



THE CITY OF SAN DIEGO

DATE: January 16, 2015

TO: Dennis Gakunga, Director, Purchasing & Contracting Department

FROM: Eduardo Luna, City Auditor

SUBJECT: The City Needs to Address the Lack of Contract Administration and Monitoring on Citywide Goods and Services Contracts

During our audit of Citywide Contract Oversight, we found significant deficiencies in the manner in which the City oversees and monitors Citywide goods and services contracts. Specifically, we found that contract administrators have not been assigned to monitor all Citywide goods and services contracts and an ineffective critical control designed to prevent City staff from exceeding contract thresholds. Contract administrators have not been assigned to monitor contractor performance for approximately 97 Citywide goods and services contracts. Purchasing & Contracting Department provided data showing purchase orders exceeding \$123 million related to those contracts. However, this does not capture the total multi-year award amount of the 97 contracts. In compliance with Government Auditing Standards Section 6.78, Early Communication of Deficiencies, we are issuing this memorandum prior to completing our performance audit due to the significant inherent risks these conditions pose to the City.

Although the Municipal Code¹ assigns responsibility for goods and services purchases to the Director of Purchasing & Contracting, we were unable to identify any written Citywide policies, procedures, or administrative regulations that deal with assigning contract administration and monitoring responsibilities regarding Citywide goods and services contracts. The Purchasing & Contracting Department defines a Citywide contract as a contract used by two or more City departments. According to the Director of Purchasing & Contracting, the department assists in the processing of Citywide contracts requested by other departments. Additionally, Purchasing & Contracting will lead and enter into cooperative agreements on behalf of the City to maximize best pricing. After the contract is executed, administration and monitoring responsibility has been decentralized to the department that requests and initiated the contract. Purchasing & Contracting has also stated that administration and monitoring for Citywide contracts is the responsibility of the department that is specified and authorized in the City Council resolution for contracts approved by City Council. Those departments are considered the lead department and typically expend the majority of the contract. However, in most cases we found that many departments we spoke with were unaware that they were responsible for monitoring the entire Citywide contract.

The City is exposed to operational and financial risks when preventative controls such as contract administrators and automated limitations do not exist or operate effectively. Preventative controls mitigate risks such as:

¹ San Diego Municipal Code, Chapter 2, Article 2, Division 32.



- Overpayments;
- Not receiving required good or services;
- Receiving substandard good or services; and
- Not obtaining required authorization from City Council.

During our review, we identified the following Citywide contract issue related to the lack of monitoring services and invoices for compliance with contract terms and expenditures not-to-exceed spending thresholds:

The Citywide contract with MEK Enterprises (formerly known as Complete Relocation Services) was initially established in January 2011 to move or relocate City staff on an as-needed basis. During September 2013 City payments reached the \$1 million contract threshold allowed without City Council approval, and as of December 2014 the City has paid over \$1.335 million without obtaining City Council approval. Of the \$1.335 million paid to MEK, invoices totaling at least \$632,000 were approved for payment by departments to move 450 personnel without sufficient supporting documentation to approve the invoice payments. The project manager informed us that the contractor had provided listings of employees and hours worked that were not verified, validated, or retained by the City employees. The charges were based upon the contractor providing trucks, drivers, supervisors, movers and installers at specific rates to accomplish the City's office move from 600 B Street to 525 B Street in August and September 2013.

Factors Contributing to Control Deficiencies

We identified two primary factors that have contributed to the control deficiencies. First, after Purchasing & Contracting has assisted a department with processing their Citywide contracts, contracts have been issued without clearly defining responsibility for contract administration and monitoring. Purchasing & Contracting personnel assumed that the Department requesting assistance with processing their contract, as well as the department specified in the City Council resolution, would be responsible for contract administration and monitoring. However, this expectation was not clearly provided to the applicable Department Directors or Deputy Directors. Conversely, the department personnel assumed that someone in Purchasing & Contracting was responsible for the overall contract administration/monitoring because they were Citywide contracts; and therefore, division personnel only monitored contractor performance for their orders.

Second, a significant control designed to prevent departments exceeding contract thresholds and contract award amounts can be easily bypassed. Contracts in the City's Financial System (SAP) have a programmed target value that defines the dollar value limit of purchases made against the contract. This target value should be created based on the terms and limits defined in the contract. When the purchases against the contract have reached this target value, SAP prevents any additional purchases against the contract to process until the target value limit is increased by Purchasing & Contracting staff in accordance with their internal processes and controls. However, any requisitioning department can intentionally or unintentionally get around this control by omitting the contract reference (agreement number) when they create the purchase requisition. The avoidance of the contract award controls can result in exceeding contract limits without detection, including those approved by the City Council.

Purchasing & Contracting staff are aware of this control weakness and they advised that they are working on reports to detect this activity. SAP has the capability (once configured) to reduce the bypassing of this control for purchase requisitions prior to the approval by requiring information that is not currently required.

Recommendation 1:

The Purchasing & Contracting Director should take immediate action to ensure contract administration responsibilities are assigned to appropriate personnel for all Citywide contracts and provide those individuals with the tools to properly monitor each contract. This should include but is not limited to providing a copy of contract with all terms and conditions listed, pricing agreements, and the responsibilities involved with contract administration. (Priority 2)

Recommendation 2:

The Purchasing & Contracting Director should take immediate action to ensure the Target Value control is enforced on contractual purchases. Specifically, the Director should implement the following detective controls:

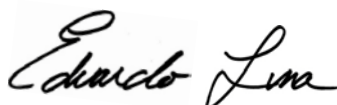
- Ensure that the report in development will clearly identify orders made without references to the appropriate contract and his staff is trained to utilize the report.
- Create a policy defining the intervals of review and actions taken to correct the control weakness.

Additionally, the Director should review the potential for preventative controls to minimize the circumvention of the Target Value control. (Priority 2)

Attached you will find Appendix A: Audit Objective, Scope and Methodology and Appendix B: Definition of Audit Recommendation Priorities. The Administration's response to our audit recommendation can be found after page 5.

We appreciate the assistance provided by Purchasing & Contracting staff during this review.

Respectfully submitted,



Eduardo Luna
City Auditor

cc: Honorable Mayor Kevin Faulconer
Honorable Members of the City Council
Honorable Members of the Audit Committee
Scott Chadwick, Chief Operating Officer
Stacey LoMedico, Assistant Chief Operating Officer
Brian Pepin, Director of Council Affairs
Jan Goldsmith, City Attorney
Andrea Tevlin, Independent Budget Analyst

Appendix A: Audit Objective, Scope, and Methodology

In accordance with the City Auditor's Fiscal Year 2015 Audit Work Plan, we are currently conducting a performance audit of Citywide Contract Oversight. The objective of this audit is to determine whether the city adequately conducts contract oversight. This memorandum reports on key risks associated with the contract administration process for Citywide contracts. The remainder of the audit is currently ongoing and an additional report will be issued at a later date.

Our scope for this audit was on all Citywide contracts active during fiscal year 2014. To determine whether City established controls adequately address key risks in the contract administration process we developed and issued an audit survey to City employees tasked with contract monitoring/administration and/or payment approving responsibilities. The 658 surveyed employees were identified and provided by Department Directors within the various City departments. To validate the information we received through the survey and perform our testing, we conducted interviews with Purchasing & Contracting staff to determine current contract oversight responsibility and processes. We interviewed some of the department contacts to identify their oversight practices and confirm their understanding of monitoring responsibility for the Citywide contracts. We analyzed Citywide contracts to determine who should be responsible and to determine appropriate pricing for the Citywide contracts. We also analyzed SAP contracting data and system documentation to determine whether the information available in the system for Citywide staff with appropriate access was sufficient to manage contracts. We were unable to locate documentation to support invoices for the MEK contract move. Additionally, we analyzed system and vendor documentation to identify additional SAP functionality to improve controls over the contracting process.

We conducted this portion of the 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.

Appendix B: Definition of Audit Recommendation Priorities

DEFINITIONS OF PRIORITY 1, 2, AND 3 AUDIT RECOMMENDATIONS

The Office of the City Auditor maintains a priority classification scheme for audit recommendations based on the importance of each recommendation to the City, as described in the table below. While the City Auditor is responsible for providing a priority classification for recommendations, it is the City Administration's responsibility to establish a target date to implement each recommendation taking into considerations its priority. The City Auditor requests that target dates be included in the Administration's official response to the audit findings and recommendations.

Priority Class ²	Description
1	Fraud or serious violations are being committed. Significant fiscal and/or equivalent non-fiscal losses are occurring. Costly and/or detrimental operational inefficiencies are taking place.
2	The potential for incurring significant fiscal and/or equivalent non-fiscal losses exists. The potential for costly and/or detrimental operational inefficiencies exists.
3	Operation or administrative process will be improved.

²The 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.



THE CITY OF SAN DIEGO

MEMORANDUM

DATE: January 15, 2015

TO: Eduardo Luna, City Auditor

FROM: Dennis Gakunga, Director, Purchasing and Contracting Department

SUBJECT: Preliminary Departmental Response to the Contract Administration and Monitoring on Citywide Goods and Services Contracts Audit Report

This memorandum provides Management's response to the City Auditor's memorandum dated on December 18, 2014 on the City's Contract Administration and Monitoring of Citywide Goods and Service Contracts. Management understands that the audit on Contract Administration and Monitoring on Citywide Goods and Services Contracts is still in progress and a full report will be issued later this calendar year. Management appreciates the City Auditor bringing these concerns forward in a timely manner and would like to highlight the many improvements that have been concurrently initiated during this audit period.

Over the last 18 months, new leadership in the Purchasing and Contracting (P&C) department has taken a holistic review of citywide requirements and embarked on an overhaul of the department operations and procurement practices within the City. This has resulted in implementation of new streamline measures, a citywide e-procurement system and other Information Technology (IT) tools. The e-procurement and new IT tools are critical to improving department operations, contract management, oversight and compliance.

The following are key improvements completed during this timeframe:

- The implementation of an electronic vendor registration system. To date over 4,700 new vendors have been registered
- City Council approval of an e-procurement system and a new contract management module to improve contract management and administration capabilities
- The implementation of a City-wide procurement forecasting process, to facilitate increased dialogue between City departments and City Council with a new City Council contract pre-approval process

- Launched an extensive ‘procurement-through-payment’ comprehensive review of the City’s SAP system with the Office of the City Comptroller and the Department of IT. (Review is on-going)
- Established regional partnerships and collaborative efforts with peer agencies, including the County of San Diego to strengthen the City’s procurement processes and leverage best practices
- Implemented posting of awarded City contracts on the City’s website: <http://www.sandiego.gov/purchasing/bids-contracts/index.shtml>
- Implemented 34 new P&C templates and department procedures working with the Office of the City Attorney to simplify review timelines
- Implemented fourteen P&C Process Narratives. In addition, a new P&C Contract Administration Process Narrative to increase internal controls over contract administration was developed and submitted to the Office of the City Comptroller.

Although there have been significant improvements to the purchasing and contracting procedures and processes, as the City Auditor’s memorandum points out there is more work needed to improve the effectiveness of citywide contract oversight. Management is committed to making further improvements and to ensure this object is met.

Recommendation 1

The Purchasing & Contracting Director should take immediate action to ensure contract administration responsibilities are assigned to appropriate personnel for all citywide contracts and provide those individuals with the tools to properly monitor each contract. This should include but is not limited to providing a copy of contract with all terms and conditions listed, pricing agreements, and the responsibilities involved with contract administration. (Priority 2)

Management Response: Agrees with the recommendation.

The P&C department has been working on the immediate steps necessary to complete this recommendation and anticipates it will be completed by the end of April 2015.

- Staff is identifying contract administrators listed in the contract file for each of the citywide contracts identified in the audit report so that a memorandum can be issued to memorialize the assignment of contract administrators listed in the contract file. A copy of the contract with all terms & conditions and pricing information will also be provided to each assigned contract administrator and a meeting will be held to ensure there is a clear understanding of the roles and responsibilities of the contract administrator.
- The P&C department is developing a Contract Administration Handbook (CA handbook) that will provide guidelines and serve as a quick reference to all citywide contract administrators. The CA handbook will provide clear roles and responsibilities of contract administrators for citywide contracts. The CA handbook is currently being drafted and is anticipated to be released by the end of the fiscal year.

Recommendation 2

The Purchasing & Contracting Director should take immediate action to ensure the Target Value control is enforced on contractual purchases. Specifically, the Director should implement the following detective controls:

- *Ensure that the report in development will clearly identify orders made without references to the appropriate contract and his staff is trained to utilize the report.*
- *Create a policy defining the intervals of review and actions taken to correct the control weakness.*

Additionally, the Director should review the potential for preventative controls to minimize the circumvention of the Target Value control. (Priority 2)

Management Response: Agrees with the recommendation.

P&C department staff has been working on this as part of the streamlining efforts approved by City Council last summer. This has included working with the Office of the City Comptroller's and the Department of Information Technology staff on various efforts that address this recommendation. These include the following:

- The P&C department has partnered with the Dept of IT and Internal Controls to make systematic improvements to SAP for improved monitoring, contract compliance and oversight of citywide contracts. This includes developing a system enhancement in SAP that will link contracts to requisitions (when applicable) as a system check.
- The P&C department has successfully updated all fourteen P&C department Process Narratives. This includes development of a new Contract Administration Process Narrative that has been submitted to Internal Controls for review.
- The identified "target value" in the SAP system is non-binding to the City and only serves as a P&C department internal control value. The P&C department is working with the Dept of IT to implement appropriate fields in the SAP system that will be used for effective monitoring and tracking of authorized contract values.
- The P&C department continues to work on a joint effort with the Office of the City Comptroller to develop robust reporting for improved monitoring, compliance and contract surveillance of citywide contracts. This includes the following specific report initiatives:
 1. A report to ensure threshold limits are not bypassed by the splitting of purchase orders (*purchases splitting report*);
 2. A report that checks for expired insurance policies linked to current vendors (*expired insurance report*);
 3. A report to detect where purchases have been made without utilization of existing contracts or agreements (*existing contracts purchases report*);

4. A report to ensure that engaged vendors are licensed to perform business within the City (*vendor license report*);
5. A report that checks that purchases are not being linked to expired contracts (*expired contracts report*);
6. A report to detect shell purchase orders for budget control purposes (*PO/budget control report*).

Management appreciates the Office of the City Auditor's efforts in conducting this audit and looks forward to reporting on successful improvements to the citywide contract administration processes.



Dennis Gakunga
Director, Purchasing & Contracting

cc: Scott Chadwick, Chief Operating Officer
Stacey LoMedico, Assistant Chief Operating Officer
Ronald H. Villa, Deputy Chief Operating Officer, Internal Operations
David Graham, Deputy Chief Operating Officer, Neighborhood Services
Tony Heinrichs, Deputy Chief Operating Officer, Infrastructure/Public Works
Mary Lewis, Chief Financial Officer
Rolando Charvel, City Comptroller
Jonathan Behnke, Interim Director, Department of Information Technology
Brian Pepin, Director of Council Affairs