forwarded to the Human Resources Department-Labor

²⁴ Purchase orders contained a website link to terms and conditions. However, when the link is followed, it only leads to the P&C website. No terms and conditions are readily accessible.

²⁵ Memorandum of Law, Overview of City Charter and Municipal Code Requirements for City Contracts, Office of the City Attorney, City of San Diego, December 18, 2009, p. 5.

²⁶ We also checked with both the City of San Jose and the City of San Francisco about whether agencies there could use a purchase order as a new contract. In both instances, they said agencies could not do so.

Relations Program (Labor Relations Program). In the event that the Labor Relations Program determines that the contract is a transfer of bargaining unit work, they notify the departments and indicate that the City must meet and confer prior to entering into the contract. However, since City departments continued purchasing services where five-year contracts expired, the Labor Relations Program could not perform their reviews prior to the services being provided to the City.

Conclusion

As noted in the report, the practice of hiring nonprofits and agencies without competition has been in place without significant changes for over ten years, during a time when the City operated under a City Manager form of government. Since then, there have been significant changes to the governance structures, which affect the City purchasing practices.

In our audit report, we identified instances that reduce City Council's authority to review and approve expenditure of substantial public funds. Specifically, these activities create a situation in which City departments can noncompetitively award contracts totaling millions of dollars to a single vendor without City Council review and approval. Further, City departments may not utilize competition to receive the best price and quality for the services.

As a result, we recommend that the Office of the City Attorney review the issues discussed in this report and issue a written legal opinion to the City Council and the City Administration clarifying the Office of the City Attorney's interpretation of the current San Diego Municipal Code (SDMC) as it relates to the maximum allowable amount that the City can expend on the same vendor for the same services within the same fiscal year without competition and City Council review and approval. Additionally, the Office of the City Attorney should clarify how and when a purchase order can be used to extend services beyond the original contract term of five years. Based on this written legal opinion, the City Council and the City Administration should evaluate the appropriateness of these service arrangements under the current SDMC and determine whether changes should be made to the SDMC or other purchasing laws and regulations. Finally, the City Administration should ensure compliance with any changes in provisions that the City Council may adopt.

Recommendations

- Recommendation #1** The Office of the City Attorney should issue a written legal opinion to the City Council and the City Administration to clarify the current San Diego Municipal Code as it relates to the maximum allowable amount that the City can expend on the same vendor for the same or very similar services within the same fiscal year without City Council review. Additionally, the written legal opinion should address whether the City can use purchase orders to continue services on contracts that exceeded the maximum allowable duration of five years. See Appendix C for a detailed list of questions that the written legal opinion should address. (Priority 1)
- Recommendation #2** Based on the written legal opinion provided by the Office of the City Attorney, if the City Council believes the San Diego Municipal Code needs modification, it should instruct the City Administration to take immediate steps to: (1) establish clear and specific San Diego Municipal Code language, which prescribes thresholds for nonprofit and agency service contracts, (2) specifically state when and whether purchase orders can be used to extend nonprofit and agency service contracts beyond the maximum allowable duration of five years without City Council review, (3) describe when and whether a purchase order can be considered a new contract, and (4) redress any current practices that do not comply with that understanding. (Priority 1)
- Recommendation #3** The Office of the City Attorney should review the 11 nonprofit and agency contracts and all purchase orders we identified in this report to determine whether purchasing practices complied with all City, State, and Federal laws and regulations. Additionally, in the case their review identifies any issues or opportunities for improving purchasing practices, they should submit a written report to the City Council for their review. (Priority 1)

Recommendation #4 The City Administration should conduct a full review of purchasing practices and design a purchasing process with appropriate internal controls to ensure full compliance with any changes the City Council makes to the San Diego Municipal Code provisions and with the written legal opinion issued by the Office of the City Attorney. (Priority 2)

Other Pertinent Information

During the course of our audit, we identified other procurement issues related to data management and vendor records regarding the City's accounting system. We believe that these issues may impact P&C's ability to effectively execute oversight functions and manage purchasing operations. Thus, we would like to bring these issues to the City Administration's attention.

Data Management

During the course of this audit, P&C was unable to provide reliable data pertaining to its bid processing due to the corruption of data that has taken place over time and is largely associated with the use of internally developed databases that are no longer adequately supported due to staffing reductions and loss of database development capability. Consequently, P&C was unable to provide a reliable and accurate, comprehensive report showing the total population of bids received and processed.

In addition, when a database is compromised and corrupted, it is difficult to extract information broken down by areas of interest or years under analysis, and, even if it could, the information may never be accurate and reliable.

Lack of proper data management may impact P&C's ability to monitor bids and contracts to prevent the issues identified in this report and to conduct any reliable analysis necessary to efficiently and effectively manage purchasing operations.

Vendor List

During the course of this audit, we found that the vendor list may contain numerous duplicate vendors. This was a prior finding in our audit of the Enterprise Resource Planning System Implementation issued in January 2011. Duplicate vendor entries are due to errors resulting from the conversion from a legacy system to SAP, which were never cleared out of the

system. Errors can also result from P&C personnel inserting vendor information more than once.

The Office of the City Comptroller is currently in the process of cleansing the vendor database in advance of an AP recovery audit scheduled for February / March 2012. To date, the vendor database has been cleansed of appropriately 30,000 inactive vendors.

In addition, we found that there were over 1,000 vendors related to EOCP vendor contacts (inquiry only, not active vendors) not entered into the City's Master Vendor List because P&C indicates it did not have sufficient staff to perform the work. While P&C was unable to provide a rationale for entering these vendors into the City's Master Vendor List, the Office of the Comptroller is revising the issue.

Appendix A: Objectives, Scope, and Methodology

We began this audit as an evaluation of the efficiency and effectiveness of the City's contracting process and the adequacy of the City's internal controls in preventing fraud and abuse within the process. During the course of our review, however, we became aware that City departments contracted with two nonprofit and two agency vendors that submitted invoices with similar scope of work during the same fiscal year that if, arranged as one contract, would have cumulatively exceeded the legal thresholds that require a competitive process and City Council review and approval. We also determined that work was continuing even though several of the contracts had expired. As a result, we changed the focus of this audit to address the manner in which the City contracts with nonprofit and agency vendors and the expenditure of public funds by purchase orders to extend services beyond the original contract terms without City Council review and without using the competitive process.²⁷

We reviewed a total of 11 nonprofit and agency contracts that the City entered into during fiscal year 2006 and 2007 with four nonprofit and agency entities performing services such as brush management, weed abatement and graffiti removal. We focused our review on data related to these contracts from fiscal years 2011 through 2012, unless otherwise noted. We performed data reliability testing of the data provided to us for this report and searched for indicators of fraud.

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

²⁷ The City is currently conducting its own internal review of contracting procedures. We will wait for the results of that review before deciding whether to resume additional work addressing economy, efficiency, and controls in the overall contracting process.

Appendix B: Definition of Audit Recommendation Priorities

DEFINITIONS OF PRIORITY 1, 2, AND 3 AUDIT RECOMMENDATIONS

The Office of the City Auditor maintains a classification scheme applicable to audit recommendations and the appropriate corrective actions as follows:

Priority Class ²⁸	Description ²⁹	Implementation Action ³⁰
1	Fraud or serious violations are being committed, significant fiscal or equivalent non-fiscal losses are occurring.	Immediate
2	A potential for incurring significant or equivalent fiscal and/or non-fiscal losses exist.	Six months
3	Operation or administrative process will be improved.	Six months to one year

²⁸ The City Auditor is responsible for assigning audit recommendation priority class numbers. A recommendation which clearly fits the description for more than one priority class shall be assigned the higher number.

²⁹ For an audit recommendation to be considered related to a significant fiscal loss, it will usually be necessary for an actual loss of \$50,000 or more to be involved or for a potential loss (including unrealized revenue increases) of \$100,000 to be involved. Equivalent non-fiscal losses would include, but not be limited to, omission or commission of acts by or on behalf of the City which would be likely to expose the City to adverse criticism in the eyes of its residents.


³⁰ The implementation time frame indicated for each priority class is intended as a guideline for establishing implementation target dates. While prioritizing recommendations is the responsibility of the City Auditor, determining implementation dates is the responsibility of the City Administration.

Appendix C: Legal Questions to Address by the Office of the City Attorney

- 1) What is the maximum allowable amount that the City can expend on the same vendor, for the same nonprofit and agency services, within the same fiscal year without the competitive process and City Council review?
- 2) How do you define when a project/contract has the same scope of work and thus should be logically grouped into one contract?
- 3) What is a purchase order?
- 4) What is a contract?
- 5) How does a purchase order differ (if at all) from a contract?
- 6) If the Office of the City Attorney finds that the City can use purchase orders for low expenditure contracts, such as small purchase orders or "pre-approved form" contracts, what is the dollar threshold?
- 7) When services between the City and a nonprofit and agency vendor has exceeded five years, is the City required to competitively award public funds and/ or obtain City Council approval?
- 8) In which circumstances can the City utilize a purchase order as a contract?
- 9) Can the City consider a purchase order that lacks the appropriate signatures and terms and conditions a new contract and thus continue to extend the same services with the same vendor - without City Council review and approval and without using the competitive process - after the original contract term expired?
- 10) When is the City required to competitively award federal funds?
- 11) What is the process that the City should follow to ensure that the appropriate labor law reviews are done prior to engage nonprofit and agency services?

Note: Those questions are only indicative and are meant to serve to the Office of the City Attorney as a guide based on the issues raised in this report. If during their review the Office of the City Attorney believes there are additional purchasing areas related to engaging nonprofit and agency services that should be clarified, those should be included in this Memorandum of Law as well.

Appendix D: Purchase Order Used to Extend Nonprofit Services Beyond Five Years



City of San Diego
PURCHASE ORDER
MODIFICATION

PO No. 4500024500

<p>Ship To: Center ID: ESMF EVMNTL SRVS-MIRAMAR LNDFIL-FLD OPS MS50 5108 CONVOY ST SAN DIEGO CA 92111-0000</p>	<p>Bill To: EVMNTL SRVS-MIRAMAR LNDFIL-FLD OPS MS1103A 9601 RIDGEHAVEN CT STE 310 SAN DIEGO CA 92123-1676</p>	<p>Date: 08/19/2011 Page 1 of 2</p> <p>Billing Contact: [REDACTED]</p> <p>Telephone: [REDACTED]</p>		
<p>Vendor: Alpha Project for the Homeless for ACH payment 3737 5th Ave Ste 203 San Diego CA 92103-4217</p> <p>Vendor ID: 0010016533 Phone: 619-542-1877</p>		<p>Terms: Within 30 days Due net</p> <p>Delivery Terms: FREE ON BOARD</p> <p>Deliver on or before: 06/30/2012</p> <p>Buyer: [REDACTED]</p> <p>Telephone: [REDACTED]</p>		
Line #	Item ID/Description	Quantity/UM	Unit Price	Extended Price
This is a MODIFICATION to an existing Purchase Order Do Not Duplicate Shipment. See Notes Below for Specific Modification(s)				
1	Dept open, work crews for Landfill. Furnish work crews consisting of twelve (12) men at \$1,100/day to work at various locations. For period of 07/01/11 through 08/30/12. [REDACTED]	330,000 EA	USD 1.00	USD 330,000.00
2	Dept open, work crews for Landfill. Furnish work crews to work at Miramar Landfill. Add line 2 for additional half crew, 5 days a week, for period of 10/3/11 to 8/30/12. [REDACTED]	110,000 EA	USD 1.00	USD 110,000.00
Notes: The Terms and Conditions of this Purchase Order are available at http://sandiego.gov/purchasing/				SEE LAST PAGE FOR TOTAL
				IMPORTANT! To ensure prompt payments, PO # must appear on all shipments and invoices, and all invoices must be directed to Billing Contact person at Bill-To address listed above

Note: The document does not appear to have the required signatures by the Mayor or a Designee, the Contractor, or the City Attorney to be considered a validly executed contract. We redacted personnel names and contact info above. This purchase order contained a website link to terms and conditions. However, when the link is followed, it only leads to the P&C website. No terms and conditions are readily accessible.

Appendix E: The City of San Diego's Purchasing Process

The City's purchasing process is generally as follows:

1. A department requests services and/or goods;
2. The requesting department develops a statement of work defining what material or service is needed;
3. The requesting department creates a purchase requisition, which is a request to purchase a certain quantity of materials or services from an outside vendor. Once the purchase requisition is keyed into SAP, the system ensures sufficient funds are available for the amount entered and will not accept the requisition if funds are not available;³¹
4. The Office of the City Comptroller receives the purchase requisition and reviews item descriptions and ensures that the appropriate GL accounts are being used;³²
5. P&C develops procurement;
6. P&C solicits requests for proposals and coordinates evaluation of vendor responses;
7. P&C awards the contracts to the selected vendor response;
8. The Office of the City Attorney reviews the contract;
9. City Council reviews and approves a contract above certain dollar thresholds for the winning proposal;
10. P&C reviews that all the necessary documents, such as properly executed contracts, are attached to the purchase requisition and all appropriate approvals are received;
11. P&C approves a purchase order, which is the official mechanism establishing a maximum expenditure limit and authorizes a department to make purchases; and
12. The department makes purchases as necessary up to the authorized expenditure limit.

³¹ Systems Applications and Products in Data Processing.

³² Refers to the City's financial general ledger.



THE CITY OF SAN DIEGO

MEMORANDUM

DATE: March 1, 2012

TO: Eduardo Luna, City Auditor

FROM: Scott Reese, Interim Director, Purchasing & Contracting

SUBJECT: Purchasing and Contracting Department Response to February 2012 Performance Audit of the Purchasing and Contracting Department

The Purchasing and Contracting Department (P&C) would like to express its appreciation for the continued efforts of the Office of the Auditor (OOA) for incorporating many of the key comments and recommendations offered during interview sessions and for working with the department to enhance the impact and utility of audit analysis and recommendations.

The general focus of the audit is the current San Diego Municipal Code (SDMC) Section 22.32 and the City Charter Section 99 provisions associated with City department practices regarding contracting with non-profit agencies and governmental organizations for needed services. The OOA is recommending the City Attorney Office (CAO) review the current SDMC and a sampling of recent City contracts and provide a Memorandum of Law that will provide a more uniform understanding of the Code to improve the precision of departmental compliance with the Code in concert with their individual operations. While several recommendations are directed to the CAO and the City Council, this response will focus on recommendations #4, as it is the only one directed to the City's administration. In addition, we have included general comments regarding certain audit findings and attempt to summarize them below.

- **Interpretation of the SDMC as it pertains to contracting with non-profit and government agency organizations:** City staff from several departments in conjunction with the City Attorney's Office have acted consistently and according to the explicit language and prevailing operational understanding of the SDMC pertaining to contracting with non-profits. This pattern of consistent action is shown to exist over many years in the awarding of work to non-profit and government agencies. Contracts were approved by the CAO and entered into, in accordance with SDMC requirements that allow different departments to issue separate contracts based upon varying criteria such as the timing of work, location of work, capabilities and availability of contractor work crews.

Thus, no apparent violation of City Code occurred and all work was contracted for according to long standing City and Department practices.

- **Aggregated Contracting:** P&C and client departments do not support an aggregated approach that treats contracts in a singular nature (i.e. initiated by a single department, with a single contracted agency, apply the same scope services, occur at the same location, and/or contain similar funding requirements). Based on our experience, departments have unique and changing program needs that fluctuate at different times and at different locations. Additionally, varied funding sources dictate differing financial requirements. Therefore, it is not practically feasible or operationally desired to aggregate these contracts

Cost Comparison: The OOA expresses their view that current provisions of the SDMC providing for non-competitive award of contracts without City Council review and approval may not render the best price or quality of services in all cases. We believe the record indicates that the City Council considered these issues in the establishing these special provisions within SDMC for contracting with non-profit and governmental organizations.

Based the professional experience and industry knowledge of the contracting departments, we believe non-profit and government directed programs are inherently more cost effective due to lower overhead and labor costs. Non-profit and Governmental Agencies such as the California Conservation Corps, Alpha Project, Urban Corps and the County of San Diego Probation Department provide inherent social value through career training, develop individual confidence and self-sufficiency, employ local youth and adults, curtail crime, and inject funding into the local economy by putting residents to work. We further believe the City Council recognized this societal value when it instituted specialized procurement guidelines for agencies like these. Community based organizations have been extremely responsive in tailoring their programs and services to meet the explicit needs of City departments and as a result feedback regarding performance has been strikingly positive.

- **Use of purchase orders:** Use of purchase orders to serve as a contract is a common practice, with thousands issued annually. The current purchase order system was approved for use via an approval process involving the Controller's Office, the Financial Management Department, the Purchasing and Contracting Department, the City Clerk's Office and the City Attorney's Office and has been in place for at least the past 30 years. During this time, no signatures have been required on purchase orders nor have any Charter changes occurred to require such an operation.

In addition, all purchase order forms direct holders of the purchase order to the P&C website, via a web link, where the most current version of the City contract Terms and Conditions exist. This customer service feature is not only consistent with the City's desire to reduce paper consumption but it also reduces the additional postage associated with mailing the document, the costs for reprinting with each change of Terms and

Conditions while providing for real-time updating of information. We agree the web link could lead users more directly to the Vendor information section of the website where the information is provided. Consequently, we are reviewing implementation of this enhancement.

- **FEMA Compliance:** City, State and Federal procurement guidelines contain provisions for waiving of competitive bidding requirements in time of a declared emergency or when an emergency is seen to exist. Part 1 of the Uniform Administrative Requirements (UAR) for Grants and Cooperative Agreements to State and Local Governments by the California Emergency Management Agency provides that grantees are to use their own procurement procedures which reflect applicable State and local laws and regulations, provided that the procurements conform to applicable Federal law and standards as well. In this case the procurement would have followed City of San Diego policy. Further UAR provisions allow for simplified procurement processes for small relatively simple purchases.

It is our belief that all Federal, State and City purchasing requirements were met based upon the knowledge that reimbursements have been received and the fact that reimbursement requests are scrutinized closely for compliance with FEMA requirements as they passed from the department through the Office of Homeland Security, the California Emergency Management Agency, and FEMA.

- **Labor Relations Review:** As standard operating procedure, labor review and approval is required of all contracts by Purchasing and Contracting and Labor Relations. It is the responsibility of the originating departments to secure the review and provide proof of approval with purchase requisitions. P&C is currently evaluating this process to ensure that contracts that exceed five years receive additional labor relations review when necessary due to possible restructure of work scope based upon changing needs.
- **Vendor Data:** The OOA indicated they found over 1000 EOCP vendors not entered in to the City's Master Vendor List, which they indicate is because staffing is insufficient. In actuality, this data was not entered into the master vendor list because of recent decisions between Financial Management, Comptroller, Purchasing and Contracting and Equal Opportunity Contracting Program not to use SAP to capture and store data on non-active vendors. Capturing this data does not serve any practical utility that would justify the expenses involved because there is currently no means to apply the data. Further, there has been recent agreement to remove existing non-active data from the database. If funding is made available to implement other components of SRM, we will then have the ability to capture, use, and report on this type of data.
- **Response to Recommendation #4-** *"The City Administration should conduct a full review of purchasing practices and design a purchasing process with appropriate internal controls to ensure full compliance with any changes the City Council makes to the SDMC provisions and with the Memorandum of Law issued by the Office of the City Attorney."*

We agree with recommendation #4 and will effectuate any procedural changes prompted by City Council action or legal reviews. We cannot identify a timeline for implementing any such changes at this time since we cannot predict what the changes might be.

Finally, it is important to note that the sample of 11 non-profit contracts entered into between 2006 and 2007 used for the purposes of the Audit and Recommendations represents an extremely small percentage of contracts with these types of organizations and an even smaller percentage of the total 6,900 contracts issued by the department. We appreciate the Auditors focused attention to this sub-set of contractors and welcome the opportunity to explore process improvement that will enhance service delivery.

A handwritten signature in black ink that reads "Scott Reese". The signature is written in a cursive, slightly slanted style.

Scott Reese
Interim Director of Purchasing and Contracting
City of San Diego.

cc: Jay Goldstone, Chief Operating Officer
Wally Hill, Assistant Chief Operating Officer
Ed Plank, Deputy Director

**Office of
The City Attorney
City of San Diego**

MEMORANDUM

533-5800

DATE: February 28, 2012
TO: Eduardo Luna, City Auditor
FROM: City Attorney
SUBJECT: Request for Legal Opinion

During your preparation of an audit report relating to the City's Purchasing and Contracting Department, your office requested that we provide a written opinion on the legal interpretation of Municipal Code Section 22.3222 regarding the City's authority to award service contracts to agencies and non-profits without competitive bidding or City Council approval. This memorandum confirms receipt of the request and that it will be assigned to a Deputy City Attorney familiar with this matter.

Based on discussions with your office, the opinion will include an analysis of whether purchase orders are contracts or can be used to extend existing contracts beyond five years. We will also review the 11 service contracts your office has identified for compliance with applicable laws. We understand these issues are important to your office and will do our best to provide a timely response. If you have additional questions, do not hesitate to contact our office.



Thomas C. Zeleny
Deputy City Attorney