San Diego City Auditor

AUDIT REPORT

SAN DIEGO DATA PROCESSING CORPORATION
FOLLOW-UP AUDIT

November 30, 2009

Office of the City Auditor
Eduardo Luna, CIA, CGFM, City Auditor

This Page Intentionally Left Blank

THE CITY OF SAN DIEGO

November 30, 2009

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

Transmitted herewith is a follow-up audit report on San Diego Data Processing Corporation which includes a review of governance. This report is in accordance with City Charter Section 39.2. An Executive Summary is presented on page 1. The Corporation's response and the Administration's response to our audit recommendations can be found after page 34 of the report.

If you need any further information please let me know. We would like to thank San Diego Data Processing staff, the Department of Information Technology staff, as well as representatives from other City departments for their assistance and cooperation during this audit. All of their valuable time and efforts spent on providing us information is greatly appreciated. The audit staff responsible for this audit report is Judy Zellers, Tricia Mendenhall and Kyle Elser.

Respectfully submitted,

Eduardo Luna
City Auditor

cc: Jay M. Goldstone, Chief Operating Officer
Mary Lewis, Chief Financial Officer
Andrea Tevlin, Independent Budget Analyst
Jan Goldsmith, City Attorney
Naresh Lachmandas, Department of Information Technology Department Director
Nader Tirandazi, Financial Management Department Director
Tom Fleming, San Diego Data Processing Corporation, Chief Executive Officer
Reed Vickerman, San Diego Data Processing Corporation Board of Directors, Chair
Don Del Rio, San Diego Data Processing Corporation Corporate Counsel

OFFICE OF THE CITY AUDITOR
1010 SECOND AVENUE, SUITE 1400 ● SAN DIEGO, CA 92101
PHONE (619) 533-3165, FAX (619) 533-3036

This Page Intentionally Left Blank

Table of Contents

Executive Summary 1

Introduction 2

Background 3

Audit Objectives, Scope and Methodology 8

Audit Results 9

Most of the 2004 Audit Recommendations have been implemented by SDDPC. 9

SDDPC bylaws, Operating Agreement and City policies pertaining to SDDPC should be revised to improve transparency and accountability. 10

Conclusion 27

Appendix A Schedule of Prior Audit Recommendations and Status of Implementation 28

Appendix B Extract From SDDPC FY 2008 AND 2009 Check Register Payments To All Vendors 32

Attachments:

San Diego Data Processing Corporation Audit Report Response

City of San Diego Management Audit Report Response

EXECUTIVE SUMMARY

The San Diego Data Processing Corporation (SDDPC), the City's sole technology agency since 1979, defines its purpose as supporting, improving, building and maintaining information technology (IT). In 2004, the Office of the City Auditor & Comptroller performed an audit of SDDPC administrative expenses in response to allegations that SDDPC's expenses for meals and corporate events were excessive. The 2004 report concluded that SDDPC lacked sufficient policies and proper oversight of administrative expenditures, specifically those related to meals and travel, and made certain corrective recommendations.

Subsequent to the appointment of the City Auditor and at the request of the Audit Committee, we have performed a follow-up audit to determine whether SDDPC fully implemented the recommendations made in 2004. During the follow-up audit, we found indicators of weaknesses in the Operating Agreement governing SDDPC's procurement function. Therefore, we took additional steps to review and assess the City's oversight of SDDPC to determine whether improvements could be made to strengthen controls. Also, we reviewed issues that came to our attention regarding compensation and budgeting approval and we issued a report on this in May 2009.

Based on our review, we found:

- SDDPC implemented most of the recommendations made in 2004;

- The contract terms between SDDPC and the City do not establish sufficient performance and reporting requirements, specifically in the areas of the budget disclosure, procurement standards and billing processes; and

- The SDDPC bylaws do not incorporate controls to enhance transparency of SDDPC operations and SDDPC's accountability to the City.

We have made 16 recommendations to strengthen the City's oversight and approval of SDDPC activities, improve SDDPC's competitive practices and transparency related to IT procurement for the city, and to ensure adequate internal controls over SDDPC's procurement, billing, and financial reporting.

INTRODUCTION

Since 1979, San Diego Data Processing Corporation (SDDPC) has been the City's sole technology agency whose purpose is to support, improve, build and maintain information technology (IT). The corporation is governed by bylaws approved by the City, the sole member of the corporation. An audit report, issued by the Office of the City Auditor & Comptroller in 2004, found SDDPC did not have effective policies regulating the use of funds for overhead expenses charged to credit cards; administration of contracts lacked adequate controls resulting in overpayments to vendors; and improper purchases by City Departments were billed through SDDPC. The lack of policies and controls led to misuse of funds such as excessive meal and alcohol purchases authorized by the former Chief Executive Officer. The 2004 report included 12 corrective recommendations.

Subsequent to the appointment of the City Auditor and at the request of the Audit Committee, we have performed a follow-up audit of SDDPC to determine if the 12 recommendations made in 2004 have been fully implemented. The recommendations were made to improve the Board's oversight of SDDPC and prevent future inappropriate use of taxpayer monies by SDDPC. This report provides the results of the follow-up audit and our assessment of the other governance issues that came to our attention.

BACKGROUND

The City's primary provider of information technology services is SDDPC. As shown in Table 1, the City has spent over $250 million on IT expenses[1] from fiscal year 2005 through fiscal year 2008. Approximately 96 percent of these IT expenses were procured through SDDPC.

Table 1: SDDPC Billings Compared to Total City IT Expenses FY 2005-2008

Description	Fiscal Year (FY)				
	2005	2006	2007	2008	Total
City IT Expenses procured from or through SDDPC [1]	$55,514,320	$57,889,934	$58,712,546	$73,695,228	$245,812,028
Total City IT Expenses procured from all vendors	$59,567,286	$59,662,590	$62,118,846	$75,052,206	$256,400,928
Percentage of City IT expenses procured from or through SDDPC	93%	97%	95%	98%	96%

Source: Office of the City Comptroller's Simpler System
[1] Increase is primarily due to an increase in pass-through expenses at the City, as shown in Table 2. Some OneSD costs, a project approved by Council, are included in procured services.

As shown in Table 2, there are two components to the City's payments to SDDPC; payments for SDDPC services as defined in the annual Service Level Agreement (SLA), and payments for pass-through goods and services which are procured for the City from third party vendors by SDDPC.

The annual budget presented to City Council includes the goods and services defined in the SLA; it has not always included procurement of pass-through goods and services. Therefore, it is unclear if pass-through goods and services have been approved by Council. Also, the Operating Agreement does not require SDDPC to comply with City regulations when procuring pass-through goods and services. Instead, SDDPC procurement is governed by its Board approved internal procurement policies.

We asked the City Attorney whether SDDPC was authorized to enter into contracts for pass-through goods and services which directly benefit City departments. They advised us that SDDPC is authorized to enter into contracts; however, these are not City contracts.

[1] City IT expenses do not include personnel technology costs estimated at $12 to $14 million annually as shown in Report 09-091 to Council.

Table 2: Components of Payments Made by the City to SDDPC FY 2005-2008

Description	Fiscal Year (FY)				
	2005	2006	2007	2008	Total
SDDPC Services per SLA [1]	$37,542,203	$40,057,168	$39,615,796	$43,562,530	$160,777,697
Pass-Through Expenses	$17,972,117	$17,832,766	$19,096,750	$30,132,698	$85,034,331
City IT Expenses procured from or through SDDPC	$55,514,320	$57,889,934	$58,712,546	$73,695,228	$245,812,028

Source: Office of the City Comptroller's Simpler System

[1] The SLA is the annual Service Level Agreement that includes SDDPC's services to the City and the annual rates.

The City budgeted $72.6 million for technology costs in FY 2009 and $81 million in FY 2010, which is 2.3 percent and 2.7 percent of the City's gross budgeted expenses respectively.

SDDPC was created in 1979 to provide IT services to the City. The City Manager report, dated November 16, 1978, explained that the objective of forming the corporation was to acquire and retain data processing staff in a competitive environment. City officials envisioned benefits to the City by:

- Improved technology;
- A Board of executives with technical and managerial experience;
- Competitive compensation to attract employees; and
- Potentially, an agency to provide data processing to other governments which would achieve further economies.

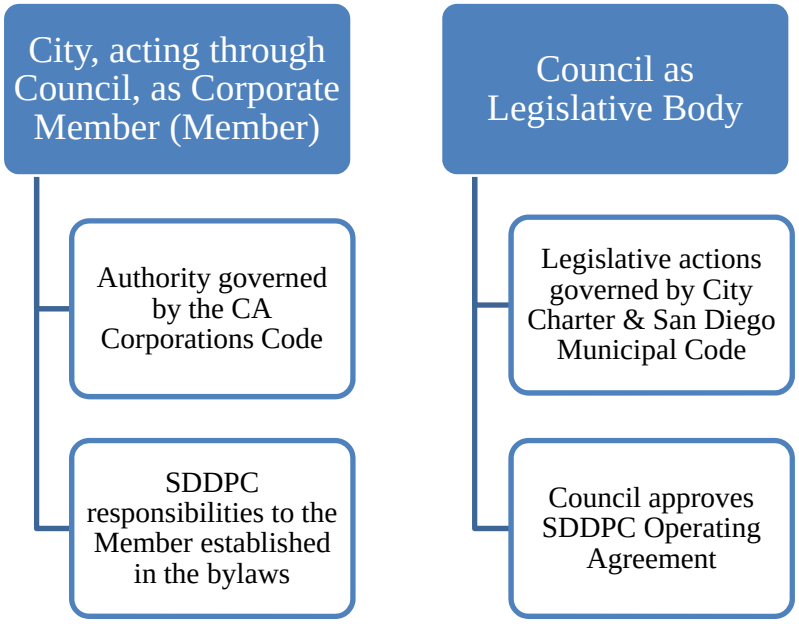
Also, the Operating Agreement permitted SDDPC to procure technology goods and services for the City. Currently, SDDPC operates the City's data center and network, administers telecommunications for the City, provides project management and application support services, provides desktop and messaging services, and procures IT goods and services for the City.

The City Council has dual roles pertaining to SDDPC. First, the City normally exercises its powers as the sole member of the corporation through the acts of the City Council[2]. The Council, acting as member, may approve corporate bylaws, define the corporate organizational structure and establish certain reporting requirements. Secondly, as the legislative body of the

[2] Fifth Amended and Restated bylaws of SDDPC, Article II, Section 1.

City, the City Council also approves the terms of the Operating Agreement or contract between the City and SDDPC for technology services. The Mayor is responsible for operational oversight of the contract terms. Rights and responsibilities of a corporate member differ than the rights and responsibilities of a party to a contract.

Figure 1: City Council's Dual Roles Pertaining to SDDPC



Source: Auditor generated

Corporate Organization

The City, acting through its City Council or designee, is governed by the California Corporations Code in its role as the sole member of SDDPC. Corporate members' rights include the authority to:

- Authorize others to vote for them by proxy (§5613);
- Enact and change the corporate bylaws (§5150 & 5034);
- Approve changes to the articles of incorporation (§5812);
- Elect, remove and replace directors (§5220, 5222, & 5224);
- Approve corporate merger (§6012 & 6015);
- Approve the sale of corporate assets (§5911); and
- Voluntarily dissolve the corporation (§6610, 5033).

SDDPC's business purposes are stated in the articles of incorporation and permit SDDPC to provide technology services to other agencies. However, the City is the corporation's primary customer[3]. The corporate bylaws establish the organizational structure within SDDPC and its reporting requirements to the member. There are seven members of the Board who each serve two year terms. In fiscal year 2005, the City Manager amended the corporate bylaws to change the composition of the seven member Board of Directors to include three voting City staff (the Chief Information Officer (CIO) and two other staff at the Deputy City Manager or Department Director level) and four public members. Since 2005, the City Manager (now the Mayor) has exercised sole control over the appointment and removal of Board members. In 2006, the City Council authorized the Mayor to further amend the SDDPC bylaws to remove City of San Diego officers from the Board as voting members and require Board Directors to have a broader technology background. The SDDPC bylaws require an annual member meeting and three reports to the City including a bi-annual report related to technology, fiscal and other pertinent topics, a monthly financial report, and a quarterly financial report in a Form 10-Q format. The Form 10-Q is a SEC Form that includes both financial reporting requirements and internal control reporting.

Contract Between the City and SDDPC

The Operating Agreement, last amended September 14, 1999, is the contract[4] between the City and SDDPC for technology services. City Council approved the agreement and the Mayor is responsible for monitoring SDDPC performance in accordance with the agreement. The agreement authorizes the Mayor to negotiate annual rates for services which are recorded in an annual Service Level Agreement (SLA). The agreement establishes the general terms of service, and the SLA specifies the annual services and rates. The rates are set to reimburse SDDPC for their costs; however, actual SDDPC revenues may exceed costs incurred or vice versa.

The contractual agreement between the City and SDDPC, includes:

- A general description of the services to be provided;
- The budget approval process;
- Insurance requirements;
- How the City may terminate the contract; and
- Other general contract provisions such as payments and required audits.

[3] SDDPC is included in the City's Comprehensive Annual Financial Report as a component unit and an internal service fund.
[4] The contract between SDDPC and the City has not been competitively bid.

The Department of Information Technology[5] has a key role in monitoring SDDPC's compliance with the Operating Agreement. The department negotiates the annual IT rates and monitors the City's IT budget. The Interim Chief Information Officer and the Purchasing and Contracting Director authorized the FY 2010 SLA. The Department of Information Technology has revised the terms of service in the SLA to improve the City's procurement oversight. The department also monitors citywide service costs; department specific services are monitored by the requesting department.

Recently, the City appointed a Director of Information Technology and is in the process of reorganizing its oversight of IT projects. An Information Technology Business Leadership Group has been formed whose role will include the review of major City IT projects.

[5] The Department of Information Technology (DOiT) was formerly the Office of the CIO.

AUDIT OBJECTIVES, SCOPE AND METHODOLOGY

At the request of the Mayor and the Audit Committee, the City Auditor included a follow-up audit of SDDPC in the Fiscal Year 2009 and 2010 Audit Work Plans. Also, we reviewed the governance process to determine whether it provides the City with adequate oversight of SDDPC and makes SDDPC sufficiently accountable to the City. We did not audit the operations of SDDPC except for testing related to prior audit findings.

To accomplish our objectives related to SDDPC, we performed the following audit procedures:

- Examined the SDDPC articles of incorporation, the bylaws, the Operating Agreement with the City and the annual Service Level Agreement;
- Reviewed the SDDPC procurement, financial and personnel policies, Board agendas and minutes applicable to the audit period;
- Examined City reports related to SDDPC;
- Inquired with City staff on matters related to SDDPC;
- Examined the fiscal year 2008 City payments to SDDPC;
- Inquired with SDDPC staff on internal governance controls;
- Performed testing necessary to conclude on implementation of prior audit recommendations; and
- Examined technology reports of other cities.

We evaluated internal controls related to the audit objectives. Our conclusions on the effectiveness of these controls are detailed within the following audit results.

We conducted this 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 the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

AUDIT RESULTS

MOST OF THE 2004 AUDIT RECOMMENDATIONS HAVE BEEN IMPLEMENTED BY SDDPC.

At the request of the Audit Committee, we performed a follow-up review to determine the current status of the 12 recommendations made related to SDDPC in the audit report issued June 9, 2004 by the City's Auditor and Comptroller Department. A summary of all recommendations and their current status can be found in **Appendix A**.

Generally, we observed:

- The SDDPC Board has implemented policies that have resulted in a decrease in overhead administrative costs related to meals and other inappropriate expenses identified in the prior audit;

- Meal costs were reduced on average from $2,227 per month in fiscal year 2003 to $543 in fiscal year 2008 for an estimated cost savings of $20,200 annually;

- $35,132 was refunded to City departments as a result of the prior audit's review of contracts and billings. Also, SDDPC billed SA Ventures $9,594 in February 2005 to recover payments made not in accordance with the contract; however, SA Ventures did not respond and SDDPC determined the cost of pursuing recovery was not cost effective; and

- SDDPC negotiated a termination of their lease at the Calle Fortunada location, resulting in rent savings from January 2005 through November 2008 of approximately $2 million.

We found policies related to reimbursing contractors for alcohol and retention of bid documents are verbal, not written; however, our testing in these areas did not identify any issues of concern.

Recommendation:

1. **SDDPC's Board should require SDDPC to have written policies related to reimbursements to vendors and the retention of bid documents.**

SDDPC BYLAWS, OPERATING AGREEMENT AND CITY POLICIES PERTAINING TO SDDPC SHOULD BE REVISED TO IMPROVE TRANSPARANCY AND ACCOUNTABILITY.

We found the performance and reporting standards in the Operating Agreement and bylaws were not always clearly stated and lack sufficient requirements to improve transparency and accountability to the City and the taxpayers. Similarly, City policies pertaining to SDDPC were not always clear. In our opinion, the Operating Agreement should be amended to improve its general contract terms, capital budget approval requirements, procurement standards and billing requirements. SDDPC should report their performance in a manner that is more useful to the City for decision making and the City should define reporting standards to be incorporated into SDDPC's bylaws. Improved standards of open reporting are necessary for the City to assess SDDPC's effectiveness in delivering cost efficient goods and services to the City and assurance that internal controls are effective. Also, we noted instances in which SDDPC's bylaws were either not complied with or did not include all regulatory requirements. The deficiencies in the terms of the Operating Agreement and the bylaws increase the risk that technology costs will not be fully disclosed and assessed by the legislative body independent of City operations, and the City may not receive the best value for procured goods and services through SDDPC.

Improvements should be made to SDDPC's budgeting requirements and practices in order to ensure adequate assessment by Council and disclosure of technology costs to Council and the public.

During our audit, we found the following indicators that SDDPC's budget practices and budget requirements per the Operating Agreement could be strengthened to mitigate risk:

- SDDPC budget has not always been approved by Council as required in the agreement. This weakens controls due to the lack of budget review by Council who is independent of City operations;

- The agreement does not require Council approval of the SDDPC capital asset acquisitions; however, depreciation expense is included in the budget which impacts cash flows between the City and SDDPC; and

- Approval of pass-through expenses by Council during the budget process is unclear and is not addressed in the agreement resulting in limited disclosure to Council of procurement practices by the City through SDDPC.

These conditions indicate that the Operating Agreement and SDDPC bylaws do not always clearly address budgeting issues. Controls could be strengthened by modifying the agreement to require SDDPC to self assess and report on their compliance annually and by developing a City process whereby the Mayor's designee would review the accuracy and completeness of this assessment.

Budget Approval

The SDDPC budget has been presented but not been approved by Council as required by the terms of the Operating Agreement between fiscal years 2004 and 2009. The agreement is a contract between SDDPC, as the vendor, and the City, as the customer. Provisions of the agreement, such as required budget approval, cannot be delegated unless directed by Council. We could not identify Council actions to delegate this budget approval to City administration. Council delegated its voting proxy as a corporate member to the Mayor in 2004. The delegation did not address budget approval. Council budget approval is a control which could decrease the risk of excessive technology costs.

The City does not have a process in place to make an adjustment for annual payments made to SDDPC in excess of actual costs incurred to deliver technology services to the City. The Operating Agreement requires SDDPC to include a "Budgetary Transfer to City" line item in their budget; however, the City Manager approved bypassing this process in fiscal year 2005. Because the Operating Agreement calls for a budgetary transfer rather than a rate refund, the Office of the City Attorney raised concerns that such a transfer to the City could be considered as a distribution to a member that the California Corporations Code prohibits. As a result of these concerns, SDDPC has not made any budgetary transfers since.

Payments in excess of costs are a result of a rate setting process based on estimates and projections of costs. For instance, in fiscal year 2008, SDDPC had net operating income of $1.4 million as a result of the rate setting process. In fiscal year 2008, SDDPC used $4 million of unrestricted net assets from prior years' operating income for two City projects, the OneSD and Computing Infrastructure Projects. However, Council did not amend the Operating Agreement to authorize the practice of directly applying SDDPC's surplus revenues to fund technology projects versus making a budgetary transfer to the City.

The risk of overpayments to SDDPC would be mitigated by incorporating into the Operating Agreement a process to refund payments made by the City in excess of actual SDDPC costs to provide these services. Mid-year rate adjustments or annual refunds could be utilized to achieve this.

Capital Budget Approval

Controls over the City's approval of SDDPC's investments in capital assets are weak. During the audit period, the SDDPC budget presented to Council did not include information on capital expenditures. Instead it included depreciation[6] expense, a non-cash item. The Operating Agreement does not specify whether depreciation, capital expenditures, or both should be presented to Council for budget approval. Capital expenditures usually involve a significant outlay of funds for purchases of items that will benefit the organization over a number of years. SDDPC capital expenditures were $9.8 million between fiscal years 2006 through 2008. Depreciation was $10.4 million for the same period.

SDDPC does not include planned capital purchases in the budget presented to the City Council. According to SDDPC, Council members are sent copies of the Board packet which lists capital expenditures made during the year. However, the City Council is not informed of the purpose and benefit of high dollar value capital items prior to their purchase. The SDDPC capital budget is discussed with the Chief Information Officer (CIO) during the rate setting process and in the past some planned purchases have not been made based on these discussions. However, the CIO has no authority per the Operating Agreement to disallow expenses if they are not in the best long term interest of the City or if the expenses should be deferred to future years. Although some capital expenses are critical to operations, others may be discretionary and warrant additional justification. The cash impact of depreciation expense and capital expenditures for fiscal years 2006 through 2008 is shown below on Table 3. Over three fiscal years, the net cash impact is approximately $600,000 of cash inflows to SDDPC versus outflows. In years that cash receipts exceed cash outflows, cash balances may be available to fund future capital purchases.

Table 3: Net Cash Impact of Depreciation Expense and Capital Purchases

Fiscal Year	Cash Inflow to SDDPC Related to Depreciation Expense	Cash Outflow from SDDPC for Capital Purchases	Net Cash Impact
2006	$3,411,544	$2,343,319	$1,068,225
2007	$3,175,465	$2,461,146	$714,319
2008	$3,821,014	$4,979,162	<$1,158,148>
Total	$10,408,023	$9,783,627	$624,396

Source: SDDPC Financial Statements fiscal years 2007 and 2008.

[6] Depreciation is an accounting method of allocating that expense over the useful life of the goods.

If the agreement required approval of the capital budget, the transparency of SDDPC's expenditures and their benefit to the City would be improved. This would also reduce the risk of unnecessary or excessive capital expenditures.

SDDPC Pass-Through Expenses

In fiscal year 2008, SDDPC did not include the City's pass-through expenses in its budget presented to Council. It is not clear whether the payments made to SDDPC that exceeded their approved budget were properly authorized by Council. These pass-through expenses are purchases of goods and services by SDDPC from third parties at the request of the City departments. These expenses have not always been included in the SDDPC budget presented to Council. In fiscal year 2008, the SDDPC budget was $45.8 million; pass-through expenses were an additional $30.1 million.

SDDPC pays the vendor and bills the City for pass-through purchases. As a result, SDDPC is the City's vendor and authorization is required to pay SDDPC for these expenses. Normally, approval of payments to City vendors cannot be made without the following approvals:

- Council's approval of the department's budget for supplies & services; and

- Council's or City Officials' approval of the vendor contract which specifies the deliverable and the dollar amount to be paid to the vendor. For example, the City Council must approve consultant contracts exceeding $250,000 and certain contracts that extend beyond five years.

This normal approval process does not occur when the City makes purchases through SDDPC. Instead, the department directors and the Department of Information Technology can authorize purchases using a 1399 Form. Although Council approval is not required, in some instances such as OneSD, financing approval has been requested from Council.

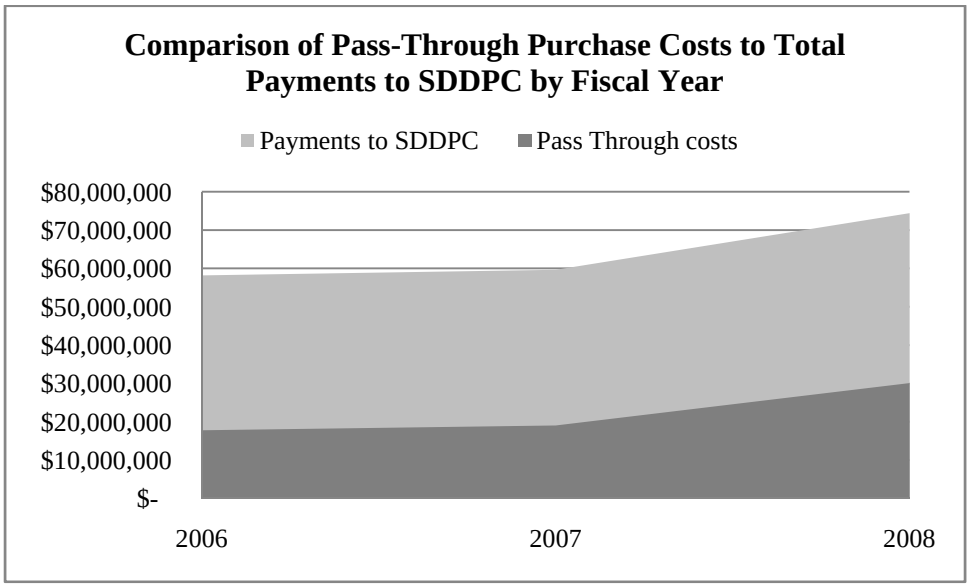
The authorization for the City Comptroller to pay SDDPC for pass-through expenses is not clear. The Operating Agreement is a contract with SDDPC; however, unlike other City contracts, it does not authorize the amount to be paid to SDDPC. Instead, payment authorization is included in the appropriation ordinance. The 2009 appropriation ordinance[7] stated that the City Comptroller, at the direction of the Mayor, is to transfer funds to related City entities in accordance with the Annual Budget Document and appropriate funding source rules and regulations.

[7] Ordinance 19774, Section 9.

The City's Financial Management Department explained that they interpreted this to be in accordance with the City's Annual Technology Budget, not SDDPC's. The language authorizing the City Comptroller to pay SDDPC is subject to interpretation and could be clearer to ensure payments are properly authorized.

Pass-through expenses for fiscal years 2006 through 2008 totaled over $67 million compared to total payments to SDDPC of approximately $190 million. Pass-through expenses were 35 percent of payments made to SDDPC between 2006 and 2008. Figure 2 below shows a comparison of pass-through purchases to total payments to SDDPC for fiscal years 2006 through 2008.

Figure 2: City's Pass-Through Expenses



Source: SDDPC Audited Financial Statements & City Comptroller Payment Record

Given the magnitude of pass-through purchases, the Council authorization for these payments to SDDPC should be clear in the appropriation ordinance.

Recommendations:

2. **Design controls to ensure a review of compliance with the Operating Agreement terms is performed annually. Consider requiring SDDPC to self-assess their compliance with the agreement terms and submit the assessment to the Mayor, or designee, for their review prior to executing the annual Service Level Agreement.**

3. **Modify the Operating Agreement to establish a process by which payments by the City that exceed costs for services are refunded by SDDPC.**

4. **Modify the Operating Agreement to define costs which are unallowable without a justification of benefit to and approval by the City, including the procurement of capital assets.**

5. **Consult with the City Attorney to ensure pass-through purchases are properly and clearly authorized by Council as required by the Municipal Code and Charter.**

6. **The City should ensure the appropriation ordinance language clearly authorizes payments to SDDPC for pass-through expenses.**

The Operating Agreement lacks adequate procurement standards and disclosure requirements to ensure competitive and cost effective practices.

Although SDDPC has Board approved procurement policies, we found indicators that best practices for procurement of goods and services could be improved. The Operating Agreement allows SDDPC to procure goods and services for the City; however, it does not establish competitive procurement standards or require SDDPC to follow City regulations for City procurements. Following best procurement practices may decrease an organization's risk that some purchases are not obtained at the best value.

The SDDPC Board has established procurement policies which address authorization and competition requirements based on the type and dollar amount of the procured goods or services. A memo is presented to the Board for each contract requiring approval. Also, a list of contracts is included in the Board packet. We did not test the accuracy of the information; however, we noted the list excluded some maintenance contracts, regardless of their value. Additionally, the list does not identify which contracts are for procured services versus in house and does not summarize the number of contracts entered into during the period, the number of sole source contracts, and the competitive process used to procure the services (quotes, bid, etc.)

Generally, we noted the Operating Agreement does not require SDDPC to provide assurance of competitive practices to the City. The Institute of Internal Auditors (IIA) recommends, "If any intermediaries are used in the procurement process in order to tap skill sets not available in an organization, the competitive principle must be ensured through appropriate organizational oversight of the intermediaries." We recommend incorporating competitive procurement requirements in the Operating Agreement to ensure adequate oversight by the City.

During our follow-up procedures for the June 2004 audit, we performed testing on a limited number of contracts to review SDDPC procurement practices, and we noted the following indicators of weaknesses in SDDPC's competitive procurement practices.

- Responses to four requests for quotes were required within five business days related to a request for a consultant to assist with selection of an Enterprise Resource Project (ERP) Integrator. Only one response was received. The contractor received payments exceeding $244,000 for contract work. A standard minimum response time for consultant contracts has not been established to ensure sufficient responses. Also, additional requests for quotes have not always been pursued when there is a sole responder. Limited vendor response times increases the risk that the contract may indirectly favor a vendor.

- Information presented to the Board and to the public does not always include sufficient information on sole source or sole responder contracts. For example, a memorandum to the Board described the process to contract with a consultant as taking "several months of recruiting." The memorandum does not describe the competitive process undertaken to perform this recruitment. The contractor was paid in excess of $400,000 in fiscal years 2008 and 2009. Sole source or sole responder contracts are non-competitive contracts and in our opinion complete disclosure to the Board and public is warranted.

- System maintenance contracts are not limited to a specific fixed term. Instead, contracts are amended without bidding. Therefore, contracts can extend for many years without a determination whether the existing system provides best value to the City. For example, general fund expenses exceeding $1,000,000 have been paid to a contractor in fiscal years 2008 and 2009 for maintenance of the Criminal Records Management System. The same contractor has been utilized without bidding since 1998. In another instance, SDDPC has contracted with the same vendor for water system modeling since 1998; fiscal year 2008 and 2009 total payments to the vendor were $377,684. According to SDDPC staff, the City has not established guidelines prohibiting them from extending maintenance contracts. Although the nature of technology systems may warrant some extended contracts, all contracts should have a fixed term to require a review before new fixed contracts are issued.

Although we did not test grant funded procurements, we noted that the Operating Agreement could be improved by incorporating controls for compliance with Federal or State procurement policies related to grant funded technology projects. Grantors may require certain levels of market competition. For instance, the U.S. Department of Justice permits grantees to use the same policies used for procurement from non-Federal funds, provided policies conform to certain Federal Regulations. These regulations require purchases exceeding $100,000 to be

publicly advertised and solicited from an adequate number of known suppliers[8]. Furthermore, the 2009 Federal Stimulus Package includes an estimated $4 million in Justice Assistance grants to the City. A portion of this may be used for technology improvements. There is a risk that procurement through SDDPC could jeopardize future grant funded technology projects if the Operating Agreement does not require SDDPC to comply with grant requirements.

Best Practices

We reviewed best practices recommended by the Institute of Internal Auditors (IIA) and other agencies.

- The guidelines for procurement recommended in the 2008 Auditing the Procurement Function published by the IIA Research Foundation included the following best practices:
    - Time scales for procurement actions should be adequate to enable potential vendors to put together their submissions;
    - If an insufficient number of potential vendors have submitted quotations or bids, the procurement function may approach additional vendors to suggest participation in the procurement process. For the open tender of major procurement actions, it may advertise (or re-advertise) details of the procurement action to encourage greater participation;
- The Government Accountability Office (GAO) recommends collecting information for decision makers "to evaluate the impacts and opportunities created by proposed or continuing IT investments";
- The GAO best practices for IT Business Systems Acquisition recommend an analysis of proposed IT investment's likely costs versus benefits over its useful life and an analysis of associated risks; and
- The Federal government controls sole source contracts by requiring publication of the justification for the sole source procurement[9].

[8] Code of Federal Regulations Title 28 § 66.36.
[9] Federal Acquisition Register, Subpart 6.3.

The Operating Agreement does not require SDDPC to establish policies to ensure transparency and to increase both the public and the City's confidence that SDDPC's procurement practices are competitive and cost effective. Transparency is the full, accurate, and timely disclosure of information and it is a tool to provide assurance to the public that government is operating in a responsible manner. SDDPC's mission includes supporting the City's IT needs through an open and honest partnership.

Recommendations:

7. **Amend the Operating Agreement with SDDPC to improve best practices by requiring:**

    a. **A dedicated public vendor webpage for posting:**
        - **Requests for quotes or proposals;**
        - **Results of requests for quotes or proposals; and**
        - **Justifications for sole source / sole responder vendor contracts;**

    b. **Standard minimum response times to requests for quotes or proposals;**

    c. **Re-advertising for requests for quotes or proposals if an insufficient number of responses are received from vendors for contracts exceeding a specific value, such as $250,000 unless sufficient justification is documented, presented to the Board and the justification is posted to the website;**

    d. **Fixed terms for contracts; and**

    e. **Annual report to the City summarizing competitive practices.**

8. **City management should consider establishing policies and regulations specific to procurement of long term system maintenance contracts.**

9. **The City and SDDPC should develop policies and procedures to ensure compliance with competitive standards applicable to federally funded technology projects.**

10. **Add language to the City's Purchasing and Contracting Department website directing vendors to SDDPC web site for technology procurement opportunities.**

SDDPC does not provide sufficient documentation for City staff to verify the accuracy of the billings for procured services.

We found that SDDPC does not provide City Departments sufficient documentation of vendor invoices to confirm that the amount billed matches the third party vendor invoice. The controls to ensure accurate City reimbursements to SDDPC for services procured from third parties are weak, and the City has not incorporated adequate billing standards to address this in the Operating Agreement. SDDPC's current billing process for procured services does not provide adequate access to SDDPC's documentation to allow City Departments to verify the accuracy of the amounts billed. The lack of controls increases the risk that the City would not detect improper billings by SDDPC.

Under the current process, pass-through purchases made through SDDPC are initially requested by departments and are subject to City approval requirements. The City Comptroller receives only a summarized file of expenses without supporting documentation and pays the amount billed for these purchases. If departments dispute billings paid by the City Comptroller, they can contact SDDPC to resolve the dispute.

Controls at the City would be improved if departments had open access to the vendor invoices and other documents received by SDDPC in order to verify the accuracy of SDDPC's pass-through billing to the department. Vendor invoices, contracts and vendor payment history are not readily available to City departments. Furthermore, the funds are not always encumbered at the City for specific contracts purchased through SDDPC. Although no billing errors came to our attention during our review, access to third party contracts and invoices is a preventative control to decrease the risk of billing errors.

SDDPC's third party contracts and billing to the City result in redundant processes. The City has a process and systems in place to contract with and pay vendors. The City's process allows City employees access to contracts, vendor invoices, and payment records. SDDPC also has a process and systems in place to pay vendors, yet their payment systems cannot be accessed by City staff; therefore, City staff does not have view access to SDDPC contracts, invoices, and payment data. Some weaknesses of this process are:

- The third party invoice is not posted to a site permitting City employees open access to review these invoices. Also, the billing files do not cross reference the number of the invoice being reimbursed. This increases the risk that billing errors to the City will not be detected.

- Contracts are not posted to a site accessible to all City employees. Contracts may be requested from the Corporation. This process is cumbersome and increases the risk that payments made might not be in accordance with the terms of the contract.

- New information technology projects are authorized by City staff on the City Information Technology Business Leadership Group (ITBLG); however, citywide controls are not in place to verify on-going SDDPC project billings to the department do not exceed the approved costs by the ITBLG. City encumbrances have not been established to limit payments to SDDPC for a project to an approved amount.

Recommendations:

11. **Either SDDPC should permit view access by City employees to their contract, invoice, and vendor payment history for procured goods and services in order to verify the accuracy of SDDPC billings, or the procurement of these goods and services should be made directly through the City's procurement process in consultation with SDDPC staff. The selected process should ensure the best operational efficiencies for the City that incorporate strong internal controls.**

12. **The City should establish encumbrances for ITBLG approved new project costs procured through SDDPC to ensure actual costs do not exceed approved budgeted costs.**

Some controls in the Operating Agreement and Service Level Agreement could be improved by revising contract terms, and other controls have not been properly monitored.

The City regulations and policies applicable to the SDDPC Operating Agreement are unclear in the following areas:

- The Operating Agreement has no defined term, as required by City regulations for most other City contracts;

- The Operating Agreement does not require that annual rates paid for services provided by SDDPC are agreed upon timely; and

- The Operating Agreement and SLA do not state annual not to exceed amounts for services under the SLA or pass-through purchases.

Other City contracts for goods and services must be executed prior to payments being made and have a not to exceed amount.

The Operating Agreement has no defined term. The City Charter[10] requires that continuing contracts extending beyond five years be authorized by ordinance and a two-thirds' majority vote of Council after holding a public hearing. The City Attorney commented that this may not be applicable to the SDDPC contract as the amount of the contract is reviewed annually during the budget process. The original agreement with SDDPC, a fixed term five year contract, was approved by resolution in 1979. The practice has been to amend the agreement by resolution; however, the five year term was removed from the agreement. Therefore, the terms of the agreement have not been updated since 1999. A fixed contract period would ensure the scope and terms of the agreement are periodically reviewed.

The Operating Agreement does not require that the Service Level Agreement (SLA), which establishes the annual rates paid for services provided by SDDPC, be executed in a timely manner after the City budget has been approved. The fiscal year 2008 SLA was not signed by the City and the fiscal year 2009 SLA was not signed until the third quarter of the fiscal year. The Interim CIO advised the rates were agreed upon and payments were in accordance with these rates. The delays in signing the SLA were due to issues pertaining to terms and conditions other than the rates. In addition, the City Comptroller made payments to SDDPC without a signed fully executed SLA. Making payments without a signed agreement would not be an acceptable practice for other vendors who have contracts with the City. Controls would be strengthened if the agreement required the SLA to be executed by a certain date and that payments to SDDPC not be made without a signed SLA.

The Operating Agreement and the SLA do not state annual not to exceed amounts for either the SDDPC operating budget or procured goods and services, referred to as pass-through purchases. Also, Council approval has not been required for pass-through purchases made through SDDPC. Some of the purchases made through SDDPC would have required Council approval, due to the dollar amount and type of purchase, if they had been made through the City Purchasing and Contracting Department. For example, Forest Glen Group, a consultant, entered into a contract in fiscal year 2007 with SDDPC that authorized payments not to exceed $294,500. The City requires Council approval for consultant contracts exceeding $250,000. The current process, which permits procurement through SDDPC, needs to be clarified to ensure compliance with all City regulations.

[10] Charter Section 99: Continuing Contracts.

Recommendations:

13. **Consult with the City Attorney and amend the Operating Agreement to a more traditional professional services contract to provide the City with specific IT services and as-needed services. The agreement should have a fixed term and incorporate appropriate levels of approval at the City prior to SDDPC processing a request for services.**

14. **Amend the Operating Agreement to establish a timeline for execution of the annual SLA and to establish the level of City approval required prior to making payments if an SLA is not executed within the timeframe.**

SDDPC was not in compliance with all of its bylaw requirements and its bylaws should be amended to improve accountability to the City.

SDDPC's Board has not held an annual meeting with the City Council, the CEO has not reported to the Member as required by the bylaws[11], and controls have not been designed to ensure compliance with these bylaws. According to SDDPC counsel, the reporting requirements were verbally waived by a former City Assistant Chief Operating Officer. The lack of reporting weakens internal controls over the City's monitoring of the corporation. Furthermore, the reporting requirements are general and do not require SDDPC to clearly demonstrate the corporation's performance and its benefit to the Member and the public.

The bylaws require an annual member meeting and three reports; a biannual report related to technology, fiscal and other pertinent topics, a monthly financial report, and a quarterly financial report in a Form 10-Q format. The Form 10-Q is a SEC Form that includes both financial reporting requirements and internal control reporting. We requested copies of reports to City Council or Committees in the past three years and found the following:

- The last quarterly financial report submitted to the Mayor's office was dated May 5, 2006. The quarterly report was not in a 10-Q format. Specifically, it lacked a statement of management's responsibility for establishing and maintaining adequate internal controls over financial reporting and an evaluation of the effectiveness of these internal controls; and

- Monthly financial reports have been submitted to the City Comptroller and the SDDPC Board which includes City officials. Also, SDDPC advised the Board minutes are sent to Council members monthly. However, Board minutes and audited financial statements

[11] Bylaws Article II, Section 4 and 6.

are not posted to SDDPC's public web site. Also, we noted that the Operating Agreement does not require the CEO and CFO to certify that management assumes full responsibility for the completeness and reliability of the information contained in the SDDPC financial report. SDDPC financial reports are included in the City's CAFR and providing a certification by SDDPC's CEO and CFO would strengthen the City's internal controls over financial reporting.

We found that the reporting requirements could be improved so the City could better monitor SDDPC performance. The following information is not presented to the City Council in an annual report and meeting:

- SDDPC's strategic plan;
- Annual goals;
- Major projects, their benefit, budgeted implementation time and costs, and return on investment; and
- Results of the prior year's goals and actual implementation time and costs versus budgeted.

We noted that a 2007 annual report[12] was posted to the SDDPC website[13]. The Steve Alexander Group (SAG) prepared this report at a cost of $34,194, The report presents an overview of the prior year's accomplishments. However, in our opinion, it lacks sufficient, relevant performance information such as SDDPC project budgets, actual project costs, and cost savings from projects implemented by SDDPC. For instance, SDDPC reported that one accomplishment was the project to standardize computing platforms, e-mail, and directory systems necessary for the ERP project. The report does not discuss the Board approved budget for this project, if any; the actual cost of resources to accomplish this project; and the cost savings to the City by implementation of this project. The report refers to the Avanade Corporation which SDDPC contracted with for implementation of this project. Although the report does not include the cost, we found Avanade[14] was paid $2,368,256 in fiscal years 2008 and 2009, placing them 11th of the top 20 SDDPC payees as shown on **Appendix B**.

The project to standardize computing platforms appears to be a fiscal year 2008 accomplishment, not 2007. However, the report does not state whether the report period was a fiscal or calendar year basis so we could not determine if this accomplishment was reported in the correct period.

[12] 2007 Annual reported entitled "New Edge Performance for a City on the Move."
[13] www.sddpc.org.
[14] The accounts payable register was used to identify payments to corporations and it does not name the projects associated with these costs. Therefore, the $2.3 million paid to Avanade may include projects in addition to the one described in the annual report.

Other City's Reporting of Information Technology Projects

While reviewing the reporting of information to Council, we reviewed other cities and found, as shown below in Table 4 that it is a common practice to report information technology projects and their results to governing bodies.

Table 4: Other City's Reporting of IT Projects

City / Agency	Report	Notes
Houston, TX	•5 year Technology Plan similar to CIP •Technology initiatives	Reports description and benefits of project; five year cost budget by major departments.
San Jose, CA	Report to Public Safety, Finance & Strategic Support Committee	Narrative description of priority projects and the benefits of the projects.
Los Angeles, CA	Information Technology Annual Report	Narrative description of project objectives and achievements.
San Antonio, TX	Information Technology Project Portfolio	Summary of costs/benefits. Detailed project review including a return on investment (Cost savings, revenue growth, cost avoidance.)
Phoenix, AZ	Budget – Technology Capital Improvement Budget	Brief description of project and five year costs.

The GAO describes technology investment oversight as a pivotal process whereby the organization monitors projects against cost and schedule expectations, as well as anticipated benefits and risk exposure[15]. The City and SDDPC do not collaborate to report this information on technology projects and their benefits on an annual basis to Council which could impact decision making by Council.

The lines of authority pertaining to the City's governance over SDDPC could be more clearly defined.

During our audit, we found the lines of authority pertaining to governance of SDDPC were not always clearly defined. Clear lines of authority exist when the roles and responsibilities of the City Council, Mayor, departments and SDDPC are defined. Some of these responsibilities include:

- Appointment of Board Directors;
- Amendments to and compliance with the SDDPC bylaws;
- Authorization of amendments to the Operating Agreement;
- Establishment of rates and execution of the SLA;

[15] GAO Report, GAO-04-394G, GAO IT Investment Management Framework.

- Monitoring contract compliance such as budget approval, budgetary transfers and reporting requirements; and
- Authorization of expenditures through SDDPC, including procured goods and services through SDDPC and capital expenditures by SDDPC.

We reviewed the bylaws, the Operating Agreement, resolutions approved by Council, the San Diego Municipal Code, and City policies and found that the responsibilities could be better defined. For instance, the resolution delegating Council's authority, as the Member, to appoint Board Directors and amend the bylaws used the term "voting proxy" to delegate their rights. Although the bylaws allow delegation of authority, the use of the term "voting proxy" in the resolution makes it unclear what authority was delegated and whether this delegation should be renewed periodically. Also, the Operating Agreement permits SDDPC to acquire special hardware or software as authorized by the City; however, "the City" could be interpreted as City Council, the Chief Operating Officer or department directors. Clarifying roles and terms used in governing documents would strengthen controls by establishing clearer lines of authority.

City Council does not approve SDDPC President (CEO) contract.

Under the current bylaws, the Mayor does not appoint and City Council does not approve the appointment of the SDDPC CEO or the employment contract terms. Therefore, in our opinion, the CEO is not directly accountable to the Mayor and City Council. Additionally, the contract terms set compensation (salary and bonuses), defines the responsibilities of the President, and specifies who and under what conditions the CEO's contract can be terminated. The Mayor's and Council's involvement in this process would improve the CEO's accountability to the City, and the transparency of the CEO's contract terms and costs.

The Board does not approve the Chief Financial Officer's compensation.

The CEO approves compensation of SDDPC's Chief Financial Officer (CFO). State rules[16] require the Board to approve compensation awarded to the CFO upon hiring or when there are changes not applicable to all other employees. May 23, 2008, a $5,000 bonus awarded to the CFO did not have Board approval. At the time the bonus was awarded, the Board approved policy governing merit and bonus payments did not require Board approval of any bonuses other than the CEO's. Although SDDPC advised their Human Resource Policies now require this; the bylaws require the Board set and approve the compensation of only the CEO. Controls would be strengthened if the bylaws were modified.

[16] California Corporate Code Section 12586.

Recommendations:

15. **City management, in consultation with the City Attorney, should advise the City Council to consider amending SDDPC's bylaws to include the following:**

    a. **The Mayor and City Council shall approve the hiring of the CEO and the CEO's contract terms;**

    b. **The Board shall approve the compensation of the CFO unless increases in compensation are applicable to all employees;**

    c. **The CEO shall provide an annual report to the Mayor and City Council on SDDPC's compliance with its Bylaw requirements;**

    d. **SDDPC shall provide to the Mayor and City Council an annual report on its performance, including its strategy, current year's goals, status of major projects, and comparison of prior year's goals to performance; and**

    e. **SDDPC's CEO and CFO shall certify to the City that SDDPC management assumes full responsibility for the completeness and reliability of the information contained in the financial report.**

16. **City management, in consultation with the City Attorney, should advise the City Council on the appropriate action to be taken regarding delegation of member rights.**

CONCLUSION

The San Diego Data Processing Corporation (SDDPC) has been the City's sole technology agency since 1979 providing information technology services. Our review found that the City's oversight and monitoring of SDDPC's activities could be improved by establishing sufficient performance and reporting requirements for SDDPC activities. In our opinion, additional controls should be incorporated into SDDPC's bylaws, Operating Agreement and annual Service Level Agreements to enhance the transparency of activities and accountability to the City. We made recommendations to incorporate additional controls that will help to ensure taxpayers receive the best value for goods and services procured through SDDPC.

APPENDIX A

Schedule of Prior Audit Recommendations and Status of Implementation

	Recommendation	Status
1.a.	Request repayment of $6,661 paid to EMA for disallowed reimbursable expenses and $200 in labor exceeding the contract terms and reimburse these amounts to the City Department.	Implemented. In response to our prior audit recommendation, a comprehensive review of the EMA contract was performed by SDDPC which resulted in refunds to the Water Department of **$32,273.72** from EMA.
1.b.	Request repayments of $950 in costs exceeding the reimbursable limits from SA Ventures and the $860 spent on equipment.	Implemented, not recovered. SA Ventures was found to owe $9,594.60 to SDDPC for overages related to disallowed expenditures not in compliance with the contract. There was no response for requests for repayment. SDDPC elected not to pursue recovery due to the cost of potential litigation.
1.c.	Analyze all payments to SA Ventures, its president, and to EMA to determine whether reimbursements were within the maximum monthly allowance and other contract terms, including labor costs. Request reimbursement from the vendors for overpayments, if any are found. Provide this schedule with documentation to the City. Submit refunds from EMA, if any, to the City Department.	Implemented. A comprehensive schedule of overages was provided and we confirmed refunds were credited to City departments.
1.d.	Design appropriate controls to ensure payments are made in accordance with policies and contracts. Also, if requests are received from City staff to make payments not in accordance with contract terms, do not make payments, unless the contract terms are amended or proper support is received.	Documentation of controls used to ensure payments are made in accordance with contracts was not provided to us. However, we identified the following controls : • Approval policy requires managers to ensure appropriate procedures have been followed prior to approving expenditures. • CFO reviews payments prior to final processing. • The City departments' approvals are required on invoices submitted by contractors and billed to the City.
1.e.	Establish a policy prohibiting reimbursement for alcoholic beverages to contractors.	Policies related to reimbursement of alcohol to vendors are verbal; however, SDDPC provided a standard template of travel policies provided to vendors which states alcohol is not reimbursable. Also, during tests of contract reimbursements, we did not find any reimbursements of alcohol.

	Recommendation	Status
2.a.	Revise procedures to ensure that documentation is retained and verify that contracts agree with bids, and that purchases have been made at a reasonable cost.	Implemented. Bid documents have been retained. See 3.b. and 4 below for tests of the competitive process.
2.b.	Establish document retention policies to ensure they meet any legal requirements.	The documentation policy is not written. Per the Procurement Manager, bid documents are retained in perpetuity.
3.a.	Evaluate the policy of not requiring new bidding of contracts which significantly increase in percentage.	Implemented. In response to the audit findings, SDDPC implemented a policy requiring solicitation if a contract awarded without competition was amended and increased to an amount requiring competition. This excluded sole source contracts.
3.b.	For existing contracts that are subsequently amended causing the dollar threshold to exceed the amount requiring quotes: a) ensure staff complies with the policy to obtain additional quotes, or b) clearly indicate to the Board that the contract is a sole source, what the criteria is for this, and indicate to the Board that the procurement policy is being waived and why.	Implemented. Test of Competitive Process disclosed, SDDPC complied with the internal policies in place at the time of the contract for the 5 following contracts that were reviewed: >Advantica >Forest Glenn Group >Sierra Systems >Complete Campaign >Axon
4.	Review procedures to ensure the vendor provides adequate documentation to verify the invoiced amount by the vendor agrees to the contract and that the documentation is retained by SDDPC.	Implemented. Tests of payments to Advantica for travel reimbursements were satisfactory. There were immaterial meal expenses not supported by a receipt other than the credit card receipt. Based on a sample, payments to Forest Glen Group were approved by the City prior to payment; amount paid agreed to contract terms; hours worked were documented. Based on a sample, payments to The Steve Alexander Group were in accordance with the contract terms. Based on a sample, test of payments to CompleteGov.com were in accordance with the contract terms. Based on a sample, test of payments to Sierra Systems were in accordance with contract terms. Based on a sample, test of payments to AT&T were in accordance with contract terms.

	Recommendation	Status
5.a.	Evaluate, in conjunction with the City, the billing process to ensure billing information is clear and adequate.	See report page 19 and 20 for additional review of this recommendation. SDDPC established an email account that departments may use for billing inquiries. In addition to billings, SDDPC provides departments detailed project reports explaining costs and variances. However, based on the project report we reviewed, the estimated labor is not detailed by the title of the employee performing the work and expected hours. The payments tested were reconciled to the batch reports created by SDDPC.
5.b.	Review billings to Tek Systems and provide an explanation of the amounts billed on September 15, 2002.	Implemented. A credit was issued to the City Police Department for $1,920.43 billed in error by SDDPC. TEK Systems is a contract for temporary labor at Police Dept. SDDPC reconciled the invoices to the billing.
6.a.	In conjunction with the City, review procedures to add users who are authorized to request purchases. Provide written confirmation to the requesting City departments when a new user is added.	Implemented. Controls have been improved by requiring appointing authority signature to authorize an employee to make IT purchases. This is monitored by the Office of the CIO (OCIO).
6.b.	Ensure appropriate approval is obtained from the City if there are exceptions to the RA in Project Charters (project agreements).	Implemented. Per the Service Level Agreement, SDDPC may not increase tiers/rates without prior approval from the OCIO.
7.	In conjunction with the City, evaluate the billing information provided to the City to ensure billing descriptions are adequate for the departments to compare billing rates to RA rates.	Implemented in 2010 Service Level Agreement. Based on our review of a sample of billings, rates billed for SDDPC employees do not exceed the SLA rate. A chart of tier levels by SDDPC job title has not been included in the SLA. Therefore, the departments cannot verify the labor rate billed matches or is less than the tier rate. The job title / tier rates were added to the fiscal year 2010 SLA. Per the CFO, these were provided to the City in fiscal year 2005.
8.	Request SDDPC refund to the City department the overpayments of $938.	Implemented. Overpayments of $322 billed to the City for temporary labor & $616 billed for permanent labor above the rate agreement amount were refunded to departments.
9.a.	Consider requiring an annual report of meal expenses be made to the Board to ensure all employees comply with the revised policies and administrative expenses are closely monitored.	Implemented. Quarterly reports are made to the Board of meal and other overhead expenses.

	Recommendation	Status
9.b.	Ensure adequate documentation of all expenses paid, including attendees and business purpose, is retained.	Implemented. Adequate documentation of expenses related to meals and events is retained.
10. a.	Ensure expenditures of public funds are appropriate, not excessive, and have a clear business purpose.	Implemented. Purpose of credit card transactions and employee reimbursements for meals was disclosed on the authorization forms.
10. b.	Develop and formalize procedures to ensure strong internal controls over administrative expenses are in place so that costs for items such as Superbowl events will be identified and not reimbursed. Monitor and report administrative costs to the Board periodically.	Implemented. FY 2008 expenditures for meals, travel, meetings, training, dues & memberships, and coffee services were $342,000, based on unaudited SDDPC records. This was $50,000 over budget primarily due to training. This was disclosed to the Board in quarterly reports.
10. c.	Ensure that the Accounting staff requires employees, including executives, comply with all policies.	Implemented. Expenses for meetings, meals, and travel are generally reimbursed to employees through payroll. Although there were some expenses reimbursed based on credit card receipts versus detailed receipts the expenses without receipts were less than $330.
11	Request SDDPC to further review its policies regarding memberships and donations to ensure that when using public funds the membership or donation is related to providing IT services. In addition, that membership and donations be itemized and approved in the annual budget.	Implemented. Donations: Budgeted and actual donations were zero in fiscal year 2008. Memberships: Satisfactory. Total membership and dues in fiscal year 2008 were $16,511. In accordance with policies, memberships were approved by the Board and budgeted actual membership costs were reported to the Board quarterly.
12.	Work with SDDPC to sublet the leased property as soon as possible. Due to the increased overhead costs incurred by the City due to this lease, if the property is not sublet within 3 months, consider whether it would be prudent for City staff to utilize the property to offset the overhead costs passed to the City.	Implemented. The lease was terminated approximately January 3, 2005 in exchange for $125,000 paid to the landlord plus sale of existing furniture and fixtures to the future owner, The American Red Cross.

APPENDIX B

EXTRACT FROM SDDPC FY 2008 AND 2009 CHECK REGISTER,[17] PAYMENTS TO ALL VENDORS

Vendor	Note	FY 2008	FY 2009	Grand Total
SAP PUBLIC SERVICES, INC. PHILADELPHIA PA		$5,978,037.86	$10,222,770.38	$16,200,808.24
WAREFORCE CORPORATION LOS ANGELES CA		$7,162,064.88	$820,569.32	$7,982,634.20
AT&T c/o SBC DATACOMM AURORA IL		$3,128,137.57	$3,528,726.48	$6,656,864.05
AXON JERSEY CITY NJ		$2,542,895.60	$3,535,845.85	$6,078,741.45
AT&T BLS	[1]	$3,495,866.13	$2,551,856.62	$6,047,722.75
NEC UNIFIED SOLUTIONS, INC PASADENA CA		$2,184,918.49	$2,049,133.50	$4,234,051.99
SARCOM, INC. LOS ANGELES CA		$0.00	$3,869,523.68	$3,869,523.68
RESTORWARE	[1]	$1,655,110.18	$1,594,615.55	$3,249,725.73
AT & T SACRAMENTO CA		$1,010,657.78	$1,892,670.89	$2,903,328.67
HEALTH NET LOS ANGELES CA		$1,240,954.92	$1,185,555.45	$2,426,510.37
AVANADE INC	[1]	$2,193,909.81	$174,347.04	$2,368,256.85
IBM CORPORATION ATLANTA GA		$1,014,918.03	$1,121,345.55	$2,136,263.58
SOFTCHOICE NEWARK NJ		$884,295.04	$936,285.63	$1,820,580.67
BUSINESS OBJECTS AMERICAS	[1]	$68,533.19	$1,649,219.09	$1,717,752.28
CYBERTECH SYSTEMS & SOFTWARENAPERVILLE IL		$534,734.00	$1,166,412.00	$1,701,146.00
ATT/MCI PASADENA CA		$1,204,530.22	$483,697.43	$1,688,227.65
GE ENERGY SERVICES PASADENA CA		$899,652.50	$716,715.36	$1,616,367.86
NORTHROP GRUMMAN IT	[1]	$406,871.08	$901,573.18	$1,308,444.26
CITY OF INGLEWOOD INGLEWOOD CA		$61,356.04	$1,017,763.86	$1,079,119.90
SIERRA SYSTEMS CONSULTANTS, INSEATTLE WA		$566,494.05	$469,804.49	$1,036,298.54
KAISER PERMANENTE LOS ANGELES CA		$488,625.93	$453,407.49	$942,033.42
GTSI CORP. BALTIMORE MD		$387,079.31	$530,102.73	$917,182.04
ROBERT HALF TECHNOLOGY SAN FRANCISCO CA		$801,423.95	$96,796.76	$898,220.71
ORACLE	[1]	$443,785.85	$432,164.66	$875,950.51
SDGE SANTA ANA CA		$401,970.35	$416,832.98	$818,803.33
MARSH RISK & INSURANCE SVCS LOS ANGELES CA		$438,931.00	$360,533.09	$799,464.09
ZORA ANALYTICS SAN DIEGO CA	[1]	$0.00	$759,335.00	$759,335.00
TEKSYSTEMS ATLANTA GA		$414,857.00	$314,942.69	$729,799.69
INFORMATICA CORPORATION SAN JOSE CA		$476,800.02	$166,069.13	$642,869.15
ENFORCEMENT SUPPORT AGENCY	[1]	$305,300.66	$312,515.25	$617,815.91
CONDUIT NETWORKS TEMECULA CA		$164,458.75	$449,250.98	$613,709.73
STAFFING INNOVATIONS, LLC SAN DIEGO CA		$233,844.49	$361,146.00	$594,990.49
ASPECT SOFTWARE, INC.	[1]	$155,796.69	$382,233.37	$538,030.06
LIBRARY AUTOMATION TECHNOLOGIESOMERDALE		$120,607.71	$393,216.70	$513,824.41

[17] Payments are made to vendors providing services directly to SDDPC, pass-through costs billed to the City and overhead costs such as SDDPC employee benefits, insurance, utilities, etc. This excludes wire transfers.

Vendor	Note	FY 2008	FY 2009	Grand Total
NJ				
ACCUVANT, INC.	[1]	$313,636.97	$172,778.86	$486,415.83
SABER CONSULTING PASADENA CA		$326,840.00	$149,600.00	$476,440.00
3PRO INC.	[1]	$190,060.00	$273,360.00	$463,420.00
ANACOMP LOS ANGELES CA		$261,528.25	$200,686.95	$462,215.20
ESRI LOS ANGELES CA		$173,505.26	$280,737.75	$454,243.01
BENTLEY SYSTEMS, INC	[1]	$167,108.61	$276,621.83	$443,730.44
SIRSIDYNIX CORPORATION CHICAGO IL		$432,375.00	$0.00	$432,375.00
CGLIC-PHOENIX EASC CHICAGO IL		$210,543.20	$216,722.56	$427,265.76
ISLAND STAFFING OCEANSIDE CA		$184,177.78	$223,352.50	$407,530.28
COMPUTER ASSOCIATES INC. ATLANTA GA		$201,304.29	$204,057.64	$405,361.93
COMPUCOM SYSTEMS, INC. CITY OF INDUSTRY CA		$366,822.91	$33,940.00	$400,762.91
AMERICOMP INFOSYSTEMS, INC. MURRIETA CA		$379,579.65	$0.00	$379,579.65
ADVANTICA,INC. PHILADELPHIA PA		$212,237.39	$165,446.73	$377,684.12
WAUSAU	[1]	$298,198.13	$56,281.07	$354,479.20
FUJITSU CONSULTING, INC. ATLANTA GA		$186,406.39	$160,386.74	$346,793.13
TALENT BRIDGE, INC. SANTEE CA		$253,980.51	$89,591.25	$343,571.76
PROFESSIONAL ACCOUNT MANAGEMENMILWAUKEE WI		$313,309.76	$0.00	$313,309.76
HDR ENGINEERING, INC. OMAHA NE		$102,703.49	$183,307.35	$286,010.84
SSI SAN FRANCISCO CA		$117,350.20	$164,135.84	$281,486.04
NORTHROP GRUMMAN PUBLIC SAFETYHOUSTON TX		$257,646.00	$0.00	$257,646.00
COX COMMUNICATIONS PHOENIX AZ		$68,926.00	$187,700.27	$256,626.27
SYSKA HENNESSY GROUP CONSTRUCT LA, CA		$0.00	$249,355.13	$249,355.13
NETWORK APPLIANCE, INC. SAN FRANCISCO CA		$190,550.48	$56,944.50	$247,494.98
SIRE TECHNOLOGIES SALT LAKE CITY UT		$129,745.00	$116,607.00	$246,352.00
FOREST GLEN GROUP CARLSBAD CA		$199,412.50	$45,500.00	$244,912.50
G.L. FOSTER CONSTRUCTION, INC SAN DIEGO CA		$206,987.14	$37,414.72	$244,401.86
BMC SOFTWARE, INC. HOUSTON TX		$62,495.51	$164,000.00	$226,495.51
MIDCOM CORPORATION ANAHEIM CA		$118,947.60	$106,533.00	$225,480.60
ELECTRONIC OUTPUT VISTA CA		$107,472.63	$112,814.33	$220,286.96
EPLUS SYSTEMS, INC HERNDON VA		$106,809.00	$108,880.00	$215,689.00
CISCO IRONPORT, LLC SAN BRUNO CA		$0.00	$213,354.17	$213,354.17
McKOWSKI'S MAINTENANCE SYSTEMSPOWAY CA		$122,986.36	$81,683.64	$204,670.00
TRANSDYN, INC. DALLAS TX		$180,750.00	$22,500.00	$203,250.00
NEXTEL COMMUNICATIONS CAROL STREAM IL		$90,589.07	$110,224.86	$200,813.93
HEWLETT-PACKARD COMPANY SAN FRANCISCO CA		$154,144.55	$43,960.93	$198,105.48
AT&T INTERNET SERVICES	[1]	$130,128.00	$65,064.00	$195,192.00
AT&T LONG DISTANCE	[1]	$102,220.79	$92,167.99	$194,388.78

Vendor	Note	FY 2008	FY 2009	Grand Total
MICROSOFT SERVICES DALLAS TX		$96,560.00	$96,462.00	$193,022.00
VEGA BUSINESS TECHNOLOGIES, LLSAN DIEGO CA		$109,262.40	$81,729.68	$190,992.08
RELIANCE STANDARD LIFE INS. COSEATTLE WA		$124,967.01	$63,495.82	$188,462.83
COMPUCOM	[1]	$167,402.47	$18,031.11	$185,433.58
MAXIMUS	[1]	$102,789.30	$81,687.30	$184,476.60
PORTABLE COMPUTER SYSTEMS DENVER CO		$0.00	$176,072.81	$176,072.81
VALLEY OAK SYSTEMS, INC. SAN RAMON CA		$61,504.62	$113,123.62	$174,628.24
SAS INSTITUTE INC. ATLANTA GA		$82,945.96	$85,596.61	$168,542.57
FILENET CORPORATION LOS ANGELES CA		$162,097.89	$0.00	$162,097.89
MICROSOFT CORPORATION DALLAS TX		$156,609.23	$0.00	$156,609.23
THE STEVE ALEXANDER GROUP LA JOLLA CA		$106,087.50	$45,225.00	$151,312.50
HERSHEY TECHNOLOGIES LA JOLLA CA		$55,145.78	$91,980.90	$147,126.68
MANPOWER TEMP SERVICES LOS ANGELES CA		$129,617.15	$15,400.00	$145,017.15
CITY TREASURER SAN DIEGO CA		$61,087.32	$79,147.53	$140,234.85
SOUTHLAND TECHNOLOGY SAN DIEGO CA		$0.00	$137,170.00	$137,170.00
ORPAK USA (RAPAC INTL) HACKENSACK NJ		$132,164.00	$0.00	$132,164.00
PROQUIRE LLC CHICAGO IL		$123,750.00	$0.00	$123,750.00
ZASIO ENTERPRISES	[1]	$73,368.00	$50,184.72	$123,552.72
EMC CORPORATION CHICAGO IL		$85,373.70	$36,886.50	$122,260.20
NBS GOVERNMENT FINANCE GROUP TEMECULA CA		$64,217.75	$55,020.00	$119,237.75
ZONAR SYSTEMS SEATTLE WA		$102,404.34	$16,792.99	$119,197.33
AT&T (PREVIOUSLY CERFNET) ATLANTA GA		$97,587.07	$18,444.12	$116,031.19
VM WARE, INC PALATINE IL		$0.00	$115,404.97	$115,404.97
ALTIRIS DALLAS TX		$54,081.08	$55,612.22	$109,693.30
FACILITY WIZARD CHICAGO IL		$84,938.46	$22,670.00	$107,608.46
SUNGARD AVAILABILITY SERVICES CHICAGO IL		$47,659.00	$58,970.00	$106,629.00
TAMARA CARRILLO San Diego CA		$69,940.00	$36,660.00	$106,600.00
INCONTROL TECHNOLOGY, INC.	[1]	$38,800.00	$67,630.00	$106,430.00
CSCI, INC.	[1]	$85,549.63	$20,250.22	$105,799.85
CERTIFIED AIR CONDITIONING, INSAN DIEGO CA		$50,678.78	$54,424.76	$105,103.54
SWORD US, INC. NEW YORK NY		$45,115.10	$59,800.04	$104,915.14
ARC ERGONOMICS SAN DIEGO CA		$90,754.98	$11,713.38	$102,468.36
CIVIC CENTER PLAZA	[1]	$51,535.80	$50,660.99	$102,196.79
AXACORE, INC SAN DIEGO CA		$100,476.85	$1,500.00	$101,976.85
Payments to Vendors less than $100,000 each		$4,084,507.77	$3,203,763.89	$7,288,271.66
Grand Total		$54,887,876.44	$55,004,200.97	$109,892,077.41

Note: [1] Vendors with the same name, but different locations have been combined for purposes of this appendix.

SAN DIEGO DPC
SAN DIEGO DATA PROCESSING CORPORATION

DATE: November 5, 2009

TO: Eduardo Luna, City of San Diego, Auditor

FROM: Tom Fleming, President and CEO, San Diego Data Processing Corporation

SUBJECT: Response to Draft Audit Report

I want to thank you for the opportunity to work with you and your staff on the internal audit of our organization. Additionally, I want to express our strong commitment to working with the City on revising the Operating Agreement, By-laws and certain SDDPC policies.

SDDPC is currently working with the City on revising the Operating Agreement, SDDPC Bylaws and certain related SDDPC Policies. The revised Operating Agreement will be referred to by its new title the "Master Service Agreement" (or "MSA"). There is currently a team in place assigned with this task which is comprised of senior staff at SDDPC and the City's Director of IT, City's IT Operations & Technology Manager, Director of Financial Management and a Deputy City Attorney (the "MSA Team"). The MSA team has also been assigned with the responsibility of reviewing the outcome of this performance audit in detail to ensure the recommendations are considered as part of the revisions to the MSA and related documents. As noted below, many of the recommendations are being addressed as part of this effort. The recommendations and results from the MSA Team will be vetted and brought to the City Council for approval.

Regarding the specific recommendations and our responses, please see the following:

1. **Recommendation**: SDDPC's Board should require SDDPC to have written policies related to reimbursements to vendors and the retention of bid documents.

   Response: A policy to formalize today's current practices will be developed and submitted to the SDDPC Board of Directors for its review and approval.

2. **Recommendation**: Design controls to ensure a review of compliance with the Operating Agreement terms is performed annually. Consider requiring SDDPC to self-assess their compliance with the agreement terms and submit the assessment to the Mayor, or designee, for their review prior to executing the annual Service Level Agreement.

   Response: This recommendation is being referred to the MSA team as noted above.

3. **Recommendation**: Modify the Operating Agreement to establish a process by which payments by the City that exceed costs for services are refunded by SDDPC.

   Response: This recommendation is being referred to the MSA team as noted above.

4. **Recommendation**: Modify the Operating Agreement to define costs which are unallowable without a justification of benefit to and approval by the City, including the procurement of capital assets.

   Response: This recommendation is being referred to the MSA team as noted above.

5. **Recommendation**: Consult with the City Attorney to ensure pass-through purchases are properly and clearly authorized by Council as required by the Municipal Code and Charter.

   Response: SDDPC will consult with the City Attorney on this recommendation.

6. **Recommendation**: The City should ensure the appropriation ordinance language clearly authorizes payments to SDDPC for pass-through expenses.

   Response: The City will respond to this item.

7. **Recommendation**: Amend the Operating Agreement with SDDPC to improve best practices by requiring:

   a. A dedicated public vendor webpage for posting:
      - Requests for quotes or proposals;
      - Results of requests for quotes or proposals; and
      - Justifications for sole source / sole responder vendor contracts;
   b. Standard minimum response times to requests for quotes or proposals;
   c. Re-advertising for requests for quotes or proposals if an insufficient number of responses are received from vendors for contracts exceeding a specific value, such as $250,000 unless sufficient justification is documented, presented to the Board and the justification is posted to the website;
   d. Fixed terms for contracts; and
   e. Annual report to the City summarizing competitive practices.

   Response: This recommendation is being referred to the MSA team as noted above.

8. **Recommendation**: City management should consider establishing policies and regulations specific to procurement of long term system maintenance contracts.

Response: The City will respond to this item.

9. **Recommendation**: The City and SDDPC should develop policies and procedures to ensure compliance with competitive standards applicable to federally funded technology projects.

   Response: The City will respond to this item.

10. **Recommendation**: Add language to the City's Purchasing and Contracting Department website directing vendors to SDDPC web site for technology procurement opportunities.

    Response: The City will respond to this item.

11. **Recommendation**: Either SDDPC should permit view access by City employees to their contract, invoice, and vendor payment history for procured goods and services in order to verify the accuracy of SDDDPC billings, or the procurement of these goods and services should be made directly through the City's procurement process in consultation with SDDPC staff. The selected process should ensure the best operational efficiencies for the City that incorporates strong internal controls.

    Response: As currently done today, SDDPC will make invoices available to City employees on an as-needed basis.

12. **Recommendation**: The City should establish encumbrances for ITBLG approved new project costs procured through SDDPC to ensure actual costs do not exceed approved budgeted costs.

    Response: The City will respond to this item.

13. **Recommendation**: Consult with City Attorney and amend the Operating Agreement to a more traditional professional services contract to provide the City with specific IT services and as-needed services. The agreement should have a fixed term and incorporate appropriate levels of approval at the City prior to SDDPC processing a request for services.

    Response: This recommendation is being referred to the MSA team as noted above.

14. **Recommendation**: Amend the Operating Agreement to establish a timeline for execution of the annual SLA and to establish the level of City approval required prior to making payments if an SLA is not executed within the timeframe.

    Response: This recommendation is being referred to the MSA team as noted above.

15. **Recommendation**: City management, in consultation with the City Attorney, should advise the City Council to consider amending SDDPC's Bylaws to include the following:

    a. The Mayor and City Council shall approve the hiring of the CEO and the CEO's contract terms;
    b. The Board shall approve the compensation of the CFO unless increases in compensation are applicable to all employees;
    c. The CEO shall provide an annual report to the Mayor and City Council on SDDPC's compliance with its By-law requirements;
    d. SDDPC shall provide to the Mayor and City Council and annual report on its performance; including its strategy, current year's goals, status of major projects, and comparison of prior year's goals to performance; and
    e. SDDPC's CEO and CFO shall certify to the City that SDDPC management assumes full responsibility for the completeness and reliability of the information contained in the report.

    Response: This recommendation is being referred to the MSA team as noted above.

16. **Recommendation**: City management, in consultation with City Attorney, should advise the City Council on appropriate action to be taken regarding delegation of member rights.

    Response: SDDPC will consult with the City Attorney on this item.

In closing, I want to reiterate our strong commitment to working with the City to update our Operating Agreement, By-Laws and Policies. Thank you again for your advice and recommendations.

THE CITY OF SAN DIEGO

MEMORANDUM

DATE: November 30, 2009

TO: Eduardo Luna, City Auditor

FROM: Nader Tirandazi, Financial Management Director

SUBJECT: City Management Response to Draft Performance Audit of SDDPC – November 2009

I acknowledge the efforts your office made in the preparation of the draft Performance Audit of San Diego Data Processing Corporation (SDDPC), in your meeting with both SDDPC staff and City staff, and our ability to provide input into your report. In response to your draft report, provided to us on October 23, 2009, City management has the following comments.

As we have discussed with you and brought in front of the City Council Rules Committee on September 2, 2009, the City is in the process of making significant changes to several documents that define the relationship, policies, and procedures between the City and SDDPC. Your findings and recommendations were provided to the joint City/SDDPC team working on the new Master Services Agreement (MSA), so that the issues you and other stakeholders have raised are appropriately addressed. The MSA Team will be presenting its initial set of revised documents to the Rules Committee within the next few months.

The following statement is specific to your observations on Budget Approval and SDDPC Pass-Through Expense, and Recommendations 5 and 6 as listed below:

- Recommendation 5: "Consult with the City Attorney to ensure pass-through purchases are properly and clearly authorized by Council as required by the Municipal Code and Charter."
- Recommendation 6: "The City should ensure the appropriation ordinance language clearly authorizes payments to SDDPC for pass-through expenses."

The IT Budget and Procurement processes are being reviewed and will be documented in the upcoming MSA; however, we strongly believe the current practices are following legal requirements. This position is supported by the following:

- Explicit to the creation of SDDPC was the need to provide and acquire/procure IT services for City departments. Under the terms of the current Operating Agreement, this is a non-exclusive agreement; however, the majority of departmental IT procurement is done through SDDPC.
- SDDPC provides specialty services in IT procurement that has not generally been available within the City, and the need for these services is expected to continue for the near-term.
- The City's annual IT budget, of which a portion is allotted to SDDPC, is reviewed through Financial Management's budget process and approved by the City Council.
- The budgeted funds are legally appropriated for IT expenditures from department budgets, including "pass-through" costs for IT goods or services obtained by/through SDDPC from outside vendors on behalf of City departments.
- The City has procurement processes in place for departments to submit IT purchase requests that must be approved by the Originating Department Director, Department of Information Technology, Financial Management, and City Comptroller.
- The SDDPC Board of Directors is required to approve any expenditure in excess of $100,000.

The City/SDDPC MSA Team is drafting a new Master Services Agreement, along with revising the SDDPC Bylaws and recommending several City and SDDPC policies that will provide clear direction and transparency in the relationship and operations between the City and SDDPC. These documents will also clarify and protect the non-profit status of SDDPC as an independent agency, while providing the City with its intended benefits in the procurement of IT goods and services through SDDPC or other sources. These issues will be discussed in an open forum at the City Council Rules Committee, and final documents will be approved by the full City Council.

Should you have any questions or concerns, please let me know.

cc: Jay M. Goldstone, Chief Operating Officer
Mary Lewis, Chief Financial Officer
Naresh Lachmandas, Director of Information Technology
Ken Whitfield, City Comptroller