



THE CITY OF SAN DIEGO

DATE: February 11, 2019
TO: Honorable Members of the Audit Committee
FROM: Kyle Elser, Interim City Auditor
SUBJECT: Recommendation Follow-up Status of Outstanding Purchasing and Contracting Department Recommendations

Transmitted herewith is the recommendation follow up results for the Purchasing and Contracting Department's (P&C) open recommendations as requested at the November 28, 2018 Audit Committee meeting. The committee made a motion to have OCA provide a special recommendation follow up status report on all Purchasing and Contracting open recommendations.

We would like to thank P&C staff for their assistance and cooperation during this process. The audit staff members responsible for this recommendation follow up memorandum are Andy Horita, Sunny McLernon, Stephen Gomez, and Danielle Knighten.

Results in Brief

The Audit Committee requested a status update on all of P&C's open recommendations from prior audit reports issued between Fiscal Years (FY) 2014 through 2017. These audit reports addressed both contract management and contractor debarment deficiencies.

In July 2017, P&C implemented a software solution that addresses the intent of the auditor's recommendations for stronger contract management. Since the system go-live, all contracts that P&C has created or moved into the new system benefit from the automated preventative controls in place. However, the legacy contracts outside the new system do not have the same level, if any, preventative controls in place. According to P&C management, approximately 232 contracts (34 percent) of the contracts are in the new system which account for approximately \$1 billion in contract value, while 445 contracts (66 percent) of contracts reside in the previous system, also account for approximately \$1 billion in contract value.

P&C indicated that it plans to move the remaining contracts into the new system by the end of Calendar Year 2020. Additionally, P&C stated that they have mitigating controls for four of the nine outstanding audit recommendations to address contract management deficiencies for contracts that reside in the previous system. The auditor is currently working with P&C to confirm the implementation of these recommendations and those results will be reported in our semi-annual Recommendation Follow Up report.

P&C plans to address the auditor's recommendations related to the debarment of vendors, but the implementation has been delayed. According to P&C, required changes to the San Diego Municipal Code (SDMC) should be completed in the spring, at which time P&C plans to submit their updates to the debarment Administrative Regulation (AR) to align with the SDMC revisions.

In total, these audits resulted in 14 recommendations addressing contract management and vendor debarment which fall under the purview of P&C and remain "In Process". We have summarized the status of all those recommendations in the following pages.

Background

Contract Management Recommendations Summary

In FY 2015 The Office of the City Auditor (OCA) issued an audit report and a memorandum to the Audit Committee regarding Purchasing & Contracting's (P&C) Citywide contract oversight. The scope of these reports included a review of the risks related to the decentralized contract administration functions. We reviewed open contracts during FY 2014 along with policies and procedures used by contract administrators to monitor and manage contracts from issuance to closeout. Additionally, we reviewed contract administrators assigned to Citywide contracts, and system controls designed to prevent City staff from exceeding contract thresholds.

The memorandum issued by the OCA reported the following findings:

- 1) Contract administrators had not been assigned to monitor contactor performance for approximately 97 Citywide goods and services contracts; and
- 2) The critical control designed to prevent City staff from exceeding contract thresholds (contract values) was ineffective.

The subsequent audit report on Citywide contract oversight that was issued later in FY 2015 included the findings that the City does not have a standardized contract administration process to ensure compliance with contractual terms and receipt of contracted goods and services; and that that the City's contract modification and closeout processes required improvement.

As a result of the findings, the Audit Committee subsequently asked us to review a selection of City contracts to identify potential impacts of contract oversight deficiencies or loss to the City due to the weaknesses identified in the FY 2015 audit of Citywide contract oversight. The FY 2016 audit of select contracts found both administrative (contract creation and execution) and oversight issues for the six contracts reviewed. Among other things, the FY 2016 audit of select contracts reported the following P&C oversight issues:

- 1) Two contracts were not properly executed; three extensions were not completed before the contracts lapsed; and for one contract we reviewed, work was performed before the contract finalized.
- 2) Purchase orders were not properly linked to existing contracts in two instances. It is more efficient to link the purchase order to an existing contract because it saves time for the department. Also, if purchase orders are not properly tied to a contract, it reduces the transparency of City spending and may increase the risks of violating procurement policies.
- 3) Invoices were paid without verification that contract pricing was charged.

Efforts Related to Recommendation Implementation

The P&C Director indicated that with the implementation of the Ariba (new) system in July 2017, the recommendations related to contract administration will be addressed. Based on discussions with P&C management, the Ariba system is designed to strengthen the internal controls over contract administration and oversight, which would meet the intent of the recommendations, if all the contracts were in the system. However, initially only new contracts were executed through this system and existing contracts were maintained outside of Ariba, in SAP. Contracts in SAP do not have the benefits of the contract administration controls the Ariba system provides.

P&C has started to upload legacy contracts into Ariba. P&C has stated that it expects to have all contracts that have not yet expired in the Ariba system by the end of Calendar Year 2020. As of the issuance of this report, P&C reports it has approximately 232 contracts (34 percent)¹ of its contracts in Ariba and approximately 445 contracts (66 percent)² in SAP's contract module. P&C also reports the total contract value that each system currently holds contracts is approximately \$1 billion, which presents a significant risk for the contracts outside of Ariba. However, based on our discussion with P&C, it may have mitigating controls for contracts still in the SAP module.

In response to our recommendation that P&C should act to ensure the Target Value of all contracts is enforced, P&C has indicated that it does have a process to ensure that the Target Value of contracts not yet in Ariba cannot be circumvented or inappropriately changed. P&C indicated that within SAP, the Target Value of the contracts is a required field, and that very few personnel have the system permissions to modify it. Secondly, all purchase orders that are not tied to contracts (SAP Outline Agreements) are automatically routed through P&C for approval and their new process requires the department to justify it not being tied to a contract.

Additionally, P&C reports that quarterly the Department of Finance's Internal Controls Division (division) sends P&C management a report identifying all active purchase orders that are not linked to a contract. P&C is tasked with reviewing each of the purchase orders and responding in

¹ According to P&C, the contracts in Ariba account for 34 percent of total contracts, however, they account for approximately 51 percent (approximately 1.084 billion dollars) of total City executed contract values.

² According to P&C the contracts outside Ariba account for 66 percent of total contracts; however, they account for approximately 49 percent (approximately 1.026 billion dollars) of total City executed contract values.

writing to the division justifying the purchase order or closing it. If it is found that a purchase order was improperly created, on the spot training is provided by P&C to the group that created the purchase order.

Vendor Debarment Recommendations Summary

There are currently five outstanding recommendations related to debarment within the purview of P&C. The earliest recommendation was made in our March 2014 Hotline Investigation Report of Public Utilities Warehouse Supply Purchases. That recommendation was for P&C to act on the referral from the Public Utilities Department for debarment of two vendors. As we noted in our original report, one of the vendors admitted to providing two generators and cash to an employee in exchange for receiving supply orders. The initial response was that P&C was “pursuing debarment of one of the people involved with one of the now-defunct businesses.” Annual status updates since 2015 indicated that P&C was waiting for an AR to be drafted and mentioned that the SDMC was being revised. The latest update was that P&C was “determining next steps to follow upon final approval of the implementing Administrative Regulation.”

The second and third recommendations were to design policies and procedures related to debarment and debarment appeals. AR 25.90 was published and effective on January 18, 2019, but has since been removed for revision. The procedures outlined in the AR would have satisfied some, but not all of our recommendations.

The fourth recommendation was made in March 2016 based on two subsequent Fraud Hotline reports regarding the same two vendors identified in our March 2014 report. City management made a policy decision to wait to proceed with possible debarment until an update to the SDMC was complete in late 2016. However, after the SDMC revisions were complete, an unrelated vendor was successfully debarred for a one-year period that ended in January 2018. At the time of the debarment there was no AR in place.

Our fifth recommendation was made in our June 2017 Fraud Hotline Investigation of a City Vendor report. This recommendation for permanent debarment was based on a vendor who apparently made material false statements during the bidding process and submitted potentially-fraudulent documents to the City after the contract was awarded. The response was that P&C “and the City Attorney’s Office have conducted a thorough, and independent investigation and will proceed with proper notice and action afforded under the San Diego Municipal Code.” Most recently, P&C responded that the vendor was determined to be non-responsible in July 2017, is “effectively precluded” from receiving City contracts for five years, and will “make a determination as to whether further action is warranted.” We note that the non-responsible vendor process is not the same as permanent debarment.

At the November 28, 2018 Audit Committee meeting, a motion was made and approved for the Office of the City Attorney to draft a memo on debarment issues. That memo has not been published as of this report.

Each recommendation and its status related to contract management under P&C’s purview is listed in **Exhibit 1**, while each recommendation related to debarment are listed in **Exhibit 2**.

Recommendation Status

Exhibit 1:

Status of Contract Administration Recommendations under Purchasing & Contracting Purview

Report & Rec #	Recommendation	Status
15-012 #1	<p>The Purchasing & Contracting Director should take immediate action to ensure contract administration responsibilities are assigned to appropriate personnel for all Citywide contracts and provide those individuals with the tools to properly monitor each contract. This should include but is not limited to providing a copy of contract with all terms and conditions listed, pricing agreements, and the responsibilities involved with contract administration. (Priority 2)</p> <p>Original Target Date: April 2015</p>	<p>Reported Implemented; Pending Auditor Review</p> <p>P&C has stated the all Citywide contracts are managed by P&C, and as part of their process, they assign contract managers and provide the required tools to monitor and manage them.</p> <p>The OCA is reviewing evidence to confirm the recommendations implementation.</p> <p>Revised Target Date: April 2019</p>
15-012 #2	<p>The Purchasing & Contracting Director should take immediate action to ensure the Target Value control is enforced on contractual purchases. Specifically, the Director should implement the following detective controls:</p> <ul style="list-style-type: none"> a) Ensure that the report in development will clearly identify orders made without references to the appropriate contract and his staff is trained to utilize the report. b) Create a policy defining the intervals of review and actions taken to correct the control weakness. c) Additionally, the Director should review the potential for preventative controls to minimize the 	<p>Reported Implemented; Pending Auditor Review</p> <p>P&C informed the auditor they have created a process to review all Purchase Orders that are not tied to a contract, with mitigating controls enforced by the internal controls department to review these exceptions.</p> <p>The OCA is reviewing evidence to confirm the recommendations implementation.</p> <p>Revised Target Date: April 2019</p>

Report & Rec #	Recommendation	Status
	<p>d) circumvention of the Target Value control. (Priority 2)</p> <p>Original Target Date: N/A</p>	
<p>15-016 #1</p>	<p>To ensure accurate contractual information and supporting documentation are available to Citywide contract administrators and users, the Chief Operating Officer should establish policies and procedures to require:</p> <ul style="list-style-type: none"> a) All City contracts utilize an SAP Outline Agreement to centralize contract information and utilize centralized controls, access and reporting in the Citywide financial system; b) The City should track total contract awards in SAP in accordance with the full value of the awarded contract to facilitate accurate controls and reporting; c) The configuration of contract terms is standardized in SAP, in accordance to contractual terms, to facilitate better control and reporting across all contract, including the Target Value, Total Award Value, and Contract Validity Dates; and d) Supporting contracting documentation is centralized and stored electronically in SAP, i.e. attaching all contracts and related documentation to an SAP Outline Agreement. <p>Additionally, the Chief Operating Officer should establish responsibility for training contracting staff in Purchasing & Contracting and Public Works Contracting Group to ensure that information is tracked</p>	<p>Pending Remaining Contract Import into Ariba</p> <p>P&C informed the auditor that contracts within the Ariba system meet the recommendation requirements; however, the remaining contracts will not be corrected until they are imported into Ariba.</p> <p>Revised Target Date: December 2020</p>

Report & Rec #	Recommendation	Status
	<p>uniformly in SAP according to the developed policies and procedures. (Priority 2)</p> <p>Original Target Date: January 2017</p>	
<p>15-016 #2</p>	<p>The Chief Operating Officer should establish procedures detailing requirements for contract administrators, defining the responsibilities they have to complete prior to approving invoices for payment and submitting them to Comptrollers for processing. Specifically, the procedures should include:</p> <ul style="list-style-type: none"> a) Develop analytical procedures to ensure that payments are made in compliance with contractual costs and fees. b) Attach the pertinent documentation supporting the payment approval in the SAP Invoice as defined in the contract's Quality Assurance Surveillance Plan to ensure the payment can be verified as appropriate. c) Establish responsibility for training contract administrators on procedures that must be accomplished prior to recommending or approving invoices for payment. d) Establish responsibility for monitoring the contract administrators' responsibilities prior to recommending or approving invoices for payment. 	<p>Pending Remaining Contract Import into Ariba</p> <p>P&C informed the auditor that contracts within the Ariba system meet the recommendation requirements; however, the remaining contracts will not be corrected until they are imported into Ariba.</p> <p>Revised Target Date: December 2020</p>

Report & Rec #	Recommendation	Status
	<p>e) An annual review of the City's contract administration invoice approval process to ensure it is working as intended and effective; additionally, the policies and procedures should be updated as necessary resulting from this review. (Priority 2)</p> <p>Original Target Date: November 2015</p>	
<p>15-016 #3</p>	<p>The Chief Operating Officer should design policies and procedures detailing a standardized citywide contract administration process to mitigate the City's contractual risks and ensure compliance with contractual terms and receipt of contracted construction, reconstruction, repairs, goods, and services. At a minimum the contract administration requirements should include:</p> <ul style="list-style-type: none"> a) Preparation of a Quality Assurance Surveillance Plan for each contract awarded to be attached and maintained with supporting documentation to the SAP Outline Agreement; b) Mandatory training for contract administrators in contract monitoring and ethics; and c) An annual review of the City's contract administration oversight process to ensure it is working as intended and effective; additionally, the policies and procedures should be updated as necessary resulting from this review. (Priority 2) <p>Original Target Date: November 2015</p>	<p>Pending Remaining Contract Import into Ariba</p> <p>P&C informed the auditor that contracts within the Ariba system meet the recommendation requirements; however, the remaining contracts will not be corrected until they are imported into Ariba.</p> <p>Revised Target Date: December 2020</p>

Report & Rec #	Recommendation	Status
15-016 #4	<p>The Purchasing & Contracting Department should clearly define the contract amendment and close-out processes for goods, services and consultant contracts, including amendment and close-out tasks and responsible parties. Specifically, P&C should:</p> <ul style="list-style-type: none"> a) Develop contract amendment and contract close-out policies and procedures around the process to ensure that it is performed uniformly across contract types, but with adjustable scope based on contract size and type. b) Identify aspects of the process that can be automated in the Citywide Financial System where possible. c) Provide training to Citywide Contract Administrators on the new policies and procedures developed for the contract amendment and close-out processes. (Priority 3) <p>Original Target Date: November 2016</p>	<p>Reported Implemented; Pending Auditor Review</p> <p>P&C may have centralized management of the required contract documentation for this recommendation. We have requested the process documenting the management, storage, and retirement of the contract documentation to review and mark this recommendation as implemented.</p> <p>This recommendation also requires P&C to train their staff on this process; we have also requested evidence to support this requirement.</p> <p>The OCA is reviewing evidence and will make a determination of the status of this recommendation for our semi-annual recommendation follow up report.</p> <p>Revised Target Date: April 2019</p>
15-016 #7	<p>The Chief Operating Officer (COO) should require the completion of a standardized performance evaluation upon contract completion for both CIP and non-CIP contracts. Specifically, the COO should develop policies and procedures for vendor performance evaluations that:</p> <ul style="list-style-type: none"> a) Are defined at a high enough level for both the Purchasing and Public Works departments to use and add 	<p>Pending Remaining Contract Import into Ariba</p> <p>P&C informed the auditor that contracts within the Ariba system meet the recommendation requirements; however, the remaining contracts will not be corrected until they are imported into Ariba.</p>

Report & Rec #	Recommendation	Status
	<p>more detailed information as appropriate.</p> <p>b) Define specified periods in a contract lifespan.</p> <p>c) Ensure that all evaluations are centrally attached to vendor record, such as the SAP Vendor Master files Attachment.</p> <p>Ensure that past Vendor Performance is taken into account prior to issuing or renewing contracts with that vendor.</p> <p>d) Design a formalized vendor dispute and arbitration process to ensure evaluations are performed equitably; and</p> <p>e) Ensure that the process is robust enough to pursue vendor debarment when appropriate.</p> <p>Additionally, the COO should establish responsibility for training contracting staff in Purchasing & Contracting and Public Works Contracting Group to ensure that information is tracked in SAP in a uniform manner according to the developed policies and procedures. (Priority 2)</p> <p>Original Target Date: November 2016</p>	<p>Revised Target Date: December 2020</p>
16-016 #1	<p>P&C should ensure that its new purchase requisition procedures and the forthcoming digital procurement manual include a requirement for review by senior procurement specialist to try to reduce errors in purchase requisitions and purchase orders. An emphasis on ensuring that existing contracts are identified when</p>	<p>Reported Implemented; Pending Auditor Review</p> <p>P & C has finalized and published the digital procurement manual. P&C states that the Ariba system has automated features to ensure that purchase requisitions are</p>

Report & Rec #	Recommendation	Status
	<p>appropriate should be included in the procedures.</p> <p>Additionally, P&C should develop a monitoring program that periodically reviews, or spot checks, new purchase orders that have been created and were not tied to contracts. This monitoring process should review all purchasing information and vendor assignment to ensure that there was not a contract available for the goods or services. If errors are identified during the monitoring, staff at the client department and P&C should be further trained to help eliminate such errors. (Priority 3)</p> <p>Original Target Date: November 2016</p>	<p>properly created and linked to contracts.</p> <p>P&C also reports that any purchase requisitions that are created outside of Ariba and that are not linked to a contract, a review by a Procurement Contracting Officers is required.</p> <p>The OCA is reviewing evidence and will make a determination of the status of this recommendation for our semi-annual recommendation follow up report.</p> <p>Revised Target Date: April 2019</p>
<p>16-016 #2</p>	<p>P&C should continue its efforts to obtain and expedite implementation of the catalog software to, among other things, address lapses in contract pricing review of when invoices are processed. P&C should develop a clearly defined and documented plan for training P&C and client department staff as part of the implementation process. (Priority 3)</p> <p>Original Target Date: November 2016</p>	<p>Pending Remaining Contract Import into Ariba</p> <p>P&C informed the auditor that contracts within the Ariba system meet the recommendation requirements; however, the remaining contracts will not be corrected until they are imported into Ariba.</p> <p>Revised Target Date: December 2020</p>

Exhibit 2:

Status of Debarment Recommendations under Purchasing & Contracting Purview

Report & Rec #	Recommendation	Status
14-016 #4	<p>The Purchasing and Contracting Department should: Act on the referral from the Public Utilities Department for debarment of Vendor #1 and Vendor #2; Complete a thorough review of Citywide transactions conducted by Vendor #1 and Vendor #2 to determine if there are any additional transaction irregularities with other City Departments. (Priority 2)</p> <p>Original Target Date: January 2017</p>	<p>Pending SDMC & AR Revision</p> <p>The SDMC on debarment was revised in August 2016. The related AR update is still in process. P&C elected to wait to proceed with a debarment decision, but an unrelated vendor was successfully debarred temporarily in 2017 without an AR in place.</p> <p>Revised Target Date: TBD</p>
15-016 #8	<p>The Chief Operating Officer should design policies and procedures detailing a vendor debarment process to mitigate the City's contractual risks. At a minimum the vendor debarment process should include:</p> <ul style="list-style-type: none"> a) Defined submission steps and requirement. b) Assignment of accountability for the process. c) Establishment of a monitoring process. d) Designation of a location for and maintenance of the debarred vendor list. e) An annual review of the City's debarment process to ensure it is working as intended and effective; additionally, the policies and procedures should be updated as necessary resulting from this review. <p>Additionally, the Chief Operating Officer should establish responsibility for and provide</p>	<p>Pending SDMC & AR Revision</p> <p>This recommendation is dependent on the SDMC revision and release of the AR addressing debarment, which may address the recommendation or provide the framework for the policy and procedures outlining this process. The auditors reviewed the AR and determined that it did not fully satisfy the intent of the recommendation and provided that feedback to the P&C Director, who agreed to consider incorporating the changes to the AR.</p>

Report & Rec #	Recommendation	Status
	debarment training for contract administrators and managers. At a minimum the training should	Revised Target Date: TBD
	identify how, when and to whom they should submit a vendor for consideration of debarment or suspension. (Priority 2) Original Target Date: January 2017	
15-016 #9	The Chief Operating Officer should develop a debarment appeals policy and procedure to bring before the City Council for approval. (Priority 2) Original Target Date: July 2016	Pending SDMC & AR Revision This recommendation is dependent on the SDMC revision and release of the AR addressing debarment, which may address the recommendation or provide the framework for the policy and procedures outlining this process. Revised Target Date: TBD
16-012 #1	We recommend that City management review the additional information provided in the Confidential Hotline Investigation of Vendor Fraud report to determine whether adequate evidence exists to debar the two named individuals and business entities. (Priority 3) Original Target Date: June 2016	Pending SDMC & AR Revision P&C indicated that they would wait until the AR is complete before evaluating debarment options further. However, an unrelated vendor was successfully debarred temporarily in 2017 without an AR in place. Revised Target Date: TBD

Report & Rec #	Recommendation	Status
17-022 #1	Review the detailed information provided in the confidential version of our report and initiate permanent debarment proceedings with respect to the named vendor, as appropriate. (Priority 3) Original Target Date: August 2017	Pending SDMC Revision P&C determined that the vendor was non-responsible, so the vendor is "effectively precluded from being
		awarded contracts by the City for a period of five years." P&C will determine whether further action is warranted. We note that the non-responsible vendor process is not the same as permanent debarment. Revised Target Date: TBD

Respectfully submitted,



Kyle Elser
 Interim City Auditor

- cc: Honorable Mayor Kevin Faulconer
 Honorable Members of the City Council
 Kris Mitchell, Chief Operating Officer
 Stacey LoMedico, Assistant Chief Operating Officer
 Ron Villa, Assistant Chief Operating Officer
 Rolando Charvel, Chief Financial Officer
 Andrea Tevlin, Independent Budget Analyst
 Mara Elliott, City Attorney
 Kristina Peralta, Director, Purchasing & Contracting Department