



## THE CITY OF SAN DIEGO

DATE: December 4, 2017

TO: Scott Chadwick, Chief Operating Officer  
Scott Clark, Interim City Comptroller  
Andrea Tevlin, Independent Budget Analyst

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

SUBJECT: Hotline Investigation of an Information Technology Contract

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On September 14, 2017, the Office of the City Auditor received an anonymous Fraud Hotline report alleging that the Department of Information Technology (DoIT) did not disclose materially important information in a staff report to the City Council, as required by the City Charter. The staff report requested an increase in spending related to an AT&T contract for voice and data services from \$2.88 million to \$17.28 million. Our investigation did not determine that DoIT staff intentionally withheld material information. We determined that the staff report contained inaccuracies, was incomplete, and contained misleading information.

As part of our review of the invoices that were paid related to the contract, we identified an accounting error and referred it to the Office of the City Comptroller for correction. We determined that the process of invoice verification changed recently, and Office of the City Comptroller staff had stopped reviewing all invoices for accuracy and consistency with City policy once a new automated system was put in place.

As soon as we made executive City management aware of the potential \$1 million understatement in the report, the item was pulled from the September 19, 2017 City Council agenda. Our investigation did not determine that any City employee should be subject to discipline related to the staff report to the City Council. DoIT management plans to bring the item to the City Council again in the near future. We recognize that these services are vital to the ongoing operations of the City, and a contract will need to be approved soon.

We made six recommendations to improve disclosures in staff reports, verify the information in the current staff report, and improve internal controls regarding vendor payments. City management agreed with all six recommendations and emphasized that the deficiencies in the staff report were not intentional.



## Hotline Investigation of an Information Technology Contract

### Staff Report to City Council

In a four-page staff report to City Council (see Attachment A), dated August 23, 2017, DoIT staff, and several other contributors to the report from various City departments, requested authorization to amend a contract between the City and AT&T. The contract is part of a statewide cooperative agreement known as CalNet3, and relates to voice and data service lines, or circuits. Previously, the City obtained these services through a contract with Atos. The staff report noted, “The CalNet3 contract allowed the City to assume all telecommunication circuits from Atos starting January 1, 2017.”

The amount requested was an increase to the existing \$2.88 million contract by \$4.8 million. Thus, the amount to be authorized through Fiscal Year (FY) 2018 was \$7.68 million ( $2.88 + 4.8 = 7.68$ ). The request also included authorization for two additional optional extensions of \$4.8 million per year. The total amount of the authorization request for Fiscal Year 2017-20 was \$17.28 million ( $2.88 + 4.8 + 4.8 + 4.8 = 17.28$ ).

The report stated that “the City’s current monthly charges for AT&T are approximately \$320,000.” This equates to \$3.84 million per year ( $.320 \times 12 = 3.84$ ). The staff report noted that the monthly costs “can vary due to usage or the addition of upgraded telecommunication services.”

In addition to the monthly costs, the staff report requested an additional 25 percent to pay for “future enhancements, modernization, and improvements.” The costs associated with the items described “as-needed,” and “upgrades” was an additional \$80,000 per month ( $320 \times .25 = 80$ ), or \$960,000 per year ( $320 \times .25 \times 12 = 960$ ). The list of upgrades included the following five items:

1. Transition of an estimated \$60,000 of monthly services from other providers to AT&T;
2. Modernization and improvements;
3. Capacity upgrades of existing circuits, as needed;
4. Phone usage costs for local and/or long-distance calling; and
5. Additional telecommunications services for City departments, as needed, through the end of Fiscal Year (FY)18.

The base cost for services of \$3.84 million per year and the costs for the as-needed upgrades of \$960,000 per year, totaled \$4.8 million ( $3.84 + .960 = 4.8$ ).

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### **Independent Budget Analyst Report**

During the course of our investigation, the Office of the Independent Budget Analyst (IBA) prepared a four-page report (see Attachment B), dated September 18, 2017. The IBA's report provided clarification regarding the reasons for the requested contract amendment that were missing from the staff report.

The IBA report explained that the City budgets for network services, such as those covered by the contract with AT&T, in the following two ways.

1. through a non-discretionary budget that the Department of IT calculates for all City departments for citywide networks services; and
2. as part of departments' discretionary network budgets, individually requested by departments as an addition to their operating budgets if they require additional or specialized network services.

The IBA report noted that, historically, the monthly costs for AT&T services were part of the non-discretionary budget allocation for all City departments. In the past, these costs were paid indirectly through contracts with other entities, most recently Atos. The new contract involves a direct agreement with AT&T, but the monthly costs would still be part of the citywide non-discretionary cost allocation.

The IBA report revealed that the DoIT staff report omitted the fact that it significantly underestimated the costs for monthly services used in the original contract with AT&T. According to the report, the costs under the original contract of \$160,000 per month were based on incomplete inventory records that had not been maintained by the prior contractors who provided the services on behalf of AT&T. The revised estimate of \$320,000 per month was based on inventory records that staff was "currently reviewing" as of the date of the IBA report.

The IBA report noted that if the new \$320,000 per month estimate was too low, based on the incomplete or inaccurate inventory records, "they have added an \$80,000 monthly contingency" to the contract.

In conclusion, the IBA report stated, "The Department's rationale for entering into the contract is reasonable: the contract maintains the City's required telecommunications services at reduced rates."

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### **Staff Report Lacked Accuracy, Completeness, and Clarity**

We confirmed that the staff report to the City Council was inaccurate regarding the amount “paid-to-date,” as alleged in the anonymous Fraud Hotline complaint we received. According to the City’s financial system, SAP, the amount paid as of the staff report date of August 23, 2017, was \$1.5 million, rather than the \$2.8 million indicated on the report. DoIT staff paid an additional \$1.3 million on September 5, 2017, which is more than two months after the close of Fiscal Year 2017, on June 30. After confirming the initial allegation, we notified executive City management of a possible \$1 million discrepancy and the item was pulled from the agenda.

After the item was pulled from the September 19, 2017 City Council agenda, we continued our investigation and found additional problems with the staff report associated with the AT&T contact.

Specifically, we determined that the staff report did not include material facts related to:

1. Substantial cost estimate errors;
2. Invoice payment problems;
3. Overpayments to AT&T;
4. Potential unpaid FY 2017 invoices; and
5. Contingency expenditures were misleading

#### **1. Staff Report Was Incomplete Regarding Substantial Cost Estimate Errors**

As the IBA report pointed out, the cost estimate related to the original 18-month AT&T contract was for \$160,000 per month. The actual costs were later revised to be closer to \$320,000 per month. According to DoIT management, the reason for the 100 percent under-estimate in monthly costs was due to inaccurate assumptions made by AT&T when they prepared the initial estimate, which was compounded by an inaccurate inventory report provided by Atos. As of the date of this Fraud Hotline report, DoIT staff is still in the process of reconciling the inventory records by City department. Both the cost estimate error and the inventory issues were omitted from the staff report to the City Council.

According to our interviews with DoIT management, the average monthly costs associated with the AT&T contract were twice the amount originally estimated because Atos and AT&T did not provide complete inventory records when AT&T provided the monthly cost estimates. Costs incurred by City departments for AT&T services contributed to the erroneous estimate. As a result, the \$2.8 million, 18-month contract amount was consumed by invoice payments dated January through July 2017. It was not

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clear from the staff report that the original cost estimates for the contract were incorrect due to incomplete and inaccurate inventory records.

One example of the effect of the incomplete inventory records is that DoIT does not have (as of the date of this Fraud Hotline report) a complete inventory of voice and data lines by City department. As the IBA report noted, the inventory of assets “did not include those assets that departments had procured on their own...” It is not possible to accurately allocate costs between General Fund and non-General Fund departments without an accurate and complete inventory of services by department. Ultimately, the costs associated with the AT&T contract are billed to City departments as non-discretionary expenses. It is important to ensure that the inventory records, by department, are complete and accurate.

DoIT management stated that AT&T transferred the lines of service in the six months between September 2016 and March 2017. Because of the increased costs, DoIT staff revised the original purchase order related to the contract from \$690,000 to \$1.5 million before that amount was also exhausted. It was not until May 2017 that DoIT management realized that the actual costs associated with the AT&T contract were double the initial estimate and the not-to-exceed amount on the contract of \$2.88 million was about to be exhausted. DoIT management used the May 2017 invoice costs to estimate the monthly costs of \$320,000 a month.

The staff report to the City Council did not disclose that the monthly service costs were underestimated by 100 percent. Nor did the report disclose the fact that the new estimate for the three years of monthly costs was based on a single month’s data. The invoice amounts are made up of recurring charges, non-recurring charges, adjustments, taxes, and surcharges, all of which could affect the estimate significantly.

We did not evaluate the staff report’s calculations regarding anticipated cost savings of \$888,000 per year. However, during the course of our investigation DoIT management revised the estimated cost savings that were comparable to the original contract, reducing the projected savings to \$110,000. Additional benefits are anticipated based on modernization and conversion of existing circuits of \$624,000 per year.

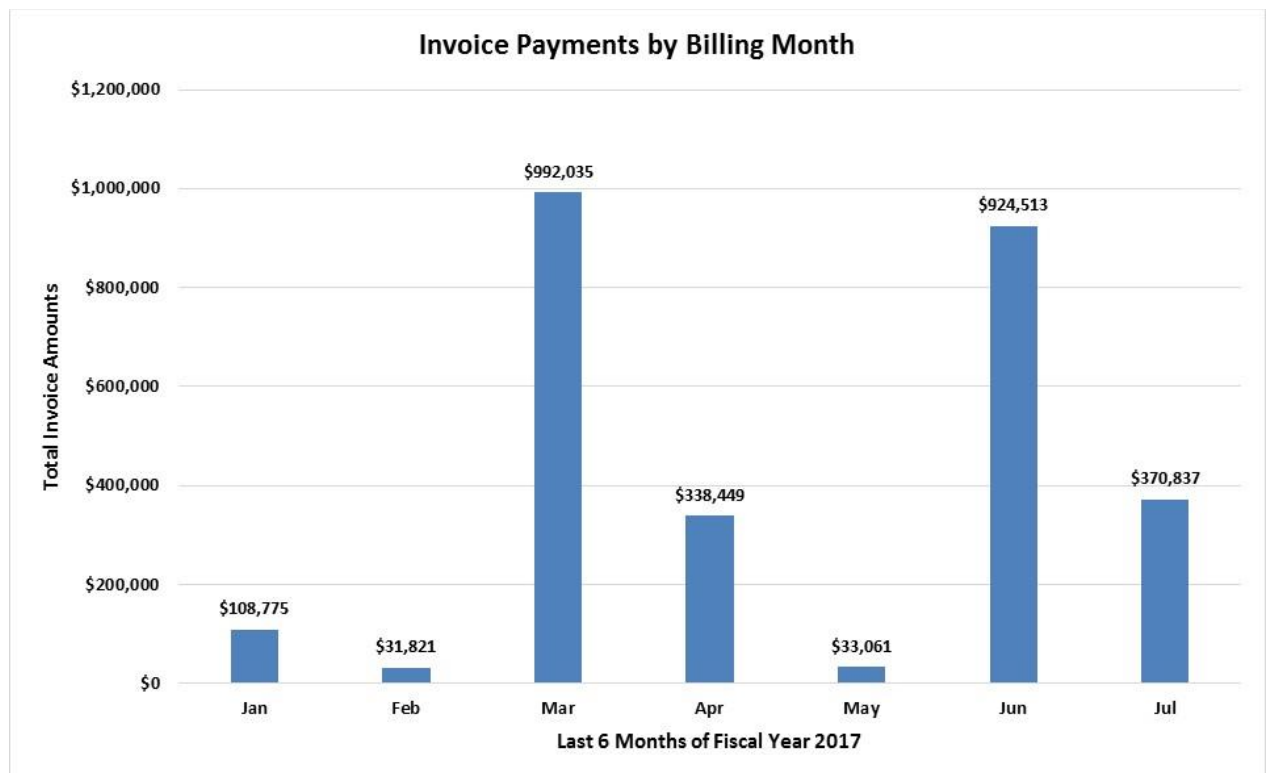
## Hotline Investigation of an Information Technology Contract

**2. Staff Report Was Incomplete Regarding Invoice Payment Problems**

We obtained and reviewed the invoice data in SAP related to the AT&T contract. In total, 43 invoices were paid between February 27 and September 5, 2017. The total amount paid was \$2,799,492.19. **Table 1**, below summarizes the invoice payment amounts by the start date of the invoice. We noted that while most of the invoices were effective on the first day of the month, some began on the 17<sup>th</sup> or 20<sup>th</sup> of the month. The summary below attributes partial months to the month in which the invoice became effective.

**Table 1****Summary of Invoice Payments by Billing Month**

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Although the \$2.8 million paid (as of the date of the scheduled City Council meeting) was included in the staff report, there was no mention of the inconsistent amounts paid each billing month. As such, the City Council would not have been aware of the issues related to the incomplete inventory records discussed previously.

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If the \$320,000 per month estimate was accurate, the expected cost for six months should be only \$1.92 million ( $.320 \times 6 = 1.92$ ), rather than the \$2.8 million paid. When we asked DoIT management about this apparent contradiction, their reply was that the costs really represented closer to nine months of monthly costs. Thus, if the monthly cost was \$320,000, for nine months, the total expenditure would be \$2.88 million ( $.320 \times 9 = 2.88$ ), which was the exact amount of the original contract authorization. However, DoIT management reported that the process of transferring lines from Atos to the City began in September 2016 and AT&T completed the process in March 2017. Therefore, it does not seem consistent that there would be nine full months of charges related to the expenditures. Also, DoIT management used the charges for May 2017 as the basis for the \$320,000 monthly estimate.

DoIT management expected that the transfer in billing would not happen until January 2017 after the six-month disentanglement period under the existing contract with Atos ended (see the staff report, page 2, for a discussion of the disentanglement period), rather than the actual process, which began in September. However, the terms of the AT&T contract made the contract effective in August, rather than January.

### **3. Staff Report Was Incomplete Regarding Overpayments to AT&T**

The early conversion of lines of service resulted in double payments to AT&T by both Atos and the City. In addition, other lines of service that were part of an unrelated Atos contract were incorrectly transferred over to the City, which also caused overpayments. DoIT management estimated the total amount of the overpayments to Atos to be \$603,000. Although DoIT management knew about the overpayments, they did not disclose the credit amount in the staff report. This is significant because the overpayments will result in offsetting credits to AT&T invoices in FY 2018, thus reducing the anticipated expenditure for that year. The City Council may also have been interested to know that there were significant problems related to invoice payments resulting in credits for nearly two months of service.

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#### **4. Staff Report Was Incomplete Regarding Potential Unpaid FY 2017 Invoices**

We determined that the \$2.8 million in invoice payments noted in the staff report included a \$1.3 million payment in September for services in May, June, and July 2017. The original contract authorization was a not-to-exceed amount of \$2.88 million. We asked DoIT management if there were outstanding invoices from FY 2017 that they could not pay because they reached the contract's spending limit. DoIT management replied, "I believe we had some issue with running out of spending authorizing for CALNET so we had some issue making all the payments for FY17. I am getting a list together for you."

DoIT management later stated that the FY 2017 invoices had been paid, but we were unable to verify that information as of the date of this Fraud Hotline report.

The possibility that there were unpaid FY 2017 invoices was not included in the staff report to the City Council. Knowing that the DoIT staff was still in the process of determining the amount owed for FY 2017 would likely have been important information for the City Council to consider when deciding whether to authorize an additional \$14.4 million in spending.

#### **5. Staff Report Was Misleading Regarding Contingency Expenditures**

The AT&T contract includes additional 25 percent contingency (computed as \$80,000 per month or \$960,000 per year) above the base cost of \$320,000 per month ( $320 \times .25 = 80$ ). The staff report describes the additional contingency costs as being for "future enhancements, modernization, and improvements." As stated previously, the staff report listed five items related to these upgrades:

1. Transition of an estimated \$60,000 of monthly services from other providers to AT&T;
2. Modernization and improvements;
3. Capacity upgrades of existing circuits, as needed;
4. Phone usage costs for local and/or long-distance calling; and
5. Additional telecommunications services for City departments, as needed, through the end of Fiscal Year (FY)18.

We pointed out to DoIT management that it did not appear accurate to describe "phone usage costs for local and/or long-distance calling" as "future enhancements, modernization, and improvements." In response to our question about phone usage costs, DoIT management agreed with our assessment and stated that they would revise that reference in the new version of the staff report. According to City management, phone



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usage is the smallest component of the billing, so it would not be a large driver in any contingency, but DoIT accounted for it in case the City's usage exceed the \$8,000 monthly baseline.

In contrast to the DoIT characterization of the 25 percent contingency costs being associated with "future enhancements, modernization, and improvements," the IBA report noted that the additional costs may be used to cover higher-than-expected monthly costs due to inaccurate and incomplete inventory records. Specifically, the IBA report stated:

Because the Department of IT is still working through verifying the asset list, they have added an \$80,000 monthly contingency to the CalNet3 AT&T Agreement. Should this contingency be needed, budget will need to be available from the Department of IT or the asset-owning department's operating department depending upon the nature of the cost.

While the expenditure of the additional 25 percent contingency costs may be due to future upgrades requested by individual departments, it appears that the costs may also be incurred by inaccurate estimates by DoIT due to incomplete inventory data. According to DoIT management, the contingency costs may be used for any purpose, including, but not limited to, monthly service costs.

The inventory data by department is still not complete as of the date of this Fraud Hotline report, the costs associated with FY 2017 are not yet completely known, and the monthly costs were estimated based on a single month of data that may not be representative of average costs over a year of service. Given this uncertainty, the staff report was misleading regarding the nature of the additional 25 percent contingency costs as being intended for as-needed future upgrades. According to City management and DoIT management, the contingency may be used for monthly service costs, if needed.

### **Several Invoices Were Processed in Violation of City Policy or in Error**

Our review of the 43 invoices related to the AT&T contract identified seven invoices that DoIT staff processed in violation of City policy. According to the Office of the City Comptroller's Internal Controls Process Narrative (PN-0026), only original invoices from vendors may be submitted for payment. The policy specifically states that invoices "cannot be altered or modified by City employees." The policy also states, that invoices containing errors, such as the amount charged, are required to be corrected by the vendor and reissued to the City. The exceptions we found contained handwritten amounts and crossed-out amounts.

We learned that the City's policy changed in November after the implementation of a new Vendor Invoice Management system. Prior to November 2016, the Process Narrative required Comptroller staff to review "invoice information entered performing a quality check comparison against the scanned invoice." After the new invoice system was implemented, the goods receipts and payments were assumed to be associated with valid, approved purchases as part of the purchase order process, and the Comptroller staff changed their practice from reviewing every invoice to reviewing a random sample. According to the City policy, the new system includes automated posting once all business rules and validations are completed. According to City management, the automated three-way match (Purchase Order, receiving, and invoice data), and segregation of job duties, are compensating internal controls that make the manual review of all invoices unnecessary.

As our review of the invoices for approximately six months of invoices for one contract reveals, there is a continuing need for additional Comptroller review of scanned invoice data to ensure that the invoice information, including amounts and dates, are accurate, and that invoices are being processed in a manner consistent with City policy. The current City policy includes a review of a sample invoice payments, but it does not appear that the invoices we identified were included in the Comptroller's quality assurance sample.

During the course of our investigation, we identified an invoice that included current charges for services related to July 2017. Since the July 2017 charges were incurred in FY 2018, they should not have been paid in FY 2017. Since this treatment is not consistent with Generally Accepted Accounting Principles, we notified the Office of the City Comptroller of the error. Unfortunately, the Comptroller's staff did not review the invoice carefully and reversed the entire amount of the invoice, which included both FY 2017 and 2018 amounts. The error should be addressed as a training issue.

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### Conclusion

Our investigation found sufficient evidence to substantiate the initial allegation that the DoIT staff report dated August 23, 2017, did not disclose that there were \$1.3 million in unpaid invoices, out of \$2.8 million spent. Our investigation determined that staff anticipated the invoices would be paid prior to the City Council meeting, which was the case. We also determined that the staff report was:

- Incomplete regarding substantial cost estimate errors;
- Missing information regarding invoice payment problems;
- Missing details regarding overpayments;
- Missing information regarding potential outstanding invoices; and
- Misleading regarding contingency expenditures.

In addition to the issues we identified related to the staff report, we identified several invoices that were processed in violation of City policy and one invoice that was processed, then corrected, in error.

City Charter Section 32.1 requires City staff to inform the City Council of “all material facts or significant developments relating to all matters under the jurisdiction of the Council...” According to Black’s Law Dictionary, material information is “[o]f such a nature that knowledge of the item would affect a person’s decision-making; significant; essential.”

Existing City policy, specifically Administrative Regulation 3.20, section 4.4 (c), requires that staff reports to the City Council “Provide as much information as may be needed to answer any anticipated questions.” The policy also requires that the staff reports include background details regarding the proposed action. However, the policy does not require that staff include sufficient background information and details that would be important for the City Council to consider in making their decision. Thus, the Administrative Regulation does not require that staff disclose all material information to the Council, as required under the City Charter.

Our investigation did not determine that any City employee should be subject to discipline related to the staff report to the City Council. The Chief Operating Officer immediately pulled the item from the City Council agenda once we notified him of the results of our preliminary Fraud Hotline investigation.

**Recommendations and Management's Responses (see Attachment C for definitions of Fraud Hotline recommendation priorities):**

1. **We recommend that the Chief Operating Officer ensure that the updated staff report to the City Council related to the "Approval of the First Amendment to the Cooperative Procurement Contract between the City of San Diego and AT&T Corporation for the Provision of Multi-protocol Label Switching (MPLS) Assets and Services" includes all material facts or significant developments that would be important for the City Council to consider in making the contract amendment authorization decision. (Priority 1)**

**Management Response: Agree.**

A new Request for Council Action will be docketed for City Council consideration on December 13, 2017. A revised Report to Council will include historical context and significantly increased material information.

**Target Implementation Date: December 1, 2017**

2. **We recommend that the Chief Operating Officer revise Administrative Regulation 3.20 to ensure that staff reports include all material facts or significant developments necessary for the City Council to make an informed decision. (Priority 2)**

**Management Response: Agree.**

Staff has already begun revising the Administrative Regulation 3.20 and it will include specific instructions as to how to include material facts or significant developments necessary for the City Council to make an informed decision.

**Target Implementation Date: June 30, 2018**

3. **We recommend that the Office of the Independent Budget Analyst review the updated staff report to the City Council related to the “Approval of the First Amendment to the Cooperative Procurement Contract between the City of San Diego and AT&T Corporation for the Provision of Multi-protocol Label Switching (MPLS) Assets and Services” to ensure that the underlying data supporting the calculation of the monthly costs is sufficient and reliable, and to ensure that any additional contingent expenditures are accurately represented, including any amounts that may be used to supplement under-estimated monthly costs. (Priority 1)**

**IBA Response: Agree.**

The Office of the IBA reviews all staff reports for all items that come before the City Council. In the time that is available for our Office to review an item—that is, the time between when the staff report and supporting documentation becomes available for review, to the time when the item is heard at Council—our Office analyzes available, applicable information according to a number of factors including: the clarity of the requests for authorization, the item’s fiscal considerations, and the item’s adherence to Council Policy. As a matter of routine, any information that our Office needs to complete an analysis is requested from staff and discussed at Council, if appropriate.

**Target Implementation Date: June 30, 2018**, as this item is expected to be heard at Council before the end of the fiscal year. Note that the actual date of our Office’s review of the item is dependent upon when the item is docketed.

4. **We recommend that the Office of the City Comptroller take the appropriate corrective action to address the journal entry errors related to the invoice we identified that contained charges for both FY 2017 and 2018. (Priority 2)**

**Management Response: Agree.**

Due to the timing of the investigation and the dollar amount relative to financial reporting thresholds, the referenced journal entry did not materially impact reporting of the City’s financial position in the FY 2017 CAFR, and therefore was within Comptroller discretion and Generally Accepted Accounting Principles to forgo the adjustment. However, staff involved with this transaction are aware of the error and adherence to accrual accounting standards and Process Narrative

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PN-0021 Expenditure Accrual Policy and Review Process has been reiterated for training purposes.

**Target Implementation Date: December 1, 2017**

5. **We recommend that the Office of the City Comptroller revise the Internal Controls Process Narrative regarding Purchase Order invoice processing to strengthen internal controls. (Priority 2)**

**Management Response: Agree.**

The Process Narrative PN-0026 will be revised to reflect appropriate practices regarding processing of vendor invoices. Existing post-process review steps will continue to apply a risk based sampling approach and documented procedures modified as appropriate. In addition, emphasis on internal controls over processing of vendor invoices will continue to be reiterated during annual trainings provided to responsible staff.

**Target Implementation Date: December 31, 2017**

6. **We recommend that DoIT, in coordination with relevant City departments, ensure that the non-discretionary IT cost allocations, by City department, are complete and accurate. (Priority 2)**

**Management Response: Management agrees with this recommendation.**

The Department of Information Technology is in the process of procuring and implementing a software solution to manage the inventory for telecommunications services and refine the existing allocation that is based on PC and phone counts in City departments. The new solution will complete a more detailed allocation of phone and network costs by splitting shared services while fully allocating specific services that are dedicated to a single department.

**Target Implementation Date: October 31, 2018**

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The information in this report is being provided to you under the authority of California Government Code §53087.6, which states:

(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 "Eduardo Luna". The signature is written in a cursive, flowing style.

Eduardo Luna  
City Auditor

Hotline Investigation of an Information Technology Contract

**Attachment A – Staff Report to City Council Dated August 23, 2017**



The City of San Diego

Staff Report

DATE ISSUED: 8/23/2017

TO: City Council

FROM: Department of Information Technology

SUBJECT: Approval of the First Amendment to the Cooperative Procurement Contract between the City of San Diego and AT&T Corporation for the Provision of Multi-protocol Label Switching (MPLS) Assets and Services

Primary Contact: Shawn Killpack Phone: (619) 533-3059

Secondary Contact: Jonathan Behnke Phone: (619) 533-3637

Council District(s): Citywide

OVERVIEW:

This action requests the approval of a resolution to authorize the City to execute an amendment to a Cooperative Procurement Contract for the Provision of Multi-protocol Label Switching (MPLS) Assets and Services ("Telecommunication Services") between the City and AT&T Corporation, increasing the not-to-exceed amount by \$4,800,000 to a total of \$7,680,000 on the initial term of the Agreement, and up to a total of \$17,280,000 inclusive of options to renew for the full term of the Agreement. This increase is required to accommodate the acquisition of additional inventory and modernization of current infrastructure, but will result in lower monthly service rates and usage charges. Discounts through the Agreement from previous monthly rates are estimated to result in cost savings of approximately \$624,000 a year for data telecommunications services, with an additional savings of approximately \$264,000 annually projected for local and long-distance calling, for an estimated net overall savings of \$888,000 per year.

PROPOSED ACTIONS:

1. Approve the resolution to authorize the Mayor or his designee to execute, for and on behalf of the City, the First Amendment to the CalNet3 Cooperative Procurement Contract between the City of San Diego and AT&T Corporation for telecommunications services, to increase the not-to-exceed amount of the current term of the Agreement by \$4,800,000 from \$2,880,000 to \$7,680,000. This includes \$3,840,000 for Fiscal Year 2018 expenses plus an additional as-needed 25% or \$960,000 for upgrades and modernization, and two optional years (FY19 and FY20) that, if renewed by the State, would increase the not-to-exceed amount for the full term of the Agreement, to \$17,280,000, and otherwise modifying the Agreement pursuant to the terms and conditions contained in the First Amendment to the original Agreement on file with the City Clerk as Document No. R-\_\_\_\_\_.
2. Authorize the Chief Financial Officer to expend an amount not to exceed \$17,280,000 over the full term of the Agreement, including any options to renew, contingent upon the adoption of the Annual Appropriation Ordinance for the applicable fiscal year and contingent upon the Chief Financial Officer first furnishing one or more certificates certifying that funds necessary for expenditure are, or will be, on deposit with the City Treasurer.

DISCUSSION OF ITEM:

Prior to 2012, all telephone and voice data services were provided by San Diego Data Processing Corporation. On July 1st, 2012, the City of San Diego awarded a contract to Xerox State & Local Solutions, Inc. ("Xerox") to provide Network Services. This included providing telephone and data telecommunications services ("circuits") as a pass-through expense in the contract. As part of their contract, Xerox assumed the AT&T and Cox contracts from San Diego Data Processing Corporation and billed the City monthly for the cost of providing those circuits. On July 1, 2015, Atos Governmental Outsourcing Services, LLC ("Atos") assumed the Network Services contract from



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Xerox to provide network services to the City to finish out the remaining Network Services contract with no changes to the terms and conditions.

Early in the Network Services contract, Xerox modernized the City's telephone system from an analog system to a new digital Voice over Internet Protocol ("VoIP") system. This change allowed internal phone calls to be made over the City's digital network saving usage charges from AT&T and brought about many technical improvements.

The remaining telecommunication services from AT&T includes telephone services for many Departmental Call Centers that service the public along with data circuits that connect all the City's computer systems together. This contract does not provide the services for 911 phone calls from the public but provides backend data circuits to the Police and Fire computer systems that are used to dispatch and service 911 calls.

The original agreement that Xerox assumed from San Diego Data Processing Corporation expired on July 1, 2016. After expiration and a 6-month disentanglement period, the government discounted rates for circuits would no longer be available to Atos and the City without a new contract. Atos explored renewing the contract with AT&T but could not obtain the same level of discounts. Atos explored moving all the circuits to other providers, but could not produce an agreement that provided an acceptable level of savings to the City.

The City explored its options to mitigate significant cost increases and identified a solution from the State of California to provide better terms and better pricing through a cooperative contract for telecommunications services.

The State of California Department of Technology Services procures deeply discounted telecommunications services known as CalNet through volume purchases on behalf of itself and other state and local government agencies. The State completed its most recent CalNet Request for Proposal (RFP) process and awarded the CalNet3 contract to AT&T on November 15, 2013.

The CalNet contracts for telecommunications and enterprise network services offer the best terms and pricing for governments due to the volume of city and county agencies in California using them to procure circuits and other services.

Section 22.3208 of the San Diego Municipal Code authorizes the City to use a cooperative procurement contract awarded by another agency where the City's Purchasing Agent certifies in writing that the cooperative procurement contract is in the City's best interests, to the City's economic advantage, and the agency's contract was awarded using a process that complies with the policies, rules, and regulations developed and implemented by the City Manager. The City evaluated the CalNet agreement with AT&T and agreed that it met all criteria.

On August 19, 2016, the City of San Diego entered into an agreement with AT&T for a term of one year and six months plus two additional one-year options to utilize the CalNet3 contract to purchase a comprehensive array of telecommunications services including local and long-distance services, voicemail, call routing services, and internet services. The CalNet3 contract allowed the City to assume all telecommunication circuits from Atos starting January 1, 2017.

The City anticipates significant savings for telecommunication services through the CalNet3 Agreement. The contract pricing is fixed for the term of the contract (including options to renew), but also provides the City with flexibility to terminate services on a month-to-month basis. If the market provides opportunities for more competitive rates or modernized services, the City has the flexibility to terminate the agreement without having to pay termination fees.

### STAFF RECOMMENDATION:

Approve a resolution authorizing the Mayor or his designee to execute the First Amendment to the Cooperative Procurement Agreement between the City of San Diego and AT&T, for telecommunications services to authorize the related expenditure of funds.

### City Strategic Plan Goal(s)/Objective(s):

## Hotline Investigation of an Information Technology Contract

Goal #1: Provide high quality public services

Objective #1: Promote a customer focused culture that prizes accessible, consistent, and predictable delivery of services.

Goal #1: Provide high quality public services

Objective #4: Ensure equipment and technology are in place so that employees can achieve high quality public service.

Fiscal Considerations:

Discounts through the Agreement from previous monthly rates are estimated to result in cost savings to the City of approximately \$624,000 a year for data communications services, with an additional savings of approximately \$264,000 annually projected for local and long-distance calling, for an estimated net overall savings of \$888,000 per year.

Under the CalNet3 AT&T agreement, the City's current monthly charges for AT&T are approximately \$320,000 a month (\$3.8 million annually) but can vary due to usage or the addition of upgraded telecommunication services. The City is requesting to increase the spending authority under CalNet3 with AT&T by \$4.8 million through the current term expiring on June 30<sup>th</sup>, 2018, and by \$9,600,000 through any options to renew to a new total amount not to exceed amount of \$17,280,000.

The Fiscal Year impact can be seen in the following table:

			Extension Option	Extension Option	
	FY17	FY18	FY19	FY20	Subtotal
FY Impact	\$2.88m	\$4.80m	\$4.80m	\$4.80m	\$17.28m
Calculation	Paid-to-date	\$320,000 x 25% x 12 months	\$320,000 x 25% x 12 months	\$320,000 x 25% x 12 months	FY17 + FY18 + FY19 + FY20

In addition to the current monthly costs of \$320,000, the City has also included an additional 25% for future enhancements, modernization, and improvements including:

1. Transition of an estimated \$60,000 of monthly services from other providers to AT&T;
2. Modernization and improvements;
3. Capacity upgrades of existing circuits, as needed;
4. Phone usage costs for local and/or long-distance calling; and
5. Additional telecommunications services for City departments, as needed, through the end of Fiscal Year (FY)18.

The telecommunications costs will be billed to Departments as non-discretionary expenses. New additions or upgrades will be billed back to Departments as discretionary expenses via separate POs before the implementation of new services. Departments will be required to maintain their respective budget spending authorities.

Expenditure of these funds is contingent on sufficient funding being included in each participating City department's approved budget each fiscal year. By increasing the expenditure authority, the City is not obligated to spend up to the maximum amount of the agreement.

Environmental Impact:

This activity is not a "project" as defined in CEQA Guidelines Section 15378 because it involves execution of a contract which, on its own accord, will not cause a significant environmental impact. As such, this activity is not subject to CEQA pursuant to Section 15060(c)(3). This determination is predicated on Section 15004 of the guidelines, which provides direction to lead agencies on the appropriate timing for environmental review.

Equal Opportunity Contracting Information (if applicable):

## Hotline Investigation of an Information Technology Contract

This Agreement is not subject to the City's Equal Employment Opportunity Outreach Program (San Diego Ordinance No.18173, Section 22.2701 through 22.2708).

This Agreement is subject to the City's Non-Discrimination in Contracting Ordinance (San Diego Municipal Code Sections 22.3501 through 22.3517).

Previous Council and/or Committee Actions:  
Not applicable.

Key Stakeholders and Community Outreach Efforts:  
The key stakeholders associated with this item includes all City residents and businesses, Small and Local Business and Enterprises, Local Community Outreach Programs, and City Employees.

Jonathan Behnke

Chief Information Officer

Ron H. Villa

Deputy Chief Operating Officer

**Attachment B – Staff Report to City Council Dated August 23, 2017**



THE CITY OF SAN DIEGO

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**OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT**

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**Date Issued:** September 18, 2017

**IBA Report Number:** 17-30

**City Council Docket Date:** September 19, 2017

**Item Number:** 330

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## **Review of the Request for City Council Approval of the First Amendment to the Cooperative Procurement Contract between the City and AT&T Corporation**

### **OVERVIEW**

The Department of Information Technology (IT) provides operational support for the City's IT applications, infrastructure, and wireless technologies. The Department also manages citywide IT services contracts that support City staff's ability to perform their work including: communicate via phone, email, or web interface with other staff members and City residents; store and retrieve large amounts of data; and support or create applications that support staff transactions, communication, analysis, and other efforts. Department of IT staff provide some of these services directly to client departments, as well as manage large, citywide IT services contracts on behalf of the City. An amendment to one of these contracts—for telecommunications services with AT&T Corporation (AT&T)—that includes the potential for two one-year extensions, is being brought to Council for approval as the proposed costs of the contract has changed in its current term. The full amount of the contract amendment and two one-year options for renewal is approximately \$17.3 million.

In preparing for this report, our Office met with Department of IT staff to discuss the proposed contract amendment. This report provides some clarification on the reasons for this contract amendment, reviews the costs associated with those services, and recommends some questions that Council may wish to ask in consideration of this item.

**OFFICE OF THE INDEPENDENT BUDGET ANALYST**  
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TEL (619) 236-6555 FAX (619)-236-6556

## Hotline Investigation of an Information Technology Contract

### BACKGROUND

The City contracts with AT&T for a number of telecommunications services including data circuits, voice circuits, internet, and analog telephone lines. AT&T has been the City's service provider for a number of years: the City had used San Diego Data Processing Corporation (SDDPC) for its IT needs and SDDPC had procured telecommunications services from AT&T on the City's behalf. When the City moved from working with SDDPC to contracting with Xerox State & Local Solutions (Xerox) for citywide network needs in FY 2013, the contract with AT&T was transferred from SDDPC to Xerox. Subsequently, Xerox's IT Outsourcing business was acquired by Atos Governmental Outsourcing Services, LLC (Atos), and Atos assumed the City's network contract including the AT&T pass through expense. The City budgets for its network services in two ways: 1) through a non-discretionary budget that the Department of IT calculates for all City departments for citywide networks services; and 2) as part of departments' discretionary network budgets, individually requested by departments as an addition to their operating budgets if they require additional or specialized network services.

The SDDPC contract for AT&T services that Xerox, and subsequently Atos, assumed, expired on July 1, 2017. Atos was not able to secure a replacement contract at a comparable cost and the City explored other options, eventually entering into a contract with AT&T through the State's telecommunications cooperative procurement contract (CalNet3). The contract was signed in August 2016, and was for the term January 2017 through June 2018, with two one-year extension options. Compensation for the original term of the contract was a not-to-exceed amount of approximately \$2.9 million, which is under the \$3.0 million threshold for Council approval. The \$2.9 million 18-month contract was a reduction in network costs of \$3.0 million from the City's previous contract, which would have been approximately \$5.9 million over that same time period. The Department of IT notes that there was a reduction in the budgeted allocation for the Atos contract to account for the fact that the City was now contracting directly for AT&T's services.

However, per Department of IT staff, since the City has contracted directly with AT&T, it has become apparent that the number of telecommunications assets (circuits and analog telephone lines) that the City believed it had was not a complete inventory list. Atos charged the Department of IT \$329,000 per month, the cost of the citywide assets that were being supported by the AT&T contract and that were included in the non-discretionary network charge in departments' operating budgets. However, the inventory of those assets only reflected the items maintained by the Department of IT, it did not include those assets that departments had procured on their own through the Atos contract (or previously through the Xerox and SDDPC contracts.) Additionally, a complete list of department-procured assets and their associated costs, had not been maintained by SDDPC, Xerox, or Atos and so the Department of IT had no visibility into the full number of assets or why departments required them.

Therefore, when the City entered into the contract with AT&T through CalNet3, it had an inventory number that did not capture all of the City's assets. Based on the inventory list that it did have, the Department of IT believed that the CalNet3 Agreement would afford the City significant savings: a cost of \$160,000 per month compared to the \$329,000 per month paid to Atos.

However, after the Agreement was entered into AT&T confirmed that City assets requiring AT&T services was larger than what had originally been thought, and that the true cost was \$320,000 per month, not \$160,000. The Department of IT worked with AT&T to produce a full list of City

## Hotline Investigation of an Information Technology Contract

assets, and department staff is currently reviewing the list to verify that all assets belong to the City and that they are still being utilized. Because the Department of IT is still working through verifying the asset list, they have added an \$80,000 monthly contingency to the CalNet3 AT&T Agreement. Should this contingency be needed, budget will need to be available from the Department of IT or the asset-owning department's operating department depending upon the nature of the cost.

Therefore, while the CalNet3 AT&T Agreement includes some reduced costs for the City—mostly due to reductions in long-distance rates and legacy internet connections—there will be no related reductions in costs to the City if the contingency is expended. The table below outlines monthly and annual costs associated with the services when provided through Atos, the original CalNet3 contract, and the proposed contract Amendment 1, as described in the preceding paragraphs. Note, however, that the Atos contract amount in the table below **only includes citywide network costs, not the cost of the assets paid for separately by departments with their discretionary funds.** As mentioned earlier, the Department of IT is still reviewing the list of departments' network assets, and so the total annual cost of departments' discretionary network inventory under the Atos contract is not known at this time.

AT&T Telecommunications (Network) Services			
	Inventory	Monthly (\$)	Annual (\$)
Atos Contract <sup>1</sup>	Citywide AT&T telecommunications services managed by the Department of IT only	\$ 329,000	\$ 3,948,000
Original CalNet3 Agreement	All City AT&T telecommunications services	\$ 160,000	\$ 1,920,000
Amended CalNet3 Agreement <sup>2</sup>	All City AT&T telecommunications services	\$ 400,000	\$ 4,800,000

<sup>1</sup>Amount of Atos contract for AT&T telecommunications services includes general citywide costs only. Some City departments had purchased circuits from Atos directly and those costs are not included in this figure.

<sup>2</sup>Amount of amended CalNet3 contract includes costs of \$320,000 per month—a slight decrease to the monthly costs under the Atos contract—with an additional 25%, or \$80,000, in contingency for future enhancements, modernization, and improvements. This dollar amount represents projected expenses for all City AT&T telecommunications services (general citywide services and services requested directly from individual departments.)

## ITEMS FOR COUNCIL CONSIDERATION


The Department of IT is requesting that Council approve an amendment to the City's current contract with AT&T through CalNet3. The Department's rationale for entering into the contract is reasonable: the contract maintains the City's required telecommunications services at reduced rates. However, the reasons for the need to increase the not-to-exceed amount of the contract raise questions that Council may wish to consider as part of the review of the item:

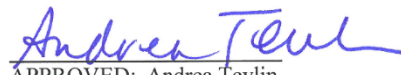
1. The not-to-exceed amount of the contract is being increased, due primarily to the inclusion of previously unaccounted for City telecommunications assets. **What steps is the Department of IT taking to fully account for City IT inventory related to this and other contracts?**
2. The Department of IT is requesting City Council approval to increase the current term of the contract plus approve future options to renew for a total not-to-exceed amount of approximately \$17.3 million. Council will not have the opportunity to review this contract

Hotline Investigation of an Information Technology Contract

again until the options through FY 2020 have been exercised, or if the not-to-exceed amount is projected to be surpassed. **If Council is interested in an update on the City's telecommunications asset inventory or progress on citywide telecommunications upgrades and improvements, Council could consider requesting the Department to return to Council or Committee with an annual citywide IT services report.**

Should Council wish to receive additional information on the City's IT contracts or services, our Office is available to work with the Department of IT in this endeavor.

  
Christiana Gauger  
Fiscal & Policy Analyst

  
APPROVED: Andrea Tevlin  
Independent Budget Analyst

**Attachment C – 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.

<b>Priority Class<sup>1</sup></b>	<b>Description</b>
<b>1</b>	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.
<b>2</b>	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.
<b>3</b>	Operation or administrative process will be improved.

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<sup>1</sup> 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 number.