



THE CITY OF SAN DIEGO

DATE: September 11, 2019

TO: Honorable Audit Committee Members
Honorable City Councilmembers
Kris Michell, Chief Operating Officer

FROM: Kyle Elser, Interim City Auditor
Office of the City Auditor

SUBJECT: Hotline Report of Abuse Related to the Unfair Award of a
Multi-Million-Dollar Contract

Summary of Investigative Results

The Office of the City Auditor investigated a Fraud Hotline report that the City unfairly awarded a multi-million-dollar contract to a vendor using a cooperative procurement process. During the course of our investigation, we conveyed our preliminary investigation results to City management and the contract with the vendor was not renewed.

Our investigation found sufficient and appropriate evidence to form the following opinions:

- **City Staff Did Not Perform Adequate Due Diligence in Advance of the Contract Award:** Best practices and some of the City's policies were not followed in part because City staff were under pressure to get a contract in place quickly. We found that only one vendor was included in the due diligence research process, which we determined is not adequate for a multi-million-dollar contract. This may have been a violation of the San Diego City Charter Section 100, which is titled, "No Favoritism in Public Contracts," and begins with the phrase, "No officer or employee of the City shall favor one bidder over another, by giving or withholding information ..."

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- **Department of Information Technology (DoIT) Staff Reviewed the Vendor's Services but No Other Vendors:** In a series of meetings, DoIT staff was asked to evaluate whether City forces could write software equivalent to the vendor's, but they were not asked to evaluate other vendors. DoIT staff determined that the vendor's services were more cost effective than utilizing City staff because the vendor relied on lower cost outsourced workers.
- **Some Contracting Process Steps and Best Practices Were Not Followed:** City policy states that a cooperative procurement contract "allows other agencies to use the terms, conditions, and pricing of the original contract for goods or contract for services." We determined that the City modified some of the terms, conditions, and pricing from the original contract with the source organization. City staff also incorrectly certified that the vendor's services were "unique" because other vendors could have performed the services. We also found that the contract may not have been to the City's economic advantage because the source organization is much smaller than the City, which eliminates any potential benefit from an economy of scale.
- **City Staff Mischaracterized the Nature of the Vendor's Services to Obtain Approval from the Human Resources (HR) Department:** Contract terms are required to be reviewed and approved by HR to ensure that City forces will not be displaced without first following procedures involving recognized employee organizations. A key City staff person highly involved with the formation of the contract mischaracterized the fact that City staff were currently providing some of the services outlined in the contract. Instead, the information provided to HR stated that the contract involved services that City staff cannot perform. If the HR Department had known this was not true, HR staff stated that this information would have changed their decision to allow the contract to move forward without further discussions with recognized employee organizations.
- **City Staff Made Significant Changes to the Source Contract's Terms, Conditions, and Pricing:** San Diego Municipal Code "allows other agencies to use the terms, conditions, and pricing of the original contract for goods or contract for services." However, significant changes to the source contract could violate the cooperative procurement procedures. The City's contract

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terms were changed from a fixed price to prorated variable service terms, and there were changes to the frequency of payments. These changes may be considered significant changes to the contract terms, which may not have been permitted.

- **Using the Source Organization’s Consultant Contract May Have Required City Council Approval:** The Municipal Code requires most consultant contracts over \$250,000 to be approved by the City Council, and this contract was not sent to Council for approval because it was considered a “service contract.” However, the source organization’s contract referred to the vendor as a “consultant,” and the same scope of work was used in the City’s contract. It appears that consultant contracts may not be eligible be awarded using a cooperative procurement contracting process, but further legal analysis on this issue is necessary.
- **The Vendor Appears to Have Defined the Scope of Work for the Contract They Were Awarded:** The City’s Procurement Manual generally prohibits a vendor from acting as a consultant to define the scope of work for a contract and then being awarded the resulting contract. We determined that the vendor received exclusive access to City management, was highly involved in the planning process, and was influential in the decisions that City management made. Our investigation found 10 different examples of the vendor’s involvement in actions that appear to have defined the scope of work for the contract awarded.
- **Potential City Charter Violations Related to Sections 94, 97, 100, and 101:** Based on our investigation, we found there were potential violations of the City Charter sections. The Audit Committee and City Council, in consultation with the City Attorney’s Office, should evaluate whether City Charter violations occurred and take appropriate action, as indicated in our confidential report.

When asked about the deviations from City policy and best practices, City staff stated that the vendor was “at the right place at the right time and they provided advice to [City staff].” City staff was also under pressure to establish a contract quickly. Apparently, since the vendor was the first company to contact the City and

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guide City staff regarding the implementation of the services, City staff used a cooperative procurement, or “piggyback” contract, to award the vendor the contract that the vendor helped to develop.

We found that the Administrative Regulation (AR) and Municipal Code that outlines the process to be followed for a cooperative contract does not specifically state that City staff must consider and evaluate other vendors when establishing a cooperative agreement, although it could be inferred from these directives. City staff responsible for obtaining the contract believed that it was acceptable to only look at one vendor in this case because they were relying on the competitive process used by the source organization to obtain the cooperative contract. In addition to other recommendations, we recommend the AR be updated to make it clear that no employee of the City shall favor one bidder over another when securing a contract, per the City Charter.

During the course of our investigation, we conveyed our preliminary investigation results to City management and the contract with the vendor was not renewed.

We made nine recommendations and management agreed to implement all of the recommendations directed to them. Implementation of these recommendations and any corrective actions resulting from them, or any actions taken independent of our recommendations, are subject to existing procedural and due process rights afforded to City employees and other parties under relevant law and policy. As such, the independent Office of the City Auditor will review the actions taken in satisfaction of the recommendations, but will not be involved in the substantive implementation process with respect to the agreed-upon recommendations.

The City Awarded a Multi-Million-Dollar Contract Using a Cooperative Procurement Process

As detailed in a separate, confidential version of this report, the City entered into a cooperative procurement contract with the vendor. Under the contract, the vendor was to provide the City with certain services. Since the cooperative procurement process was used, no other vendor was invited to participate in a competitive bidding process with the City. Rather, the City used a cooperative or “piggyback” contracting process that relied on the competitive bidding process and procedures of another organization.

Cooperative procurement contracts are allowed under the San Diego Municipal Code (SDMC). Specifically, SDMC § 22.3208(c), states that a cooperative procurement contract may be awarded if the City’s Purchasing Agent certifies in advance that the cooperative procurement contract:

- (1) Is in the best interests of the City; and
- (2) Is to the City’s economic advantage; and
- (3) Was competitively awarded using a process that complies with the policies, rules, and regulations developed and implemented by the City Manager.

In this case, the competitive process that the City relied on took place in a much smaller organization. The Request for Proposal (RFP) process the source organization used was deemed sufficient to meet the standards of the SDMC, according to a Cooperative Procurement Certification (Certification) memorandum. The Certification was signed by the City’s Purchasing Agent, not the person submitting the form. As such, there was no declaration by the submitter that the facts in the Certification were true and correct.

Arguably, the City’s contract with the vendor may provide the best value to the City, as required by SDMC § 22.3206(a). Moreover, the services that the vendor provides may be better than every other firm that offers similar services. However, those factors, if true, would not compensate for the deviations from the City’s contracting process and procedures that we identified during our investigation.

City Staff Did Not Perform Adequate Due Diligence in Advance of the Contract Award

A City staff person involved with the formation of the contract stated that they did not perform any independent business case analysis to determine what services were needed, but instead relied exclusively on the information provided by the vendor. Nor did they personally research the services that other vendors provided. In fact, they did not return calls or emails from other vendors who contacted them before the contract with the vendor was signed. The staff person believed that contacting other vendors would have been inappropriate because “we had already been in the process of researching whether we were going to do the cooperative agreement.” They added that the plan was always to use the vendor who was awarded the contract. This plan was apparently formed months before the contract was executed. Our investigation determined that the vendor had been in contact with the City for over two years before the contract was signed.

Several City staff involved with the process noted that the contracting process was rushed. One person noted that they were on a “tight timeline” and did not have the time to complete a normal competitive Request for Proposal (RFP) process, which could take “a year or two” to complete.

Rather than conducting a thorough review of the costs and benefits of using any of the other potential vendors for the cooperative contract, a City staff person who was highly involved with the contract formation relied on reference checks for the vendor alone. According to the City staff person, the references that the vendor provided were all positive. However, we determined that relying on references provided by a selected vendor alone, without contacting any other vendor to research their services, is not adequate due diligence and is unfair to other vendors who were not given the opportunity to compete for the City’s contract.

Information Technology Department (DoIT) Staff Reviewed the Vendor’s Services, Not Other Vendors

We interviewed a DoIT staff person who was brought in for a series of two-hour daily meetings. The meetings included around a dozen City staff from various City departments. The DoIT role was to determine if software that the vendor used could

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be developed internally. They estimated that it would cost roughly \$500,000 for the City to write software that could do what the vendor's software appeared to do.

When asked if other vendors were discussed as an alternative to using the vendor, the staff person recalled hearing someone at the meeting mention other vendors. However, DoIT was not asked to evaluate any other vendor. The DoIT staff person determined that the other vendors would not be suitable since they apparently provided services, but this vendor would be providing software.

Although DoIT assumed that the City would be purchasing software from the vendor, we determined that the City had actually purchased what would likely be considered consulting services.

The DoIT staff person had a series of meetings with the vendor to discuss "what they do and how (they do it)." The staff person was surprised to learn that a lot of what was described "sounded a lot more manual than automated." Specifically, the DoIT staff person found that the vendor's method involves an outsourced pool of people who work on piecemeal projects online. The DoIT staff person concluded that City staff could manually do the same work, but "not as cost effectively." The staff person's opinion was that the vendor's costs were "very reasonable" when compared to the cost of developing the software in-house and having City forces perform the analysis.

Some Contracting Process Steps and Best Practices Were Not Followed

The process steps and tasks required to form the cooperative procurement contract with the vendor appear to have been generally followed, based exclusively on a review of the documentation. For instance, the required forms and checklist items were completed and approved before the contract was executed. However, our detailed analysis revealed that there were deficiencies with how the process was handled.

The general process steps for cooperative procurement contracts are defined in SDMC § 22.3208(c). In addition, AR 35.11 provides some specific guidance, including a detailed checklist and a template version of the Certification memorandum. We obtained additional best practice information from national purchasing organizations.

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A cooperative procurement contract, more precisely referred to as a “piggyback” contract in this case, “allows other agencies to use the **terms, conditions, and pricing of the original contract** for goods or contract for services,” according to SDMC § 22.3003 (emphasis added). This definition indicates that the intent of the cooperative procurement contract process is to use the same terms, conditions, and pricing as the original contract that was issued after a fair competitive process without modification. Additional terms to meet City-specific legal requirements, such as the City’s general contract terms and provisions applicable to goods, services, and consultant contracts, were necessary and are consistent with best practices, but do not impact the important terms of the contract (such as the frequency of payments, payment terms, and scope of services included).

Our detailed analysis, further discussed below, determined that the City modified the terms, conditions, and pricing from the original contract. Specifically, the City agreed to make more-frequent quarterly advance payments for piecemeal, prorated services, whereas the source organization contract required semi-annual advance payments for all the identified services. Also, the City’s contract pricing is variable after the first year, but the source organization contract price is fixed.

Best practices from the National Institute of Governmental Purchasing (NIGP) state that cooperative contracts should be considered “on a case-by-case basis, and only after proper due diligence has been performed.” According to the NIGP guidance, due diligence should include: reviewing available cooperative contracts, researching the market, analyzing all costs, and determining whether such an agreement is appropriate under the circumstances. There is no current City policy specifically requiring documented due diligence for cooperative procurements, but the City’s Charter section 100 begins, “No officer or employee of the City shall favor one bidder over another...”

Our investigation determined that key City staff only reviewed the vendor’s cooperative contracts and did not conduct adequate market research. In addition, the agreement was likely not appropriate under the circumstances since consulting contracts at that dollar value may not be eligible to be awarded without City Council approval, and it is not clear if a cooperative contract can be used to obtain consulting services. Further legal analysis on this issue is required.

In general, SDMC § 22.3208(c) requires a Certification regarding the three elements of a cooperative procurement contract. Those elements are: (1) the contract is in the

best interests of the City; (2) the contract is to the City's economic advantage; and (3) the process the source organization followed complied with the City's policies, rules, and regulations. We determined that the Certification was not accurate because the vendor's services are not "unique," as claimed, and the contract pricing may not have been to the City's economic advantage because only one vendor was considered.

Recommendation 1

We recommend that the Chief Operating Officer ensure that Administrative Regulation 35.11 regarding the Citywide Department Use of Cooperative Procurement Contracts be revised to require documentation of a business case analysis listing other vendors that provide the goods or services, an analysis of the costs and benefits of a competitive procurement process, an evaluation of other cooperative procurement contracts available from other vendors, a certification that the City's process was fair to other vendors, and a signature by the City employee submitting the Certification declaring that the facts and information presented are true and correct.

The Vendor's Services Are Not Unique

The Certification's two-sentence explanation for the contract being in the best interest of the City stated that the vendor's services are "unique" and are "necessary" to perform the proposed work. If the characterization of the vendor's services is interpreted as "unique" under the common definition of "the only one of its kind," the statement in the Certification is false. We were able to identify at least four other firms that offer the same service to government agencies. So, although the process step of asserting that the contract is in the best interests of the City was completed, the description of the services as "unique" was not accurate.

We asked the City staff person who wrote that section of the Certification, what they meant by the vendor's services being "unique," given that there were four other companies that offer the same type of service. The staff person replied that they were not aware of the other vendors in the marketplace. Although they relied on the source organization's competitive bidding process that was based on more than one vendor, the staff person stated that they did not review the other vendors' bids.

The staff person later added, “I would not have been able to come up with a good reason to sole source [the contract with the vendor] because there are other companies who do [the same thing].”

We concluded that since the vendor’s services were not unique, and no other cooperative contracts were considered, this contract may not have been in the best interests of the City.

Contract May Not Have Been to the City’s Economic Advantage

The Certification described the services to be offered by the vendor, but did not explain the economic advantages of the contract. There was no reference to an analysis of the cost structure underlying the source contract. Similarly, there was no mention of a comparison of the costs associated with pursuing a competitive procurement process to the terms of the subject cooperative agreement or other available cooperative agreements based on market research.

In fact, the only reference to economic factors was the statement, “In addition, the City will save time and resources by utilizing this existing Contract, in lieu of putting this item out to bid.” However, this statement is part of the Certification template attached to AR 35.11.

When asked, the City staff person with knowledge of that section of the Certification stated that the contract was to the City’s advantage because the vendor’s services will combine the work that would normally be split between two City departments. However, according to an email we obtained, the City plans to add several full-time equivalent (FTE) staff positions to perform the work, even with contract in place; a fact known to the City staff person who wrote that section of the Certification.

Our analysis of the cost structure of the source organization contract revealed that aspects of the pricing was not to their economic advantage. Similarly, the cost structure of the cooperative contract with the City may not have been to the City’s economic advantage. Details of our analysis are contained in the confidential version of this report.

The pricing in the City’s contract reflects the same line-item costs per listing as what was used in the source organization contract. However, that price was based on

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more volume than what the source organization actually experienced. Also, the City received no consideration for the economy of scale associated with servicing a much larger organization.

The National Association of State Procurement Officials (NASPO) guidance on best practices for cooperative procurements states, "Since 'piggyback' contracts are not based on aggregated volume, governments do not benefit from true economies of scale." The City had no means to evaluate the reasonableness of the per-item cost in the source organization's contract with the vendor because a competitive process was not used for an organization of a comparable size to the City.

Guidance from NASPO states, "Cooperative contracts are especially advantageous for small governments because they benefit from the market share leveraged by larger government consumers." In this case, the opposite situation occurred. The City relied on a cooperative contract with a much smaller organization.

A key City staff person involved with the contract acknowledged that the vendor did not have successful competitive bids with other large cities to use as the basis for a cooperative procurement. They noted, "It's much harder to get big cities than it is smaller cities. You build yourself up. But the service is the service regardless." This indicates that the staff person did not consider the potential disadvantage of "piggyback" contracts in terms of economies of scale and was aware that the vendor did not have large-city clients.

City Staff Mischaracterized the Nature of the Vendor's Services When Seeking Approval from the Human Resources Department

Current City procedures require the Human Resources Department (HR) to review the scope of work of City contracts to determine, among other things, if City employees may be displaced as a result of the contract. This review is a required process step. Denial by HR could mean that the contract would have to either go through a lengthy meet-and-confer negotiation process with the recognized employee organizations, or the contract process could be abandoned.

We determined that the information contained in the HR Contracting Out Form related to the identified contract stated that City staff could not perform the tasks that were included in the scope of work for the contract. However, we confirmed

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that City staff have performed similar duties for several years, including employees in Classified positions, which are subject to the Civil Service provisions of the City Charter and State law.

The City staff person who completed the form noted that the data appeared to be inaccurate, based on our questions, but noted that the form was reviewed and approved by a senior manager before being submitted.

The form was approved by HR on the same day that it was submitted, along with a note, "Based on the Department's representation, this contract is approved from a labor relations perspective." When interviewed, the HR staff person stated that they had a conversation and exchanged emails with a senior manager regarding the request form and asked for a more thorough description of the work to be done. The manager replied with an email that largely repeated the description on the form, but included the specific assertion that City forces cannot perform the duties associated with the identified contract.

The two also spoke by phone, and the manager stated that currently "the services were not being done by City employees." We pointed out to that City employees were currently, and at the time, performing some of the contracted services and had been for years. The HR staff person replied that if they had known that, it would have made a difference in their decision to approve the form and allow the contract to be awarded without first seeking the approval of recognized employee organizations.

We noted that the form was certified as "true and correct" by an administrative staff person, but personally approved by a manager. The discrepancy between the manager, who was responsible, and the administrative person, who was accountable (per the form), should be addressed as a matter of policy to ensure that the same person is both responsible and accountable for the form's accuracy.

Although the San Diego Municipal Code (§§ 22.3205 and 23.1801) and Personnel Regulations (Rule XVII) require that all contracts for services be reviewed by the Civil Service Commission, we learned that the reviews are routinely conducted by the Human Resources Department, rather than the independent Personnel Department. This discrepancy should be addressed formally.

Recommendation 2

We recommend that the Chief Operating Officer review the details from our Confidential report, conduct an independent investigation, and take the appropriate corrective action with respect to any identified City employees.

Recommendation 3

We recommend that the Chief Operating Officer ensure that the Human Resources Department reviews the HR Contracting Out Form related to the identified contract to determine if City policy or agreements with recognized employee organizations were violated, and take the appropriate corrective action.

Recommendation 4

We recommend that the Chief Operating Officer revise the HR Contracting Out Form to require that the declaration that the facts and information are true and correct be provided by an Appointing Authority.

Recommendation 5

We recommend that the Chief Operating Officer, in consultation with the City Attorney's Office, update SDMC §§ 22.3205 and 23.1801, requiring a review of all service contracts by the Civil Service Commission, to reflect the current practice.

City Staff Made Significant Changes to the Source Contract's Terms, Conditions, and Pricing

Our investigation determined that City staff made several changes to the City contract's terms, conditions, and pricing, which deviated from the source contract. This appears to be contrary to the requirements of SDMC § 22.3003 and AR 35.11. The changes included more-frequent advance payments for piecemeal, prorated services, with variable pricing, rather than fixed pricing.

The semi-annual prepayments in the source organization contract were changed to a more-frequent quarterly basis in the City's contract. Although the change to more-frequent prepayment terms was identified as a modification from the original terms, it is not clear if merely identifying a change in the terms is consistent with City policy that appears to forbid changes to the "terms, conditions, and pricing of the original contract."

The source organization's contract states that the costs will be fixed. Language was inserted into the draft version of the contract that the annual contract price if the City elects to renew will be, "adjusted" each year based on a defined variable. The change to variable pricing was not identified as a modification to the terms of the source organization's contract. Thus, the variable pricing that was added appeared in the final version of the contract.

It is not clear why the change from fixed pricing to variable pricing was inserted, but the change may have been due to the City's desire to add another provision to the contract to prorate the costs. The prorated costs were based on the scope of services that were exercised and when the services were started. A senior City staff person familiar with the contract stated that the intent was to implement only two selected portions of the contract initially. We note that those two components account for 55 percent of the cost of the contract. The prorated services section was not identified as a modification to the original source organization contract.

A prorated piecemeal contract that involves more frequent prepayments using variable rather than fixed pricing appears to be a substantial deviation from the terms, conditions, and pricing of the original fixed-price contract that would likely make the contract ineligible for a cooperative procurement process according to the City's policy. However, further legal analysis is necessary to make this determination.

Using the Source Organization's Consultant Contract May Have Required City Council Approval

We determined that the City's contract with the vendor may not have been valid because it was likely a consultant contract, rather than a contract for services, and therefore, required City Council authorization based on the dollar value of the contract. Under SDMC § 22.3207(c), consultant contracts that do not involve public works projects, and are worth over \$250,000, "must be approved by the City Council." The City's cooperative procurement contract with the vendor, worth over \$250,000 per year, was not approved by the City Council.

The contract was treated as if it were a contract for services, but that is not consistent with the City's general interpretation of the scope of work, and it is not how the contract was described in the source organization's contract. In the source contract, the vendor is referred to as the "Consultant."

Generally, the distinction between a consultant and a service contract depends on the scope of work for the contract. Consultants normally provide specialized professional services that require specific training and education. Without identifying the contract, we asked a senior City staff person knowledgeable about the City's contracting practices if the items in the contract's scope of work were a consultant or service function. The staff person responded that each item would be considered a consulting function if the activity required professional judgement and involved more than merely passing on raw information. Considered together, if all items we listed were included in a contract, the staff person believed the contract would be a consulting contract, rather than a service contract.

When asked, the City staff person stated that "there's no reason why we can't cooperatively contract for a professional service, but we need to treat it as such," meaning that consultant contracts valued at over \$250,000 require City Council approval.

Our investigation determined that consultant contracts do not appear to be eligible to be awarded using a cooperative procurement contracting process. While there may be some ambiguity in the Municipal Code, the definition of a cooperative procurement contract in SDMC § 22.3003 specifically refers to a "contract for goods or contract for services." Also, SDMC § 22.3208(c) relating to cooperative procurements does not refer to consultant contracts, nor does it limit cooperative

procurements to goods and service contracts. However, AR 35.11 defines cooperative contracts as a “contract for goods or contract for services.” The ambiguity should be addressed through a revision to the SDMC and AR 35.11.

The City’s procedures for cooperative contracts, according to the Municipal Code and AR 35.11, appear to require that the City use the same prices, terms, and conditions as the source organization’s “contract for goods or contract for services.” We found no evidence that anyone from City management, or the Office of the City Attorney, evaluated whether the source organization’s contract would meet the City’s definition of a consultant contract before the contract was executed. Nor does there appear to be an analysis of whether the cooperative procurement process could be used for a consultant contract before the process was used and approved. City Charter Section 40 requires the City Attorney’s Office to approve the “form or correctness” of City contracts. Additional legal analysis should be conducted.

Recommendation 6

We recommend that the Chief Operating Officer, in consultation with the City Attorney’s Office, revise Administrative Regulation 35.11 and relevant SDMC sections to clarify whether or not a cooperative procurement process may be used for consultant contracts.

The Vendor Appears to Have Defined the Scope of Work for the Contract They Were Awarded

The City's Procurement Manual generally prohibits a vendor from acting as a consultant to define the scope of work for a contract and then be awarded the resulting contract. Specifically, the Manual states, "a consultant cannot assist in scoping a proposal document and then compete to win the award of the resulting contract."

We determined that the vendor received exclusive access to City management, was highly involved in the planning process, and was influential in the decisions that City management made. The vendor was not required to compete for the award of the contract since City management used the cooperative "piggybacking" procurement process discussed earlier.

We determined that the vendor acted as an unpaid consultant to City staff to develop the scope of work for the contract they were awarded in the following 10 ways: (1) preliminary planning discussions; (2) promoting their solutions; (3) exchanging project planning information with City staff; (4) applying pressure to City staff to enter into a contract; (5) providing advice that City staff relied on and used to influence the City Council's decisions; (6) discussing potential returns on investment with City staff; (7) evaluating best and worst-case scenarios; (8) guiding the City's decision-making regarding the contracting method; (9) meeting with City staff to refine and practice a presentation to the City Council; and (10) gaining exclusive access to City staff to discuss goals, exchange data, negotiate pricing, and develop an implementation plan.

The vendor also provided a free report to the City, which City staff relied on. Detailed information is included in the confidential version of our report.

Recommendation 7

We recommend that the Chief Operating Officer ensure that Administrative Regulation 35.11 regarding the Citywide Department Use of Cooperative Procurement Contracts, and other relevant policies, be revised to prohibit the City from receiving free consultation, goods, or services from vendors if doing so may reasonably be perceived to lead to favorable treatment for a particular vendor, or potentially violate State law.

Recommendation 8

We recommend that the Chief Operating Officer, in consultation with the City Attorney's Office, ensure that City staff perform a comprehensive, fair, and objective contracting process for any future related contract. Any future contract should include a clearly defined scope of work prepared by City staff, without input from the vendor involved here.

Potential City Charter Violations Related to Sections 94, 97, 100, and 101

The City Charter prohibits favoritism in public contracting and collusion in contract bidding.

Charter Section 94, titled "Contracts" states, in relevant part (emphasis added):

Pursuant to state law, no officers of the City, whether elected or appointed, shall be financially interested in any contract made by them in their official capacity. **Any officer who willfully violates this paragraph shall be guilty of a misdemeanor** and shall immediately forfeit his or her office and be thereafter forever barred and disqualified from holding any elective or appointive office in the service of the City.

California Government Code § 53087.6(b) states, "The auditor or controller may refer calls received on the whistleblower hotline to the appropriate government authority for review and possible investigation." Further legal analysis by outside

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agencies is indicated. Therefore, this report will be referred to the appropriate government agencies for review. We did not find that any City employee was financially interested in the contract.

Charter Section 97, titled "No Collusion in Bidding," reads as follows (emphasis added):

If at any time it shall be found that any party or parties to whom a contract has been awarded has, in presenting any bid or bids, been **guilty of collusion** with any party or parties in the submission of any bid or **for the purpose of preventing any other bid being made**, then the contracts so awarded may be declared null and void by the Council and the Council shall thereupon re-advertise for new bids for said work or the incomplete portion thereof. The Council shall debar from future bidding all persons or firms found to be in violation of this Section, or any future firm in which such person is financially interested.

Collusion is defined by the Association of Certified Fraud Examiners as "a type of fraud where two or more individuals agree to commit an act designed to deceive or gain an unfair advantage," and by Black's Law Dictionary as, "agreement to defraud another or to do or obtain something forbidden by law."

Further legal analysis by the City Attorney's Office should take place prior to any debarment proceeding under Charter section 97.

Charter Section 100, titled "No Favoritism in Public Contracts," reads as follows (emphasis added):

No officer or employee of the City shall favor one bidder over another, by giving or withholding information, or shall willfully mislead any bidder in regard to the character of the material or supplies called for, or shall knowingly accept materials or supplies of a quality inferior to that called for by the contract, or shall knowingly certify to a greater amount of labor performed than has actually been performed, or to the receipt of a greater amount of material or supplies than has actually been received. **Any officer or employee found guilty of violation of this Section shall forfeit his position immediately.**

Our investigation determined that the vendor began soliciting City staff more than two years before the contract was signed. We obtained detailed meeting summaries

indicating that City staff participated in meetings with the vendor, to the exclusion of any other potential vendor.

Further legal analysis by the City Attorney's Office should take place prior to any proceeding under Charter section 100.

Charter Section 101, titled "When Contracts and Agreements Are Invalid," reads as follows (emphasis added):

All contracts, agreements or other obligations entered into, all ordinances and resolutions passed, and orders adopted, **contrary to the provisions of Sections 97 and 100 of this Article may be declared null and void by the Council** and thereupon no contractor whatever shall have any claim or demand against the City thereunder, nor shall the Council or any officer of the City waive or qualify the limitations fixed by such section or fasten upon the municipality any liability whatever; provided that all persons who have heretofore furnished material for and/or performed labor on the job shall be protected by the contractor's surety bonds. **Any willful violation of these Sections on contracts shall constitute malfeasance in office, and any officer or employee of the City found guilty thereof shall thereby forfeit his office or position. Any violation of these Sections, with the knowledge, expressed or implied of the person or corporation contracting with the City shall render the contract voidable by the Council.**

Further legal analysis by the City Attorney's Office should take place prior to any proceeding under Charter section 101.

Recommendation 9

We recommend that the Audit Committee and City Council, in consultation with the City Attorney's Office, evaluate whether City Charter violations occurred and take appropriate legal action, to the extent that the Audit Committee and City Council have authority to act.

Conclusion

We identified numerous deviations from the City's established contracting process, procedures, and best practices. For instance, a key City staff person did not perform adequate due diligence prior to seeking a "piggyback" contract with the vendor and ignored contacts from other vendors. Although the DoIT staff was consulted about the vendor's services, they did not evaluate the services of any other vendor and determined that the vendor's services were obtained through outsourced labor. Furthermore, the City relied on a source contract from a much smaller organization, potentially resulting in an unfavorable dis-economy of scale.

The City modified the pricing, terms, and conditions of the source organization's contract and incorrectly certified that the vendor's services were "unique." City staff mischaracterized the nature of the vendor's services as "services that cannot be performed by City staff" in order to obtain approval from the City's HR Department to proceed with the contract. It appears that the source cooperative contract may have been a consultant contract requiring City Council approval based on the dollar amount, and consultant contracts may not be eligible be awarded using a cooperative procurement contracting process. This issue requires further legal analysis.

Finally, City staff improperly permitted the vendor to participate in preliminary discussions, negotiations, planning, and guided the contracting process that would ultimately be used as the basis for the contract that the vendor was awarded. We listed 10 examples demonstrating the extent to which the vendor defined the scope of work for the contract they were awarded in the confidential version of this report.

During a lengthy interview with a key staff person involved with the contract, we asked if the vendor's involvement with the early discussions, preliminary negotiations, compromises, guidance on City policy, planning and specifications, and involvement with the selection of a procurement method created a circumstance that would potentially be unfair to other vendors that could have been invited to the City's competitive process. The employee replied, "Absolutely not," adding, "I think that they were at the right place at the right time and they provided advice to [City staff]." The staff person went on to say that other vendors "might not be happy" about being excluded from meetings with City staff, but the vendor had positive reference checks (from the list the vendor provided). The employee noted that they

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were under pressure to complete the contract quickly. As such, "You want to make sure that you have the right people at the table that can give you the right advice..."

During the course of our investigation, we conveyed our preliminary investigation results to City management and the contract with the vendor was not renewed.

We made the following recommendations to hold City employees accountable and improve the cooperative procurement contracting process Citywide. Responses and target implementation dates are as follows.

**Recommendations, Management’s Responses, and City Auditor Comments
(See Attachment A for Definitions of Fraud Hotline Recommendation
Priorities)**

In a nine-page memorandum dated September 3, 2019, Assistant Chief Operating Officer Ronald Villa provided a response to our report that included a disagreement with all of our investigation’s opinions, but included agreement with all of our recommendations. We will provide our comments in response to management’s responses below. Management’s responses appear in the text boxes below.

This memorandum serves as a response to the Auditor's Public Hotline Report of Abuse Related to the Alleged Unfair Award of a Multi-Million-Dollar Contract. Management respectfully disagrees with all the Auditor's opinions. Management agrees with all the recommendations and has set a schedule for implementation as outlined below.

City Auditor comment regarding the statement, “Management respectfully disagrees with all the Auditor's opinions”:

Our report is based on sufficient and appropriate evidence including numerous contemporaneous email exchanges, detailed PowerPoint presentations, documents submitted to the City Council, lengthy recorded interviews with key City employees, contract documents, and national best practice standards.

Management is firmly in agreement that policies and procedures should be followed and that staff should be held accountable when improper deviation from those policies and procedures occurs. However, Management does not agree that staff purposely or improperly deviated or circumvented processes as alleged by the City Auditor. Management believes that the investigation correctly identified weaknesses in the City's Cooperative Contract process but unnecessarily faults staff for following the process as it presently exists. As such, Management has prepared the following explanatory information for each opinion.

City Auditor comment regarding the claim that our investigation “unnecessarily faults staff for following the process as it presently exists”:

City staff may have violated City Charter City Section 100, which begins with the phrase, “No officer or employee of the City shall favor one bidder over another, by giving or withholding information ...” City staff only included one vendor in the contracting process and that vendor received exclusive access to City staff to provide information about the vendor’s services and to receive information from City staff about City operations. Other vendors’ attempts to provide information to key City staff were actively ignored.

Existing City processes and internal controls, such as independent reviews of key documents like the Cooperative Procurement Certification memorandum and Human Resources Contracting Out Form were ineffective because they contained incomplete and inaccurate information. If the information on the documents had been complete and accurate, City staff reviewing the forms would have most likely taken additional steps to ensure that City policy and State laws were not violated.

1. City Staff Did Not Perform Adequate Due Diligence in Advance of the Contract Award.

Management does not agree that the Contract Administrator (CA) failed to conduct due diligence. The CA performed due diligence in advance of the contract award and followed the City's existing defined Cooperative Agreement process. The following is best practice as identified by National Institute for Governmental Purchasing (NIGP) for completing due diligence on a cooperative contract. The CA completed this due diligence as follows.

A. NIGP Best Practice requires an agency to "compare the cooperative contracts available for the required product or service, conduct market research, and evaluate whether the use of a cooperative contract is appropriate". Staff followed NIGP best practice by performing the following steps:

1. CA informed Purchasing and Contracting (P&C) that the Department had meetings with the Vendor to inquire about their services. The purpose of these meetings was to confirm that Vendor's services could assist and add value to the City's operations. At these meetings, the Department asked the Vendor if they had a

contract with another municipality. Vendor advised that they did and would provide the list of cities with whom they had participated in a competitive RFP process and were awarded a contract.

City Auditor comment regarding the statement, “The purpose of these meetings was to confirm that Vendor's services could assist and add value to the City's operations”:

The vendor met with the City to sell its services. City staff provided information to the vendor exclusively, and rejected requests for the same access from other vendors. City staff said that it would be inappropriate to meet exclusively with a vendor if the City was going to use a formal, public, and competitive Request for Proposal (RFP) contracting process. The vendor and City staff determined what the scope of the contract would be, then obtained a contract from the vendor that contained the desired scope of work. City staff avoided an independent RFP process due to the time pressure they were under.

City Auditor comment regarding the statement, “At these meetings, the Department asked the Vendor if they had a contract with another municipality”:

Nothing in the City Charter, San Diego Municipal Code, or City contracting procedures permit City staff to provide exclusive access to one vendor and then award a multi-million-dollar contract to that vendor as part of a “piggyback” procurement process. The City Charter prohibits favoritism in public contracting and collusion in bidding.

If the Purchasing and Contracting Department (P&C) had been informed that there were “meetings” with the vendor, that would not necessarily raise a concern. However, P&C staff stated that they were not aware that there had been a series of exclusive meetings with the vendor for nearly two years, during which the scope of work for the contract was negotiated.

2. CA reviewed the contracts from other municipalities and talked to other officials to determine if the Vendor had the capability to perform the tasks that were needed at the City.

City Auditor comment regarding the review of information from other municipalities by City staff:

City staff only reviewed other contract prices and options offered by the vendor that was ultimately awarded the contract. The vendor provided the pricing and worked with City staff to develop the scope of work for the contract. No other vendor's prices or services were reviewed. Only municipalities that used the favored vendor were contacted, based on information provided by the vendor.

3. The Vendor was known to the City as an industry leader and demonstrated that it could provide the necessary services.

City Auditor comment regarding City staff's knowledge of the vendor:

The vendor was known to City staff because of the vendor's exclusive marketing and consultation meetings with various City staff over a two-year period. The vendor's reputation was based on a review of the references provided by the vendor.

B. NIGP Best Practice requires an agency to "Analyze all costs associated with conducting a competitive solicitation".

Staff followed NIGP best practice by considering the time expense of conducting a competitive solicitation and determining that a competitive solicitation would not yield an advantage as immediacy was a primary factor in using the cooperative contract.

City Auditor comment regarding the conclusion that "a competitive solicitation would not yield an advantage as immediacy was a primary factor":

Pressure from City management does not permit City staff to circumvent the City's procurement rules and the City Charter. Charter Section 100 states, "No officer or employee of the City shall favor one bidder over another, by giving or withholding

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information..." In this case, only one vendor was provided with information regarding the City's needs, and that information was withheld from other vendors. Using a procurement process that does not include independent solicitation and scoring by the City will always be faster and less costly than a competitive process, but any procurement process must be fair to other vendors and consistent with State law.

The process for awarding a cooperative procurement contract requires City staff to certify that the contract is to the City's economic advantage. We determined that the contract pricing may not have been to the City's economic advantage because only one vendor was considered, and the City relied on a cooperative contract with a much smaller organization.

- C. NIGP Best Practice requires an agency to "Ensure that the use of the cooperative contract meets all competitive requirements."
1. Staff followed NIGP best practice as part of the due diligence completed by P&C. The CA received the information from the Vendor and forwarded the following documentation to P&C to determine if the Source Organization contract would meet the City's requirements to enter into a Cooperative Agreement,
 - a. Source Organization RFP;
 - b. Vendor Response to RFP;
 - c. Agreement for Professional Services between Source Organization and Vendor with attached;
 - d. Exhibit A - Scope of Services;
 - e. Cooperative Procurement Checklist identifying tasks completed by the Initiating Department;
 - f. Cooperative Procurement Certification Memorandum
 2. P&C confirmed that the Source Organization contract had a piggyback clause allowing the City to move forward with the Cooperative Agreement process. P&C approved CA to move forward but needed to complete the items outlined in the Cooperative Procurement Checklist. CA provided those items as requested.

City Auditor comment regarding the claim that “Staff followed NIGP best practice as part of the due diligence completed by P&C”:

According to best practices, due diligence should include: reviewing available cooperative contracts, researching the market, analyzing all costs, and determining whether such an agreement is appropriate under the circumstances. City staff only reviewed cooperative contract prices offered by the favored vendor. The market research was limited to information provided by the vendor regarding their proposed solutions. The costs that were analyzed were those provided by the vendor. Although a checklist of items was completed, the City’s process excluded other vendors.

D. NIGP Best Practice requires an agency to "Review the cooperative contract for conformance with all applicable laws and best practices".

Staff followed NIGP best practice by fully reviewing the contract with the City Attorney's Office.

City Auditor will refrain from commenting regarding specific legal advice received from the City Attorney's Office.

However, the Audit Committee and City Council may wish to request that the City Attorney’s Office draft a complete analysis of all of the legal issues raised by our report, or make such a report available if one has already been completed.

2. Department of Information Technology (DoIT) Staff Reviewed Vendor's Services, Not Other Vendors

Department of Information Technology staff were neither REQUIRED or PRECLUDED from reviewing the services of other vendors. The DoIT evaluation had no correlation to an evaluation of services related to the cooperative contract as the Cooperative Contract was not anticipated at the time of DoIT's review. The Initiating Department chose the Vendor pursuant to Municipal Code Requirements after performing due diligence as described above.

Department staff met with Vendor for a purpose completely unrelated to the cooperative agreement. The City's Chief Data Officer in the Performance and Analytics (PandA) Department thought the City could perform data scrubbing services in-house and wanted to see how Vendor accessed their data. After PandA's assessment, Department staff determined that the data samples from PandA lacked accuracy and therefore could not be used.

Eighteen months later, the City formed a working group. Daily two-hour meetings were scheduled to develop potential business processes.

The Audit Report mistakenly creates a nexus between the various Vendor meetings with City staff that occurred over a two-year period. The only meetings that had direct bearing on the cooperative agreement with Vendor took place. These meetings were conducted to determine if the data analytic services offered by Vendor would meet the City's needs. This analysis could be viewed as due diligence to a layperson.

City Auditor comment regarding the statement, "the Cooperative Contract was not anticipated at the time of DoIT's review":

The relevant section of our report referred to a series of "rushed" two-hour daily meetings, which took place weeks before the contract was signed. City staff responsible for the contract stated that they decided to use the vendor prior to those meetings.

At those meetings, a DoIT staff person found that the vendor's method involves an outsourced pool of people who work on piecemeal projects online. The DoIT staff person concluded that City staff could manually do the same work, but "not as cost effectively." We determined that City staff have performed similar duties for several years, including employees in Classified positions, which are subject to the Civil Service provisions of the City Charter and State law.

City Auditor comment regarding the statement, “Department staff determined that the data samples from PandA lacked accuracy and therefore could not be used”:

City staff stated that they did not rely on the accuracy of the vendor’s data either. The data that the City ultimately relied on was derived from City staff’s work evaluating the same dataset, not the vendor’s. City staff had been performing this work for several years; a fact known to the key City staff person responsible for the contract. City staff responsible for the contract stated that they planned to use only a small sample of the vendor’s data initially, until they could be confident in the accuracy of the vendor’s data.

City Auditor comment regarding the statements, “Eighteen months later, the City formed a working group. Daily two-hour meetings were scheduled to develop potential business processes.”:

This statement of fact indicates that the City had more than 18 months that could have been used to issue a fair and public bidding process. Instead, City staff met with only one vendor and excluded offers and contacts from competitors. The daily two-hour meetings may not have been necessary if City staff planned for the City’s needs in advance. City processes exist to seek competing proposals from the marketplace when the final scope of a project is unknown, such as the Request for Information process.

City Auditor comment regarding the “nexus between the various Vendor meetings with City staff that occurred over a two-year period”:

Contemporaneous email records we obtained detailed who was present for the series of meetings and discussions over a period of more than two years. The records show what was discussed and the agreed-upon next steps to be taken. The evidence indicates that the vendor’s intent in meeting with City staff was to sell their services and City staff ultimately bought the services that were negotiated during the meetings.

City Auditor comment regarding the statement, “This analysis could be viewed as due diligence to a layperson”:

The City only met with one vendor over a period of more than two years, exchanged information with them exclusively, relied on their guidance, and negotiated the scope of the contract that was ultimately awarded to that vendor. No other vendor was included in the City’s review of the potential services. Solicitations from other vendors were intentionally ignored or actively rejected. These actions are not consistent with due diligence, fairness, or best practices.

3. Some Contracting Process Steps and Best Practices Were Not Followed.

Management agrees that processes should be reviewed and improved when necessary to follow best practices. However, the CA followed the existing processing steps under the direction of the Purchasing and Contracting Department in consultation with the City Attorney's office and should not be penalized because processes were somehow inadequate or outdated. Terms and conditions of the Source Organization's Contract were allowably adjusted to the City's economic advantage.

City Auditor comment regarding the statement, “Terms and conditions of the Source Organization's Contract were allowably adjusted to the City's economic advantage”:

San Diego Municipal Code (SDMC) § 22.3003 states that a cooperative procurement contract “allows other agencies to use the terms, conditions, and pricing of the original contract for goods or contract for services.”

The source agency’s bidding process would not be comparable to the same process conducted by the City if the payment terms and scope of work that were the subject of competitive bidding by the source agency were later substantially changed by the City; regardless of any argument that the changes were to the City’s economic advantage.

There is no support for management’s claim that the prices, terms, and conditions were “allowably adjusted.” A prorated piecemeal contract that involves more frequent prepayments using variable rather than fixed pricing appears to be a

substantial deviation from the terms, conditions, and pricing of the original fixed-price contract and therefore would likely make the contract ineligible for a cooperative procurement process according to the City's policy and the SDMC.

A. City staff correctly certified that Vendor's services were unique to the City because Vendor performed a service the City did not or could not perform. There was no intentional deception by Department staff to identify Vendor's service as unique to the industry. Department's staff understood there were other service providers.

City Auditor comment regarding the statement, "Vendor performed a service the City did not or could not perform":

This statement is false. City staff have performed equivalent data analysis and compliance services for several years. The services the vendor was offering used outsourced labor, rather than City staff. City management circumvented the review by recognized labor organizations by claiming that City staff cannot perform the same services. City staff responsible for the contract knew that City staff had been performing these services.

City Auditor comment regarding the statement, "There was no intentional deception by Department staff to identify Vendor's service as unique to the industry":

City staff never referred to the vendor's services as "unique to the industry." Rather, the vendor's services were characterized as "unique" because City staff could not perform the same services. In fact, City staff have performed equivalent data analysis and compliance services for several years. This fact was known to the City staff involved. If that information had been disclosed to the Human Resources Department, it likely would have delayed the contracting process. City staff stated that they were under pressure to get the contract in place quickly.

City Auditor comment regarding the statement, “staff understood there were other service providers”:

None of the other services providers were contacted. Requests for meetings from other vendors were either passively ignored or actively rejected. One City department asked the subject vendor to stop soliciting its staff. That request was not honored, and the department followed up with a subsequent request. Other City staff who were involved with the contract formation provided information to the favored vendor, attended several meetings, and withheld information from other vendors.

B. The competitive RFP process conducted by the Source Organization identified that there were other providers in the industry.

C. The competitive RFP process conducted by the Source Organization identified that Vendor as the most responsive and responsible vendor and was compliant with the San Diego Municipal code.

D. The Purchasing and Contracting Department certified that the Source Organization's RFP process was a fair and competitive bidding process that met the requirements of the City's Municipal Code.

E. The City of San Diego did not make significant changes to the contract terms, conditions and pricing to the City's disadvantage. The language from the Source Organization contract was allowably amended to the City's advantage in that that it did not require a full annual payment upfront. Instead, the payments were divided into quarters and prorated accordingly. Department staff were concerned that if they did not change the terms of payment to Vendor, the City would end up paying the full amount up front.

The modification to the Compensation section was to the distinct advantage of the City of San Diego and resulted in a savings of hundreds of thousands of dollars.

City Auditor comment regarding the statement that the City “did not make significant changes to the contract terms, conditions and pricing to the City's disadvantage”:

The City changed what services would be included, when the City would pay for those services, and how the payments would be made. Specifically, the City agreed to make more-frequent quarterly advance payments for piecemeal, prorated services, whereas the source organization contract required semi-annual advance payments for all the identified services. The City's contract pricing is variable after the first year, but the source organization contract price was fixed.

Our report does not state that the changes the City made to the contract's terms, conditions, and pricing were to the City's disadvantage. The advantageousness of the changes is irrelevant since nothing in the existing City policy or Municipal Code permits the terms to be changed at all. The terms, conditions, and pricing were competitively bid at the source organization; changing them after the fact would not provide competitors with an equal opportunity to bid based on the new terms, and limits the comparability of the two processes.

F. The term "unique" was not used to put the City at an economic disadvantage. The auditor appears to have misconstrued the meaning and requirement of the term "unique" for this contract. This was not a sole source contract requiring a test of "uniqueness" between vendors. It was a Cooperative Contract where the term was used to reference the fact that the process is unique to services performed by City employees. Department staff were aware that there are other data vendors that perform these services, the point is that City staff do not. The HR Contracting Out Form information was used to confirm that current represented employees do not perform similar duties as the services being requested. This general description was used to pre-fill the other City forms to describe Vendor services. Staff understood that Vendor did not offer a unique service as there are other data service vendors in the marketplace.

City Auditor comment regarding the statement, “The term ‘unique’ was not used to put the City at an economic disadvantage”:

Our report does not state that the term “unique” was used to place the City at an economic disadvantage. We determined that the source contract was not to the economic advantage of the City because the City used pricing from a much smaller organization. National best practices state that cooperative procurements are advantageous when small cities can leverage the pricing offered to larger cities. Typically, larger purchasing organizations benefit from lower prices due to their increased bargaining power and the economy of scale advantage. In this case, the City used a much smaller organization’s per-item pricing, which was not to the City’s economic advantage. City staff also failed to independently evaluate the pricing and services offered by other vendors. City staff only reviewed the services, price quotes, and references from the selected vendor.

City Auditor comment regarding the statement, “The auditor appears to have misconstrued the meaning and requirement of the term ‘unique’ for this contract”:

City staff used the term “unique” to characterize the services of the vendor and claimed that the vendor’s services could not be performed by City personnel. In fact, we confirmed that City staff have performed similar duties for several years and continue to do so now. We understand that the City could not have used a sole source contracting process because there were competing vendors. However, our opinion is that City staff used the term to improperly imply that the vendor was the only one that provided the proposed data analysis services.

The City entered into a Cooperative Agreement with Vendor based on Source Organization's competitive RFP bidding process. Source Organization's competitive bidding process was approved and certified by the Purchasing and Contracting Department under the existing policies and procedures. Item #3 of the City's Cooperative Procurement Certification Memorandum certifies that "The Contract was Awarded Using a Process that Complies with the Policies, Rules and Regulations Developed by the City Manager... In addition, and consistent with Charter section 100, the [AGENCY] awarded the contract after completing a comprehensive, fair, and objective bidding process which included clearly defined criteria."

City Auditor comment regarding the source organization's competitive Request for Proposal (RFP) bidding process:

The source organization's competitive bidding process was based on an RFP advertisement that had a defined scope of work. The City's contract with the vendor used some, but not all, of the terms, conditions, and pricing of the source contract. Therefore, the City's contract with the vendor does not appear to be consistent with the Municipal Code and Administrative Regulation defining "piggyback" contracts.

We also note that the statement, "In addition, and consistent with Charter section 100, the [AGENCY] awarded the contract after completing a comprehensive, fair, and objective bidding process which included clearly defined criteria" is part of the boilerplate text of the Certification template.

Lastly, the Audit Report states that there was no reference to an analysis of the cost structure underlying the source contract. This is not accurate. The City of San Diego entered into a Cooperative Agreement process based on Source Organization's RFP process. During the Source Organization RFP process, price and scope of services were reviewed. Vendor won the competitive bidding process over other vendors. Purchasing and Contracting certified that this process met the provisions of San Diego Municipal Code Section 22.3208.

City Auditor comment regarding the statement, "there was no reference to an analysis of the cost structure underlying the source contract":

The Certification form that City staff submitted to the Purchasing and Contracting Department described the services to be offered by the vendor, but did not explain the economic advantages of the specific contract or how the pricing per line-item was derived. This is a statement of observable fact.

Management claims that our report was not accurate, but our determination was based on the text of the Certification memorandum, which they do not refute in their response. Instead, the management response indicates that since the source organization presumably evaluated the cost structure and City staff relied on their process, City staff can be credited for performing the same analysis by proxy. We point out in our report that the only reference to cost savings in the Certification

memorandum was part of the boilerplate text regarding the “time and resources” saved by the City avoiding a competitive process. In our opinion, saving time and resources by avoiding a competitive process is not a sufficient basis to use a “piggyback” contracting process, nor is time pressure from City management.

4. City Staff Mischaracterized the Nature of Vendor's Services to Obtain Approval from the Human Resources (HR) Department:

Management does not agree that City staff mischaracterized the nature of Vendor's services to obtain approval from the HR Department. The HR Contracting Out Form was completed accurately. Vendor provides a data service that is not, and cannot, be performed by City employees. Vendor services are therefore "unique" to the City. Refer to the response to City Auditor Opinion #2, above, which demonstrates that the City did try to perform these data services in-house.

Vendor provided the City with the ability to obtain this data electronically and the ability to send out correspondence in large volume. The City did not have the staff or the ability to obtain the required data. City staff are available to perform administrative functions but have no access to the data that Vendor was to provide. Arguably, as the service provided was data software, it did not even require a completion of the HR Contracting Out Form and was exempt entirely from HR review. It should also be noted that the anticipated business program already included the addition of staff to the Department to perform additional tasks. If the Department could have performed the functions that required the engagement of Vendor, they would have added those positions to the program at the same time.

City Auditor comment regarding management’s claim that the “Vendor provides a data service that is not, and cannot, be performed by City employees”:

Management’s claim that City staff cannot perform the data analysis is false. We confirmed that City staff have performed similar duties for several years, using the same dataset. The City relied on the accuracy and completeness of the data collected and analyzed by City staff, not the vendor. This fact was known to the City staff who were involved with the contract formation and made the representations

on the HR Contracting Out Form.

City Auditor comment regarding the statement, "Arguably, as the service provided was data software, it did not even require a completion of the HR Contracting Out Form...":

The scope of work for the City's contract with the vendor included specialized professional services that require specific training and education. City staff have been performing functionally equivalent services for several years and continue to do so. City staff responsible for the contract formation were informed that the vendor used outsourced labor to perform the data collection and analysis prior to the contract's execution. Both City staff and the vendor used the same dataset to perform similar work. This was not a software contract and should not be confused for one.

5. City Staff Made Significant Changes to the Source Contract's Terms, Conditions, and Pricing:

Management does not agree that City staff made significant unallowable changes to contract terms, conditions, and pricing. Cooperative Contracts, by their nature may occasionally require minor changes to fit the structure billing structure of the agency utilizing the contract. The changes made to Section 4.0 of the Source Organization Agreement were essentially minor changes related to the timing of payments. The changes do not constitute material changes to the terms condition or pricing of the Source Organization's contract. The changes were to the City's distinct advantage and prevented an overbilling of hundreds of thousands of dollars for the Vendor services rendered.

These changes did not affect the Source Organization Scope of Services "Exhibit A" nor did they affect pricing. Pricing for both the Source Organization contract and the San Diego contract were based on the same transaction. Other than these timing changes, the City's contract mirrored the requirements of the Source Organization contract. Neither SDMC § 22.3003 nor AR 35.11 have any specific language against making these changes. The contract was reviewed by Purchasing & Contracting Department and approved as to form by the City Attorney's Office. Further explanation is provided in the response to City Auditor Opinion #3 above.

City Auditor comment regarding management’s assertion that the changes to the contract’s pricing “prevented an overbilling of hundreds of thousands of dollars...”:

This response indicates that the pricing in the original contract was not to the City’s economic advantage since it would have resulted in an “overbilling.” City staff certified that the source contract was to the City’s economic advantage. Furthermore, changing the payment terms to reduce the cost by “hundreds of thousands of dollars” appears to be a material change.

In our report, we note that any changes to the terms, conditions, and pricing of the source contract appear to be prohibited according to SDMC § 22.3003 and AR 35.11. We note that further legal analysis would be required to make the ultimate determination. However, the City’s prorated, piecemeal contract that involves more frequent prepayments using variable, rather than fixed, pricing appears to be a substantial deviation from the terms, conditions, and pricing of the original fixed-price contract and would likely make the contract ineligible for a cooperative procurement process according to the City’s policy.

City Auditor comment regarding the statement, “Other than these timing changes, the City’s contract mirrored the requirements of the Source Organization contract”:

Management’s statement is contradicted by the terms of the City’s contract with the vendor. The City’s contract changed the source contract’s scope to include only those services the City elected, with payment based on when the selected services were initiated. The resulting piecemeal, prorated contract did not mirror the source contract any more than a cafeteria’s buffet mirrors a pre-set, fixed price dining experience.

6. Using the Source Organization's Consultant Contract May Have Required Council Approval:

Management does not agree that the Contract was a consultant contract and therefore the Contract did not require Council approval. This was determined through a joint process with both Purchasing & Contracting and the City Attorney's

Office. If a determination was made after the contract was let to reclassify the agreement as a consultant agreement, City staff would take appropriate action to conform with City regulations. However, there was no purposeful intent to bypass City regulations. All parties agreed that the classification of a services contract was correct and appropriate. Management agrees that improvements should be made to City policies and procedures to clarify service vs. consultant type agreements.

While the Source Organization's contract may be categorized by that Organization as a consultant contract, that is not determinative for purposes of the City of San Diego's categorization. Historically in the Department, IT system services are not categorized as consulting services.

The services offered by the Vendor provide access to external data related to an internal Department function. In addition, services included the ability to utilize Vendor's licensing and customer service. These services provide IT system services, not consultant services. It is relevant to note that Department staff were developing system business requirements with Vendor in preparation of future business activities. System requirements are not developed for consultant services.

City Auditor comment regarding the statement, "If a determination was made after the contract was let to reclassify the agreement as a consultant agreement, City staff would take appropriate action to conform with City regulations":

We found no evidence that anyone specifically evaluated whether the source organization's contract would meet the City's definition of a consultant contract before the contract was executed. Since the question was never considered, the City would not need to "reclassify" the contract after the fact. However, the City should consider the evidence now. Likewise, there was apparently no analysis of whether the cooperative procurement process could be used for a consultant contract before the process was used and approved.

City Auditor comment regarding the statement, “All parties agreed that the classification of a services contract was correct and appropriate”:

The source contract described the vendor as a “consultant.” When we asked a City staff person with expertise about the distinction between consultant and service contracts about a hypothetical contract with the same scope of work, the City staff person determined that the contract would be a consultant contract. The analytical and advisory tasks listed were apparently consistent with the work of a consultant.

City Auditor comment regarding management’s statement, “staff were developing system business requirements with Vendor in preparation of future business activities”:

Consultant services often include advising City staff regarding system business requirements. While system business requirements may not be developed for consultant services, consultants routinely assist City staff to develop system business requirements based on the City’s needs and the consultant’s expertise in designing solutions to meet those needs. Therefore, it appears that City management agrees that the vendor acted as a consultant.

Management’s claim that the vendors services were “IT system services” mischaracterizes the scope of work of the contract. The contract required obtaining and analyzing data in a manner consistent with the work that City staff have performed for several years. This was not the purchase of a software license. Prior to the contract’s execution, City staff were aware that the vendor’s services relied on an outsourced pool of labor obtained through the internet to perform the data collection and interpretation, not software.

7. The Vendor Appears to Have Defined the Scope of Work for the Contract They Were Awarded:

Management does not agree that the Vendor defined the Scope of Work for the contract they were awarded. The Department only met with Vendor to review services offered. The Scope of Work and pricing of the Cooperative Agreement were not changed from the Source Organization contract. The City formed a working group to address business needs. Daily two-hour meetings were scheduled to

develop the processes necessary to address those needs. The Scope of Work was determined during those meetings and refined internally by staff from the Department.

City Auditor comment regarding the statement that City staff “only met with Vendor to review services offered”:

According to the City’s Procurement Manual, “a consultant cannot assist in scoping a proposal document and then compete to win the award of the resulting contract.” We provided City management with a detailed confidential draft version of our report. Our confidential report contains detailed, contemporaneous email exchanges between the vendor and City staff that demonstrate the vendor’s involvement in preliminary planning, exchanging City data with the vendor, obtaining guidance on best practices, discussing potential returns on investment, negotiating pricing, and defining the scope of work for the contract over a two-year period. City staff involved in the meetings invited other departments to participate in the meetings to hear the benefits that could be offered from services that were ultimately included in the contract. Part of the discussions included the use of a “piggyback” purchasing method and the fact that City Council approval would not be required based on the dollar amount. The interactive, exclusive, and protracted process with the vendor that management refers to as a mere “review” of the services offered is contradicted by the contemporaneous detailed email summaries of who was present for the meetings, what was discussed, and the action steps that were negotiated.

8. Potential City Charter Violations Related to Sections 94, 97, 100, and 101:

As this determination is directed at the Audit Committee, City Council and City Attorney, we consider it inapplicable for a management response. We will cooperate fully with a request for further investigation.

Recommendation 1

We recommend that the Chief Operating Officer ensure that Administrative Regulation 35.11 regarding the Citywide Department Use of Cooperative Procurement Contracts be revised to require documentation of a business case analysis listing other vendors that provide the goods or services, an analysis of the costs and benefits of a competitive procurement process, an evaluation of other cooperative procurement contracts available from other vendors, a certification that the City's process was fair to other vendors, and a signature by the City employee submitting the Certification declaring that the facts and information presented are true and correct. (Priority 2)

Management Response:

Agree. The recently revised Administrative Regulation (AR.) 35.11 supports the intent of the San Diego Municipal Code provision 22.3208 (c) which allows the City to award to a contract based on a competitive solicitation that was not initiated by the City. The use of cooperative agreements is a standard best practice in public agencies. Part of the requesting department's business case is stated in the justification memo which is presented to the department director of Purchasing and Contracting. Requiring a comparison of multiple cooperative agreements may be prohibitive seeing as often, there may be only one cooperative agreement for a vendor/supplier at a given time.

For example, often in standardization efforts, preference based on systems compatibility or staff training are implemented to drive cost savings and efficiencies. Hypothetically, if the City were to examine utilization of a cooperative for auto parts, we would find that there is only one viable cooperative (to support our current business model) based on a competitive process that we could leverage. The recommendation made is limiting. In lieu of that requirement, we recommend that the business case be included (consistently) in the existing justification memo and an internal statement of due diligence be completed by the Procurement Contracting Officer handling the request in Purchasing and Contracting.

Additionally, the Purchasing and Contracting Department is available to provide instruction and training on the differences in resources necessary to conduct an RFP vs. a Cooperative Contract to any interested parties.

City Auditor comment regarding the statement, “Requiring a comparison of multiple cooperative agreements may be prohibitive seeing as often, there may be only one cooperative agreement for a vendor/supplier at a given time”:

Our recommendation refers to “an evaluation of other cooperative procurement contracts available from other vendors,” not from the same vendor.

City Auditor comment regarding the statement, “In lieu of that requirement, we recommend that the business case be included (consistently) in the existing justification memo and an internal statement of due diligence be completed by the Procurement Contracting Officer handling the request in Purchasing and Contracting”:

According to the June 22, 2018 Administrative Regulation regarding cooperative procurements, City staff, not Purchasing and Contracting Department staff, are responsible for completing the Cooperative Procurement Certification Memorandum. Since City staff submit the Certification, City staff should sign the document and declare that the “facts and information presented are true and correct.”

Target Implementation Date: February 1, 2020

Recommendation 2

We recommend that the Chief Operating Officer review the details from our Confidential report, conduct an independent investigation, and take the appropriate corrective action with respect to any identified City employees. (Priority 1)

Management Response:

Agree.

Target Implementation Date: February 1, 2020

Recommendation 3

We recommend that the Chief Operating Officer ensure that the Human Resources Department reviews the HR Contracting Out Form related to the identified contract to determine if City policy or agreements with recognized employee organizations were violated, and take the appropriate corrective action. (Priority 1)

Management Response:

Agree, HR will re-review the HR Contracting Out Form in comparison with this new information provided by the Auditor's Office and take any appropriate corrective action.

Target Implementation Date: April 1, 2020. This may be completed earlier if there is no requirement under MMBA to meet and confer with the recognized labor organizations.

Recommendation 4

We recommend that the Chief Operating Officer revise the HR Contracting Out Form to require that the declaration that the facts and information are true and correct be provided by an Appointing Authority. (Priority 2)

Management Response:

Agree, moving forward an approval email from an Appointing Authority will be required to be attached to the HR Contracting Out Review Form.

Target Implementation Date: October 2019

Recommendation 5

We recommend that the Chief Operating Officer, in consultation with the City Attorney's Office, update SDMC §§ 22.3205 and 23.1801, requiring a review of all service contracts by the Civil Service Commission, to reflect the current practice. (Priority 3)

Management Response:

Agree. Purchasing and Contracting will work with the City Attorney's office to update SDMC §§ 22.3205 and 23.1801 to reflect the current practice.

Target Implementation Date: May 2020

Recommendation 6

We recommend that the Chief Operating Officer, in consultation with the City Attorney's Office, revise Administrative Regulation 35.11 and relevant SDMC sections to clarify whether or not a cooperative procurement process may be used for consultant contracts. (Priority 3)

Management Response:

Agree, Purchasing and Contracting will work with the City Attorney's Office to determine if the use of cooperative agreements is appropriate for the hiring of consultants.

Target Implementation Date: February 2020

Recommendation 7

We recommend that the Chief Operating Officer ensure that Administrative Regulation 35.11 regarding the Citywide Department Use of Cooperative Procurement Contracts, and other relevant policies, be revised to prohibit the City from receiving free consultation, goods, or services from vendors if doing so may reasonably be perceived to lead to favorable treatment for a particular vendor, or potentially violate State law. (Priority 2)

Management Response:

Agree. Purchasing and Contracting will work on revisions to A.R. 35.11 to document what appropriate interactions with prospective vendors/suppliers should be to avoid favorable treatment to a particular vendor or a violation of State law. There are instances where City staff need to be able to engage with vendors on potential solutions. Purchasing and Contracting will provide training for City staff on cooperative agreements and vendor engagement that will address these issues. The City still maintains ethics standards and mandatory training to prevent fraud or abuse.

Target Implementation Date: February 2020

Recommendation 8

We recommend that the Chief Operating Officer, in consultation with the City Attorney's Office, ensure that City staff perform a comprehensive, fair, and objective contracting process for any future related contract. Any future contract should include a clearly defined scope of work prepared by City staff, without input from the vendor involved here. (Priority 3)

Management Response:

Agree. The contract that is the subject of this investigation has expired and there are no present plans to enter into a new contract.

Target Implementation Date: Not Applicable.

City Auditor comment regarding the target implementation date:

We will continue to monitor City contracts for future awards to the vendor and reserve the option of initiating subsequent investigations to ensure compliance with the City Charter, Municipal Code, and other policies.

Recommendation 9

We recommend that the Audit Committee and City Council, in consultation with the City Attorney's Office, evaluate whether City Charter violations occurred and take appropriate legal action, to the extent that the Audit Committee and City Council have authority to act. (Priority 1)

Management Response:

Not Applicable.

Target Implementation Date: Not Applicable.

Hotline Report of Abuse Related to the Unfair Award of a Multi-Million-Dollar Contract

This investigation was conducted by Fraud Investigator Andy Horita under the authority of California Government Code § 53087.6 which states, in relevant parts:

(b) The auditor or controller may refer calls received on the whistleblower hotline to the appropriate government authority for review and possible investigation.

(e) (2) Any investigative audit conducted pursuant to this subdivision shall be kept confidential, except to issue any report of an investigation that has been substantiated, or to release any findings resulting from a completed investigation that are deemed necessary to serve the interests of the public. In any event, the identity of the individual or individuals reporting the improper government activity, and the subject employee or employees shall be kept confidential.

(3) Notwithstanding paragraph (2), the auditor or controller may provide a copy of a substantiated audit report that includes the identities of the subject employee or employees and other pertinent information concerning the investigation to the appropriate appointing authority for disciplinary purposes. The substantiated audit report, any subsequent investigatory materials or information, and the disposition of any resulting disciplinary proceedings are subject to the confidentiality provisions of applicable local, state, and federal statutes, rules, and regulations.

Thank you for taking action on this issue.

Respectfully submitted,

A handwritten signature in black ink that reads "Kyle Elser". The signature is written in a cursive, flowing style.

Kyle Elser
Interim City Auditor

Attachment A – Definition of Fraud Hotline Recommendation Priorities

DEFINITIONS OF PRIORITY 1, 2, AND 3 FRAUD HOTLINE RECOMMENDATIONS

The Office of the City Auditor maintains a priority classification scheme for Fraud Hotline 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 findings and recommendations.

Priority Class¹	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. A significant internal control weakness has been identified.
2	The potential for incurring significant fiscal and/or equivalent non-fiscal losses exists. The potential for costly and/or detrimental operational inefficiencies exists. The potential for strengthening or improving internal controls exists.
3	Operation or administrative process will be improved.

¹ The City Auditor is responsible for assigning Fraud Hotline recommendation priority class numbers. A recommendation which clearly fits the description for more than one priority class shall be assigned the higher priority.