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Attachment 1



## **Procurement Audit**

### **Phase II – Systems and Processes**

**Report: AR10-02**

**2010 May 05**

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## Table of Contents

<b>Executive Summary</b>	4
<b>Detailed Audit Report</b>	
<b>1.0 Introduction</b>	5
1.1 Audit Objectives, Scope and Approach	5
1.2 Background	6
<b>2.0 Audit Conclusions and General Administration Response</b>	8
2.1 Audit Conclusions	8
2.2 General Administration Response	9
<b>3.0 Observations, Recommendations and Management Responses</b>	12
3.1 Competitive Procurement Processes	12
3.1.1 Request for Tenders (RFTs)	13
3.1.2 Request for Proposals (RFPs)	15
3.1.3 Opportunities for Improvements to Competitive Processes	16
3.2 Non-competitive Procurements	24
3.3 Contract Change Orders	31
3.4 Procurement by Business Units	34
3.5 Reporting of Procurement Activities	37
3.6 Reduction of Costs through Improved Strategic Procurement	42
3.6.1 Use of Exclusive Vendor and Standing Offer Agreements	43
3.6.2 Evaluated Receipt Settlement System	44
3.7 The Use of Field Buyers should be Re-evaluated	46
3.8 Computer Process and Controls Can Streamline Processes	48
3.8.1 Budgetary Control Check	49
3.8.2 Transaction Approvals	50
3.8.3 Vendor File Maintenance	52
3.8.4 Purchase Order Terms and Conditions	54
3.8.5 Closing Purchase Orders	56
3.9 Contract File Maintenance	59
<b>4.0 About the Audit</b>	61

## EXECUTIVE SUMMARY

### **Why we did the Audit**

The City's procurement activities represent a significant portion of its annual expenditures. Each year, The City processes, on average, 46,000 purchase orders (POs) to acquire goods, services and construction totaling more than \$1.35 billion.

We undertook this broad audit of procurement to assess whether The City is effectively managing its procurement activities and leveraging its buying power to achieve better pricing and deliver better value.

Procurement is an essential element of achieving The City's objectives and is inherently risky due to the large value and scope of purchasing, and the decentralized nature of City operations. The risk of fraud can grow when large sums of money are spent and activity levels are high. It is important that The City has appropriate internal controls in place to mitigate risk and demonstrate effective stewardship of public funds.

### **What we looked at**

The overall objective of the procurement audit was to assess the effectiveness and efficiency of The City's practices for the procurement of goods, services and construction work.

### **What we found**

Overall, we found that Supply Management was not fully effective in discharging its responsibilities as The City's central purchasing authority. Further, City practices were not always consistent with good public sector procurement practices and, as a result, The City was not always able to demonstrate that it conducted its procurement activities in an open, fair and transparent manner. In particular, The City should address disproportionate use of non-competitive procurements and change orders.

We also found opportunities for savings from both productivity improvements and better leveraging of The City's buying power. There is also a need for both improved public and management reporting.

Our audit report makes 13 recommendations for improvements. Management has provided a general response to the audit report (Section 2.2), and an action plan for all 13 recommendations (throughout Section 3).

## 1. INTRODUCTION

The audit of procurement was included as part of the 2009-2010 audit plan. Due to the overall value and complexity of The City's procurement activities, the audit was divided into two phases:

- The first phase examined the existing administrative policies, procedures and directives supporting The City's procurement activities (i.e. program governance), the results of which were reported separately on November 16, 2009.
- The second phase of the audit examined the systems and related administrative processes currently used to procure the wide range of goods, services and construction The City requires each year. This phase focused on assessing whether procurement practices were sufficient to achieve value for money in procurement activities.

### 1.1 Audit Objectives, Scope and Approach

#### Objectives

The overall objective of the procurement audit was to assess the effectiveness and efficiency of The City's practices for the procurement of goods, services and construction work. The specific objectives for this phase of the audit were to determine whether:

- The City's procurement processes promote open, fair and transparent competition to protect the interests of The City and its residents;
- Appropriate mechanisms are in place to manage, monitor and control the procurement activities to ensure they are efficient and cost-effective.

#### Scope

Our audit scope included procurement activities during the period January 1, 2006 to April 30, 2009, excluding corporate credit card transactions, real property transactions and utility contracts. Where warranted, we validated our findings relating to policies and processes to the end of 2009. We also researched technical literature for best practices and practices used in other government organizations.

Our review of procurement activities relating to the Calgary Police Service and The City's Civic Partners was limited to work conducted by Supply Management and purchases charged to City capital programs.

## **Approach**

Our audit approach included reviewing and analyzing relevant policies, reports, files, financial records and other supporting documentation.

We selected 100 contracts for goods and services awarded between January 2006 and April 2009 for detailed review. The contracts were selected on a judgmental basis to cover the various contracting processes. We also used data analysis and other specific procedures to supplement our results in specific areas.

## **1.2 Background**

Between 2006 and 2008 The City processed, on average, 46,000 purchase orders (POs) each year to procure more than \$1.35 billion in goods, services and construction work. While 88% of these POs were less than \$10,000, POs over \$100,000 represented over 86% of The City's annual procurement spending.

The City has established the corporate credit card (CCC) as the preferred method for procuring and simultaneously paying for goods and services under \$5,000. In addition to streamlining the procurement process, the CCC reduces the total procurement processing cost by an estimated \$50 to \$130 per transaction (i.e., PO processing costs between \$90 and \$150, versus CCC processing costs of \$20 to \$40).

For all other procurement needs, the procurement process is a collaborative effort between Supply Management and the business unit. City business units are strongly advised to consult Supply Management as soon as possible to develop a procurement strategy that will enable staff to identify the strategy that will provide the best value.

Normally, the procurement strategy involves soliciting bids through one of the following broad types of competitive processes:

- A Request for Tender (RFT) is used when clear specifications can be established for the goods or services to be provided, such as the acquisition of physical goods. The tender call is used to identify the vendors that can provide goods/services that meet the mandatory requirements at the lowest cost. The contract is then awarded to that vendor. Depending on the value, the tender may be:

- Formal quotation, used for low-value purchases;
  - Invitational (issued only to pre-qualified vendors based on their earlier response to a request for pre-qualification); or
  - Publicly advertised.
- A Request for Proposal (RFP) is used when the selection of a supplier cannot be made solely on the basis of price, such as when engaging a professional service provider to provide technical or professional advice or expertise. The basis of award is the most cost-effective solution based on specified evaluation criteria. Similar to a tender, the RFP, depending on its value, may be invitational or publicly advertised.

Contracts may also be awarded through a non-competitive process. However, the use of non-competitive award processes is normally restricted to situations that meet specific exemption criteria from the requirement for competitive bidding.

Supply Management has long been considered The City's central purchasing authority and is responsible for administering all procurement, ensuring the most appropriate procurement method is used, and processing the award of contract.

The City uses the Financial and Supply Chain Management (FSCM) module that is part of its PeopleSoft Enterprise Resource Planning (ERP) system to support and facilitate its procurement activities.

## **2. AUDIT CONCLUSIONS AND GENERAL ADMINISTRATION RESPONSE**

### **2.1 Audit Conclusions**

As previously reported in our Phase I report, the necessary procurement framework had not been established to ensure The City's procurement activities were effectively managed, monitored and controlled. While some elements of the framework existed, it was piecemeal, dated and informal. This makes it more difficult for business unit employees to be aware of how procurement is to be conducted and to ensure they act in compliance with policy and procedures.

Where The City did use competitive bid processes, we found sufficient information on the files we reviewed to substantiate that the process was open, fair and transparent and that the City obtained the best value from the competitive process.

However, we concluded that The City was not always able to demonstrate that best value was received for taxpayer resources spent on non-competitive procurements. Further, we concluded that the information on file to support procurement strategy decisions could be improved. Specifically, we found:

- A disproportionate use of sole/single sourcing to procure goods and services without evidence to support the rationale for the lack of a competitive process and to ensure compliance with the Agreement on Internal Trade (AIT).
- Business units bypassing the procurement process by ordering goods and services directly from vendors, generally without evidence of the competitive process. We noted that controls in Corporate Accounts Payable were effective in detecting the lack of purchase orders and ensuring corrective action was taken prior to payment. However, Supply Management must take steps to ensure that business units are aware of and comply with established protocols.
- A disproportionate use of change orders to substantially increase the value of many contracts.
- Reduced emphasis on price as the main factor in procurement activities. Although we recognize that, in many cases, there are other factors which must be considered in addition to price, whenever possible, The City should select its vendors to achieve the lowest cost for the procurement.

We also concluded that there are opportunities for savings from productivity improvements in a number of areas from enhancing the use of functional



capabilities of the ERP system and increased automation of manual processes and controls. Productivity savings result from improving processes and controls, which allows The City to do more with existing resources.

Finally, we noted a need for improved reporting to Council and the public as well as management reporting. Improved public reporting would enable Administration to demonstrate the effectiveness of its stewardship of public funds and improve openness and transparency of The City's procurement activities. Improved management reporting is needed to enable management to evaluate performance, detect and correct processing errors, as well as identify opportunities to exploit The City's buying power and reduce costs of procurement.

### **Additional information – March 2010**

We noted during Phase II of the audit that Supply Management was progressing on several initiatives to address some of the issues raised in our Phase I report on procurement governance. In March 2010, a suite of procurement policies that come into effect on April 1 was published to the Administration's intranet policy site. Although we have not reviewed these policies in detail, based on an initial review, we are of the view that these policies, if adhered to, will mitigate many of the issues raised in this report.

## **2.2 General Administration Response**

The City is committed to providing a fair, open and transparent procurement process and to ensuring continual improvement in our performance. In this respect, Administration values the insights provided by the audit as it helps identify areas to improve.

Administration has reviewed the audit report and is in agreement with its 13 specific recommendations. In accordance with the reporting process, Administration has prepared a detailed response to address each recommendation. Administration has also included its overall work plan below, which identifies the major areas to be addressed as well as the planned timing, based on our assessment of relative importance and priority.

Much has already been done to address the issues of policy compliance, effectiveness and efficiency. Implementation of the legislative requirements for provision of the Trade, Investment and Labour Mobility Agreement (TILMA), effective April 1, 2009, and other management actions completed or already underway address many of the audit report's concerns and recommendations.

Further, we are better equipped today to address the specific challenges of construction contracting than we were during the period covered by this audit (January 2006 – April 2009), which was characterized by extensive population growth, a super-heated economy and increased public demand for the timely provision of infrastructure. At the time, qualified labour shortages coupled with fierce competition with the private sector for contractors and inflation rate increases of 1.5 – 2 per cent per month, found The City in a situation where tenders closed with no bidders, or only one bidder. This resulted in a higher than normal use of single-source contracts and extensions.

Previous guidelines, practices and oversight policy originated from multiple administrative areas and documentation. Administration has since updated and integrated its procurement policies and established a comprehensive governance framework that is being rolled out across the organization to increase common understanding and compliance with Phase I audit recommendations. The new policies document many existing practices, and the governance framework brings the previously fragmented information together in one central location. Additional initiatives are also underway to increase vendor awareness and access to bid opportunities, enhance financial governance, process efficiencies and improve risk management and reporting.

Administration has categorized and prioritized the Procurement Phase II audit recommendations, considering their specific impact, integration requirements, sequencing and status to strategically develop the overall work plan, timelines and actions. Administration's action plan prioritizes work based on the following classification:

1. Governance and Policy – Phase I audit recommendation focusing on the establishment of a comprehensive governance framework and procurement policies has been completed. The 2010 policy rollout and education sessions for all business units is in progress, and will include building a sustainable education program to meet ongoing needs and maintain current content. The Phase II standard operating procedure work will be completed by Q4 2010.
2. Supply Procurement Internal Controls – existing internal controls and procedures will be updated through identified control improvements and enhancements to standard operating procedures, reporting, monitoring, system setup and operating rules. Where required, compensating controls have been put in place until control changes are made. The majority of this work will be completed by Q4 2010 and no later than the end of Q1 2011.
3. Procurement Efficiency – investigate key opportunities to improve resource utilization, increase effectiveness and improve accuracy

through focus on core procurement work. Work to be completed by Q4 2010.

4. Systems Enhancements - maximize existing PeopleSoft functionality to improve controls and increase efficiency and effectiveness of reporting to improve strategic sourcing and realize better value for money. This work requires longer-term review, analysis and training. Work planned for completion by Q4 2011.

The audit confirms that Finance & Supply have focused on improvement areas to address. The City is committed to bringing best value to citizens through an efficient and effective procurement process that respects the principles of fairness and transparency. The audit report recommendations also confirm the corrective actions Administration has already undertaken to strengthen procurement processes and controls. By continuing this work and implementing the recommendations, Administration is confident the outcome will enhance the overall effectiveness and efficiency of corporate spending through procurement processes and controls.

### 3. OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

#### 3.1 Competitive Procurement Processes

Government organizations must demonstrate proper stewardship of public funds. Procurement processes, which manage and control spending for the acquisition of goods and services, are an important element in demonstrating effective stewardship. The procurement processes must not only demonstrate that value for money was achieved in the use of public funds, but that contracts were awarded in an open, fair and transparent manner. This normally is accomplished by soliciting competitive bids from vendors through a Request for Tender, Request for Proposal, or other competitive methods.

Good public procurement processes also include the flexibility to respond to emergencies and special circumstances by permitting non-competitive awards under certain allowable exceptions. We found The City was using non-competitive awards extensively during the period of our audit. This is discussed further in section 3.2.

In addition, when procuring goods, services or construction work, The City must comply with the following trade agreements, which have specific monetary thresholds for public solicitation of competitive bids. Although these agreements establish competitive solicitations as the norm for government procurement, they also include criteria that limit the conditions under which “sole sourcing” is permissible.

<b>Table 1: Trade Agreement Thresholds for Competitive Bidding</b>		
<b>Trade Agreement</b>	<b>Goods/Services</b>	<b>Construction</b>
Agreement on Internal Trade (AIT)	\$100,000	\$250,000
Trade, Investment, Labour & Mobility Agreement (TILMA)	\$75,000	\$200,000
<b>Note: The TILMA, which did not apply to The City until April 1, 2009, carries fines of up to \$5 million for every incident of non-compliance.</b>		

#### Overview of City Competitive Processes

The City has long-standing practices in place for obtaining competitive bids for many of its procurements. However, the majority of these practices are not well documented. The procurement process is a collaborative effort between Supply Management and the business unit, with each purchase resulting in a contract.

In general terms, the business unit is responsible for determining what it needs to purchase (the specifications) and the basis for determining which vendor best meets the business unit’s needs. Supply Management is responsible for

administering the procurement process, providing procurement advice to business units and ensuring the overall integrity of each procurement process.

Supply Management is also responsible for maintaining the necessary documentation around the individual procurement processes and the awarding of contracts. The level of documentation required for each contract depends on its value and method of procurement.

Our selection of 100 contracts contained 55 contracts awarded through a competitive process. We reviewed each contract to determine whether the competitive process included the following key steps to ensure the contracts were awarded in a fair and open manner:

- The business unit established a clear statement of contract requirements prior to the bid call. The statement of requirements provides bidders with a clear understanding of the requirements.
- Specifications were fair and did not unnecessarily restrict bids.
- The contracting opportunity was publicly and broadly advertised where required.
- For tenders, the successful bid met all mandatory specifications and was the lowest-priced bid.
- For Requests for Proposals, the evaluation process and criteria were clear and were communicated to potential bidders. Further, responses were properly evaluated using the set criteria and process.
- Where the contract award includes an element of negotiation, these negotiations did not negate the competitive process.
- The file, where applicable, contained the minimum required documentation.

We present our results based on the broad type of competitive process used.

### **3.1.1 Request for Tenders (RFTs)**

A tendering process is used by The City when the requirement is known and can be clearly specified by the business unit, such as the acquisition of tangible goods or well-defined services. Tendering, therefore, is used to get the lowest price that meets the specifications.

Depending on the contract value, in broad terms, the tender process used by The City may be:

- Formal quotations, where written quotations are obtained from a number of vendors. Quotations are used for low dollar value purchases;
- Invitational, where tenders are only issued to pre-qualified vendors based on their earlier response to request for pre-qualifications; or
- Public tender calls, where the tender call is widely advertised and open to all potential suppliers.

We conducted limited research into the practices of other municipalities and found that most have established clear requirements, including mandatory thresholds, which govern the use of guidelines and tenders. These requirements are established by Bylaw and/or policy.

The City has not established any clear, mandatory monetary thresholds for soliciting competitive bids as have other municipalities we reviewed. The Supply Management purchasing intranet site indicated only that:

- Quotations are typically used when the goods or services are of low value and/or low risk (i.e. between \$5,000 and \$75,000);
- Tenders are typically used when the goods or services are of high value and/or high risk (i.e. over \$75,000).

However, these guidelines are not considered mandatory and are applied at the discretion of the business unit. Supply Management has not been effective at ensuring consistent application of these guidelines. This has contributed to the high level of 'sole sourcing' we found.

Of the 55 contracts we reviewed that were awarded using a competitive process, 28 were awarded using one of the tender processes.

For 18 of these awards, which were tenders greater than \$75,000, we determined that the contract was properly awarded, that the processes were fair, open and transparent and that The City obtained the best value in awarding these contracts.

For the 10 remaining tender awards, we determined that the contract award was inconsistent with existing practices and procedures as the files generally lacked evidence to support the competitive bid process and

award decision. These contracts were for amounts less than \$75,000 and the file did not contain evidence of the quotations obtained.

We reviewed these files with the buyer who agreed that quotations should be on file. The buyer indicated that in some of these cases, reliance may have been placed on the business unit to identify and recommend a vendor and, further, that they did not always obtain documentation of the decision rationale from the business unit.

Supply Management should ensure that when a competitive process is required that its files contain the necessary documentation to demonstrate that the process was followed and the contract was properly awarded.

### **3.1.2 Request for Proposals (RFPs)**

The RFP process is used by The City to engage a professional service provider (i.e., consultant) to provide technical or professional expertise, direction and guidance, including recommendations to management. It is also used in other circumstances when the selection of the supplier cannot be made solely on the basis of cost, such as when the approach or the quality of services is an important consideration.

Typically, an RFP is used in situations such as when the objectives to be achieved by a study are known, but specific expertise or assistance in determining the best solution is being sought. As a result, a competitive process is required in all cases unless one of the criteria for 'sole sourcing' is met.

Unlike a tender that results in a contract being awarded to the vendor that provides the lowest price, the RFP process awards a contract to the vendor that offers the best solution, of which price is only one factor. The RFP may be invitational (i.e. issued only to pre-qualified vendors) or publicly advertised.

As the selection of the successful proposal is dependent on a number of factors, it is important that the business unit establish the evaluation, criteria and scoring weights that will be used to evaluate each proposal. Further, the criteria and weighting should be provided to the potential proponents.

Of the 55 contracts we reviewed that were awarded using a competitive process, 27 contracts valued at \$ 185 million were awarded using an RFP process. We examined these contracts to ensure the Supply

Management file contained the necessary supporting documentation, including evidence that:

- The statement of requirements was developed prior to the solicitation of proposals and contained sufficient detail to allow potential bidders to understand the nature and extent of work requested, but was not so detailed as to unfairly exclude potential responses;
- The weighting formula and criteria to be used to evaluate the proposals were included in the solicitation of proposals and were sufficient to adequately distinguish the quality of proposals;
- Proposals were evaluated in accordance with the established criteria, assigned ratings were adequately documented and that the award was made in accordance with the ratings;
- Supply Management was effective in ensuring the use of an RFP was limited to appropriate circumstances and that RFP processes were properly carried out.

We found that, although the RFP process was not well documented and communicated, overall, the contracts were reasonably awarded. However, we noted that in some cases, the award process would have benefited from a more rigorous process to define and document both specifications and evaluation criteria. Further, in some cases it was not apparent from the file why an RFP process was used as the use of a tender process seemed more appropriate.

As the RFP process is intended for those situations where the award cannot be made solely on the basis of cost, it signals that The City is not seeking the lowest price but is willing to pay more to satisfy other requirements. In our view, procurements should be made using a tender process whenever possible.

Supply Management, as the central purchasing authority, should be responsible for certifying that the procurement is made using the most economical method. This will enhance The City's ability to demonstrate accountability and value for money.

### **3.1.3 Opportunities for Improvements to Competitive Processes**

We identified a number of areas where improvements could be made to either increase the efficiency of the competitive processes or improve The



City's ability to demonstrate that it awards these contracts in a fair and open manner.

**Processes should be clearly established and communicated within The City.**

Our review determined that the information available to business units regarding the RFP process consisted of information available on various Finance & Supply intranet pages and a set of instructions that Supply Management sends to the business unit with the proposals for evaluation.

The information available on the Finance & Supply intranet pages consisted of guidance around:

- Business units are responsible for preparing the specifications and an evaluation matrix to score the responses received;
- Business units should not discuss any aspect of the project with a consultant before the contract award because it may be perceived as providing an unfair advantage.

The Supply Management instructions for the evaluation of proposals sent with the package of proposals received included the following guidance around:

- Keeping proposals secure and not discussing their contents with anyone other than committee members;
- Declaring conflicts of interest;
- Evaluating proposals in accordance with established point ratings in the RFP and keeping all notes, discussions and point ratings confidential.

We interviewed a number of purchasing agents and buyers within Supply Management to clarify processes, determine the required approvals and assess the consistency of understanding and application given the lack of documented processes and current delegated signing authorities.

We concluded, based on these interviews, that there was a lack of a common understanding within Supply Management of processes and signing authorities. This has led to inconsistent application of the requirement to use competitive processes, use of RFPs when a tender may have been adequate and a high level of non-competitive procurement.

Of particular concern was the view held by some that the decision to use a competitive process or to award without completion or 'sole sourcing' was strictly a business unit decision and not Supply Management's role. In our view, the decision regarding which method of procurement is best to achieve the desired result requires Supply Management's procurement expertise.

There is a need to provide staff in both Supply Management and business units with a clear understanding of the RFP process, including key milestones and timelines. This would enable business units to more effectively plan their procurement activities and ensure that goods/services are received when needed.

#### Development of Specifications

Business units would also benefit from detailed guidance on how to develop specifications. Proper specification of requirements is critical to ensuring vendors develop proposals that meet The City's need. Proper specifications also help ensure the proposed evaluation criteria will allow The City to clearly determine the best fit and contribute to the fairness of the process.

Although we recognize that the business unit is ultimately responsible for the quality of the specifications, in our view, Supply Management could facilitate this process by developing templates to promote uniformity of specifications and providing a library of good examples of specifications.

#### Quality of RFP documents

The quality of the request documents is critical in ensuring proposals are received from as many vendors as possible. High quality documents can also limit the number of questions from potential bidders; the need for addendum to clarify aspects of the RFP documents; and the need to extend the closing date of the bid period.

We found that Supply Management should play a bigger role in reviewing specifications prior to release and ensuring they are complete, not unduly restrictive and will result in an open and fair contracting process. Business units could benefit more in this area from Supply Management's expertise in procurement best practices.

Supply Management should also be responsible for verifying that specifications are written whenever possible so as to permit a tender process, as this will achieve the lowest cost.

Although this is commonly a responsibility of a central purchasing authority and can be a key control over the integrity of the process, our discussions with Supply Management found they do not consider this function to be their role. They rely on the business unit to make this determination and limit their involvement to administering the process and providing advice when requested.

In our view, The City should strengthen its controls in this area by requiring Supply Management to sign off on the specifications prior to release. Where Supply Management has concerns regarding the quality of the specifications they would refer these concerns to the business unit for review and approval by an appropriate level of senior management in the department.

### Evaluation Process

The City's process for evaluating responses to RFPs considers all of the evaluation criteria at the same time. There is limited use of multi-stage evaluations and no guidance to assist business units in determining when an alternative evaluation stage might yield improved results.

Although a single stage evaluation is appropriate for the evaluation of many RFPs, there is a risk that an unintentional bias may be introduced in high dollar value or sensitive procurements.

When a single stage evaluation is used, the evaluation team is aware of the relative cost of each proposal and this may influence the evaluation of the non-monetary criteria, particularly when the cost approaches or exceeds the available budget.

Our research of best practices suggests that The City could improve its evaluation of high value and/or sensitive RFPs by implementing more rigorous evaluation standards for these RFPs, such as:

- A two-envelope approach. Under the two-envelope approach, the vendor is required to submit one envelope with their technical proposal and a separate envelope with their fee proposal. The RFP must also clearly specify a minimum technical score that must be attained for the proposal to receive any further consideration. The proposal is first evaluated on its technical merit and the vendor's fee envelope is only opened if the technical proposal meets or exceeds the minimum technical score specified in the RFP. The two-envelope approach is best suited for higher value and/or more sensitive RFPs.

- A Fairness Commissioner. Fairness Commissioners are normally independent experts in procurement and are engaged to oversee the whole procurement process for highest-value, most complex and sensitive contracts. They ensure the process is fair, open, impartial, and transparent and complies with all laws, regulations, and policies/guidelines. The Commissioner will prepare a formal report that attests to the fairness of the process and its results.

The City should consider enhancing the integrity of its RFP evaluation processes by establishing more rigorous requirements for evaluating proposals relating to high-value, complex or sensitive contracts.

### Evaluation Results

With respect to scoring, the RFP Evaluation Committee established to evaluate the proposals, normally comprised of business unit staff, must assign a score under each evaluation criteria specified in the RFP. The evaluation results are captured on the evaluation matrix, based on the consensus reached by the Evaluation Committee.

The RFP scoring process can be relatively subjective and it is therefore important for the Evaluation Committee to clearly document its rationale to support the scores assigned to each RFP criteria.

The process would be improved by determining, in advance of the solicitation, how each criterion will be applied during the evaluation either by establishing sub-criteria or by defining what the best answer would be. This would make the scoring more objective and provide a better basis for documenting the rationale to support the scores assigned to each proposal.

We were advised that Supply Management considers the evaluation of proposals to be a business unit responsibility and therefore they are not normally part of the evaluation team. They will assist only if requested by the business unit.

We agree that it is not practical for Supply Management to participate in every proposal evaluation. In our view, the integrity of the process could be enhanced by establishing a requirement for Supply Management to monitor the evaluation of RFPs that exceed a minimum monetary threshold and ensure they are fair and objective. Where concerns are

raised, they should be referred to a more senior level of business unit management unit for resolution.

**Recommendation**

1. We recommend that the Director, Finance & Supply review the processes for conducting and evaluating RFPs and, where warranted, establish the necessary enhancements to the RFP process.

**Management Response**

1. Agree.

<b>Action Plan</b>	<b>Responsibility</b>
a) The City’s procurement policy on RFX Management provides information and direction on the use of RFP documents and the differences and appropriate uses of the other RFX documents.  b) Standard operating procedures (SOPs) and process guidelines will be reviewed and updated. This content will be accessible via Supply Management Intranet, shared central process folders, and be a component of the new Supply Management LFME education content. The new policy content will also be reflected in the LFME materials.	<b><u>Lead:</u></b> Manager, Supply Management  <b><u>Support:</u></b> HR, Communications, BPR  <b><u>Completion Date:</u></b> a) Completed Q1, 2010 b) Q4, 2010

**Contracting for Consultants Can be Enhanced**

**Pre-qualified Consulting Contracts**

We found that the instructions and processes surrounding the selection and appointment of consultants at the time of our audit were unclear, at times contradictory, and also inefficient.

The City has established a list of disciplines that requires consultants to be pre-qualified. However, the Finance & Supply intranet pages on purchasing indicate that business units requiring services under one of these disciplines *should* contact the appropriate technical advisor prior to consulting Supply Management. This language is normally considered to be discretionary in policy. Our discussions with buyers and purchasing agents indicate that some treat these requirements as mandatory and others treat them as discretionary.

With respect to architectural and engineering services, the intranet page indicates that business units *must* contact a discipline champion who will guide them to follow the “Engineering and Architectural Consultant Engagement Framework” located on the Infrastructure Services’ intranet site. Depending on the dollar value, the discipline champion will determine if the business unit needs to discuss the procurement requirements with Supply Management.

These directions, to contact a technical advisor and discipline champion, contradict instructions provided on two other intranet web pages, which indicate business units should contact Supply Management:

- as soon as a need for contracting arises;
- at the planning stage or when considering an Expression of Interest or an RFP.

There is also no evidence indicating that the “Engineering and Architectural Consultant Engagement Framework” was approved for use by the Administrative Leadership Team (ALT), although we do note from our discussions that staff responsible for administrating this framework believe it was approved by the ALT.

We also determined that there was no similar framework for the selection and appointment of consultants under other disciplines.

#### Justification for Consulting Contracts

The Finance & Supply, Purchasing intranet site indicated that the business unit should have the appropriate approval from the manager or Dept ID owner and the required budget to proceed with selecting and hiring a consultant. It also indicated that a business case, approved by one of the signing authorities set out in Table 2, was required to justify the requirement and sourcing method for any consulting appointment.

<b>Table 2: Business Case Approval Levels for Appointment of Consultants</b>	
<b>Procurement Value</b>	<b>Minimum Signing Authority</b>
Up to \$25,000	Manager of business unit
\$25,000 to \$100,000	Director of business unit
\$100,000 to \$250,000	General manager (GM) of business unit
Over \$250,000	Approval from two GM's and circulation to Council

Our review of files for the hiring of consultants found that a business case was frequently not present nor was the evidence of approval of the sourcing method in accordance with the authority levels set out in the Table.

Although the rationale for hiring a consultant is often self-evident, in many cases, it is not. Our review found several contracts where consultants were hired to provide services that should be available from in-house staff. Where the rationale for hiring consultants is not readily apparent, it should be documented and approved by the appropriate signing authority prior to initiating the RFP.

These approval limits that are now said to apply to business cases appear to be derived from earlier delegation instruments relating to the award of contracts for consulting services. We were unable to determine when and why the application was narrowed to only the business case.

Our research on the practices of other municipalities indicated that it was not unusual to have lower monetary thresholds in delegations of authority relating to consulting contracts.

In our view, the level of delegated authority around consulting contracts should be reviewed and appropriate monetary thresholds established for approving these contracts. Further, Supply Management should be tasked with verifying that proper approval has been obtained prior to awarding the contract.

**Recommendation**

2. We recommend that the Director, Finance & Supply review existing practices and establish clear administrative direction and processes for selecting and appointing consultants, including appropriate monetary approval thresholds.

**Management Response**

2. Agree.

<b>Action Plan</b>	<b>Responsibility</b>
<p>Monetary approval thresholds and direction on procurement of professional services are clearly defined in the following procurement policies recently implemented at The City:</p> <p style="padding-left: 40px;">FA-033 – Guiding Principles;            FA-034 – Authority Levels.            FA-042 – Professional Services Less than or Equal to \$25K            FA-043 – Professional Services Greater than \$25K.</p> <p>Supply Management LFME content will be updated to reflect these policies.</p>	<p><b><u>Lead:</u></b> Manager, Supply Management</p> <p><b><u>Support:</u></b></p> <p><b><u>Completion Date:</u></b>            Completed Q1, 2010</p>

**3.2 Non-competitive Procurements**

Good government procurement practices ensure a ‘level playing-field’ is provided to potential suppliers and that procurement processes are open, fair and transparent to demonstrate proper stewardship and accountability for public funds. This is accomplished by requiring that most goods and services are acquired using a competitive process.

There are, however, circumstances where a competitive process is either not possible or will not provide the best overall value to the organization. Procurement processes must be flexible enough to permit goods and services to be acquired using a non-competitive process where appropriate.



In addition, The City must comply with the Agreement on Internal Trade (AIT) and (as of April 1, 2009) the Trade, Investment, Labour and Mobility Agreement (TILMA). The overall purpose of these agreements is to improve interprovincial trade by reducing obstacles to the movement of goods, services, people and investments within Canada.

We reviewed the requirements of the AIT/TILMA as they related to procurement as well as the procurement practices of a number of government organizations. We found that the organizations we reviewed had policies/regulations/directives in place that restricted the use of non-competitive procurements and defined the permitted circumstances and monetary thresholds for approving exceptions to competitive procurement processes.

We found that The City did not have at the time of our audit any documented 'sole sourcing' criteria or clear administrative processes to ensure non-competitive procurements are properly justified and approved before awarding the contacts.

### Trade Agreements

The AIT and the TILMA are both broad-based agreements that cover more than procurement practices. With respect to procurement, the agreements focus on reducing trade barriers by “eliminating local price preferences, biased technical specifications, unfair registration requirements and other discriminatory practices for non-resident suppliers in order to ensure equal access to procurement for all interested Canadian suppliers”.<sup>1</sup>

Further, the agreements each contain specific provisions that identify allowable exceptions to the requirement for competitive bidding and thus limit the use of non-competitive procurement. However, both the AIT and the TILMA are based on the premise that an open, transparent and competitive procurement is the norm.

Although the Finance & Supply, Purchasing intranet site provided links to the AIT and the TILMA, it did not provide specific guidance to business units to assist them in complying with these agreements. The intranet guidance did not:

- Summarize any of the allowable exceptions under these trade agreements and provide clear guidance to limit the use of non-competitive processes;
- Provide any clear direction to business units for completing a justification that clearly demonstrates that criteria for non-competitive procurement were properly satisfied; nor did it

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<sup>1</sup> <http://www.ait-aci.ca>. (Overview; Economic Sectors; Procurement)

- Provide clear direction for publishing a notice of intent to award without competition on the electronic tendering system to determine whether there are other vendors capable of meeting the need.

The application of the provisions of the AIT and TILMA are complex and require both procurement and legal expertise to ensure correct interpretation and there is a need to develop guidance for business units in this area. There is an opportunity for Supply Management as the central purchasing authority to add value to business units by providing this guidance.

We concluded, based on our review, that although the AIT/TILMA lists of exceptions are specific, the award of contracts on a non-competitive basis is generally permissible when:

- The contract is needed to address an urgent or emergency situation and delaying the work is either not possible (due to public safety concerns) or not in the public interest;
- There is only one potential supplier, such as in the case of proprietary goods or services or to ensure compatibility with existing products;
- The value of the contract is below a dollar threshold where the cost of a competitive process is seen to exceed the value of the contract; or
- Other specific circumstances established by policy, such as establishing requirements for competitive and non-competitive procurement for areas not covered under AIT/TILMA.

We further concluded that, while The City must ensure its procurement activities comply with the AIT and TILMA, compliance with these agreements is not sufficient to ensure value for money and best practices are achieved in procurement. The City should consider establishing more rigorous guidance around the use of non-competitive procurement in areas not covered under the AIT/TILMA.

#### Non-competitive Contract Awards

We selected 26 contract files over \$100,000, totaling \$188.7 million; awarded using non-competitive processes for review to ensure the rationale for sole sourcing or single sourcing complied with one of the above criteria and the specific applicable provisions of the AIT. Although the TILMA came into effect April 1, 2009, due to the period of our audit we did not evaluate compliance with the TILMA provisions.

We also assessed whether there was proper documentation and appropriate approval by management of the justification for sole sourcing/single sourcing and concurrence by Supply Management as to its reasonableness.

Of the 26 contracts reviewed, we concluded there was insufficient evidence on file to substantiate 22 of the non-competitive contract awards. With respect to these 22 contracts, we determined that:

- 15 construction contracts were single-sourced without going to market and posting a notice of intent to single-source, by invoking Clause G.C.3.16.2 of The City's Standard General Conditions, which states:

“If approved by the Manager, Supply Management, The City may use pricing offered on one tendered project (a project awarded in the past 36-month period) as the basis for approving an award on other similar projects without tendering.

In all cases, pricing offered on the originally accepted tender will be used as a basis for negotiating price changes.”

Supply Management indicated that invoking this clause was a business decision that was made to secure the necessary forces to do work during the Calgary construction boom, a time when contractors were scarce and material and labour costs were rapidly escalating. However, invoking this clause without first going to the market was not compliant with the AIT.

- Six contracts were sole sourced/single sourced without adequate supporting documentation to properly substantiate that they were allowable exceptions under the AIT.
- One contract, as discussed below, did not follow proper process.

Supply Management defines 'single sourcing' as the practice of concentrating purchases of particular goods or services with one source in preference over other firms in a competitive marketplace. While this practice is a valid purchasing strategy, we expected that, given a competitive market exists, the strategy would either be implemented through a competitive process or a rigorous qualification would exist to support the non-competitive award. Improved control processes are needed over non-competitive single sourcing.

We supplemented a review of 26 non-competitive contracts with data analysis. Data analysis of purchase orders over \$100,000 also identified 462 contracts totaling more than \$151 million that were not referenced to any quotation, tender or RFP file number. We also reviewed purchase orders under \$100,000 and found similarly many were not referenced to a quote, tender or RFP file.

We reviewed a number of these purchase orders with the respective purchasing agent/buyer. They advised that without a file number, there was no means of locating supporting documentation or determining whether these contracts stemmed from the competitive bidding process or were sole sourced. Further, while many of these contracts likely were sole sourced, the lack of a file number in others is likely due to new staff not being aware of the requirement to add the file number to the purchase order information.

We concluded that the file number under current Supply Management processes is a key link to important documentation supporting the use of competitive or non-competitive procurement methods. Supply Management should monitor to ensure this critical link is added to all purchase orders.

We concluded that, for the period of our audit, there was an excessive use of non-competitive procurements at The City. Our findings were consistent with a more extensive analysis conducted for Supply Management in 2008 by a consulting firm. After reviewing more than 450 contract files, the consultant reported that:

- 51% of all contracts were sole sourced, of which 68% were for consulting services;
- 34% of the sole sourcing contracts were non-compliant with the AIT;
- 2% of the files contained no data except for a file number (i.e. a quotation, tender or RFP file number)

We were advised by the Manager, Supply Management that since the TILMA came into effect on 1 April 2009, The City's use of non-competitive procurement has been reduced to around 35%.

By way of comparison, a City of Toronto audit of 'sole sourcing' dated May 2009 found that approximately 6% of that City's annual purchases were sole sourced. City of Toronto procurement policy requires that 'sole sourcing' must be pre-approved by the Purchasing Division if greater than \$50,000, and by a Standing Committee and Council if greater than \$500,000.

### Peace Bridge Design Contract

One non-competitively awarded contract that we reviewed in some detail was for the design of a pedestrian bridge over the Bow River (i.e. the Peace Bridge) that was awarded to an internationally recognized architect. The general concern being expressed by the public and media about this contract that we reviewed as part of our audit was whether The City followed proper process in awarding this contract.

Our review of this contract was limited to the procurement process used to select a proponent and award the contract for the design and construction supervision of the Peace Bridge. The contract for the construction of this bridge was separately awarded based on the results of a competitive process in late 2009.

Our review of the events surrounding the Peace Bridge contract award was based on a review of files held by both the Transportation Department and Finance & Supply and interviews of staff involved in various aspects of the project. We prepared a chronology of the events surrounding the award of this contract and assessed the activities against established processes.

We concluded that authority to award this contract valued at approximately \$3.5 million existed within the Administration. The award of contracts for consultant services over \$1 million must be approved by two General Managers. The proposed award must be circulated to Council for information under Council Policy FCS015 but did not require Council approval. However, we found that The City did not follow established policy and procedures for the award of this contract in a number of areas:

- The Centre City Plan was not followed. To meet the call for “Design Excellence”, the Centre City Plan indicates that consultant selection for the design of significant City of Calgary developments shall be through open architectural competition;
- Procedures developed by departments, in conjunction with Supply Management, for selecting engineering and architectural consultants were not followed. These procedures indicated that services valued over \$1 million would generally follow a two-step competitive process (EOI/RFP) and further that design competitions should be held for high-profile projects. The Consultant Management Committee was not consulted in advance on the procurement process as set out in the framework;
- There is no evidence that other consultants were considered even though internal briefing communications indicated other consultants were considered; and

- Evidence indicates that most of the decisions around this contract, including the decision to single source Santiago Calatrava LLC Architects and Engineers were made by the former General Manager of Transportation. Further, the decision to single-source was reached as early as January 2008, well before we found evidence of Supply Management involvement in this process. Evidence also indicates that contract negotiations with the architect started before any funding for this project was approved and that the contract was signed by both parties before the business case to support the appointment was prepared and circulated to Council in December 2008.

We researched the use of design competitions; however, the results were inconclusive regarding whether or not they are a best practice. Our research found both advocates and detractors. However, we noted that under the AIT, one of the circumstances for sole-supplier procurement is “for a contract to be awarded to the winner of a design contest”.

We concluded that the decision to award without competition was inconsistent with both the approved Centre City Plan and The City’s procedures for selecting architectural consultants, which called for the use of design competitions for high-profile projects. Further, the ‘sole sourcing’ prevented early public consultation through the use of an ‘Engage’ process.

In our view, Council approval should have been obtained prior to deviating from the principles of the Centre City Plan.

**Recommendation**

3. We recommend that the Director, Finance & Supply establish criteria for ‘sole sourcing’ contract awards and administrative control processes that ensure proper approval and monitoring on the use of ‘sole sourcing’.

**Management Response**

3. Agree.

Action Plan	Responsibility
The criteria for <b>single-source</b> contracting are contained in the TILMA legislation.	<b>Lead:</b> Manager, Supply Management
The conditions imposed by TILMA	<b>Support:</b> Communications, business unit leaders

<p>introduced in 2009 have been incorporated and are clearly defined and addressed in the new Supply Management Procurement policies implemented March 2010. FA-036 Using a Sole or Single Source Vendor.</p> <p>We will continue to communicate as required the implications of TILMA on the City's procurement activities to business unit leaders and staff, with key emphasis on new limitations on single and sole sourcing capabilities.</p>	<p><b><u>Completion Date:</u></b> Completed Q1, 2010.</p>
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### 3.3 Contract Change Orders

The City commonly includes, in many of its contracts, a specified contingency of up to 10% of the contract, particularly those for construction work. This contingency is intended to facilitate the processing of minor changes through site or work orders, and allows the project manager to process minor changes without needing to formally amend the contract.

While this contract contingency is in many cases sufficient, there are from time to time circumstances that will result in either an increase or decrease to the overall contract value or a significant change to the contract schedule or specifications. These amendments are initiated through a contract change order.

A change order is a written order issued by an owner to a contractor that amends the terms of an original contract. This results in an adjustment to the contract price and/or schedule. Each change order (CO) should be in writing, consistent with the general intent of the contract, and approved by an authorized signing authority (i.e. contract authority). All approved COs should be in the contract file.

A CO may be issued for such reasons as:

- a change in price, quantity ordered, delivery destination, or terms of delivery
- ambiguous definition of contract scope
- changes in magnitude, design or scope of work
- errors in estimating the cost of work to be done
- poor contract administration by the owner.

Three areas that require management attention to improve control over the use of change orders are discussed below.

**Change orders have been used frequently and to significantly increase the value of specific contracts**

Over a three-year period ended April 2009, change orders were issued on purchase orders over \$25,000 that totaled over \$747 million. The value of 740 of these purchase orders was increased by 50% or more, as illustrated in Table 3.

<b>% Increase</b>	<b># of POs</b>	<b>PO Amount</b>	<b>CO Amount</b>	<b>Final PO Amount</b>
50 to 99	319	131,988,067	86,683,642	218,671,708
100 to 149	143	22,623,767	27,821,017	50,444,784
150 to 200	81	9,228,248	16,358,403	25,586,651
Over 200	197	48,062,561	616,321,804	664,384,365
<b>Totals</b>	<b>740</b>	<b>211,902,643</b>	<b>747,184,866</b>	<b>959,087,508</b>

We reviewed 17 contract files with change orders valued at \$29.9 million to determine whether they were consistent with the intent of the original contract.

We found that:

- COs for construction contracts were usually for design or scope changes, underestimated costs and/or cost escalations. As these COs increase construction contracts by more than 50%, over and above the contract contingency, improved management scrutiny is needed.
- For consulting contracts, change orders were generally attributable to errors in estimating the amount or cost of work to be completed.
- COs on some consulting contracts were simply “add-ons” for additional work that was unrelated to the original contract. Two of the contracts reviewed were for consulting work within Supply Management.
- COs were issued to start work on the next phase of multi phased projects. Although in some cases, the multi-phased nature of the project was considered as part of the RFP process, in others, it was not. Where the RFP does not identify a project as multi phased and explicitly considers the subsequent phases in making the original award, a form of ‘sole sourcing’ occurs. The RFP must clearly identify any subsequent phase to a project that will be



awarded based on the initial solicitation or each phase should be subject to a competitive award process.

- Many change orders were missing from the contract files and, as a result, we could not assess the underlying cause for the change order.

Many organizations have administrative policies and guidelines which mandate re-evaluation of contracts when the total value of COs reaches a specified percentage of the original contract amount (e.g. 25% of original PO amount).

Such re-evaluations are not performed by Supply Management. The FSCM system can be used to systematically extract the volume and value of COs issued against various contracts for management's review, analysis and corrective action where necessary.

### **Authority and financial signing limits for approving COs have not been effective**

All change orders should be approved by an authorized signing authority as established by the City Manager's November 2003 Confirmation of Delegation for purchase orders to Supply Management. This document establishes clear dollar limits for each staff level for approving the release of a purchase order and, in our view, would also apply to increases resulting from change orders.

We found that the controls in place in FSCM were not effective in limiting Supply Management staff to the limits set by the delegated authority for purchase orders.

We determined that, in practice, Supply Management staff can approve change orders equivalent to their delegated authority for purchase orders. This means for example that a buyer with a \$99,999 limit for approving the release of a purchase order can approve a total of \$99,999 in change orders resulting in a contract value of \$198,998.

There was no process in FSCM to route the CO to a higher financial signing authority for approval when a revised purchase order's value exceeded the employee's financial signing limit.

### **Supply Management files are missing supporting documentation for COs**

All change orders should be in the contract file to document the rationale and approval of the revision as well as to provide a complete chronological record of all contract changes.

We found that many COs and the related supporting documentation were missing from the contract files.

**Recommendation**

4. We recommend that the Director, Finance & Supply:
- Establish business rules and processes mandating the re-evaluation of any contracts where change orders exceed a pre-determined specified percentage of the original contract;
  - Clearly delineate the financial signing authority and limits for approving COs; and
  - Develop processes to systematically extract, review, and analyze CO information related to POs.

**Management Response**

4. Agree.

Action Plan	Responsibility
<p>Supply Management will investigate options to integrate a more robust and detailed change order management process into the PeopleSoft ERP system.</p> <p>In the interim period we will define and implement business rules detailing change order re-evaluation threshold levels.</p> <p>We will determine reporting capability on Change Order transactions, and implement where this is determined to be feasible.</p>	<p><b><u>Lead:</u></b> Manager, Supply Management</p> <p><b><u>Support:</u></b> Directors for all business units.</p> <p><b><u>Completion Date:</u></b>            Complete feasibility analysis by <b>end Q4 2010</b> and implement recommendations by <b>Q3 2011</b>.</p>

**3.4 Procurement by Business Units**

Supply Management has long been considered a central purchasing authority with responsibility for procuring all goods, services and construction works required by The City and for issuing purchase orders. Information on the Finance & Supply, Purchasing intranet site states that:

- Supply Management is responsible for the overall planning, control, and administration of The City's supply chain;

- the process of preparing procurement opportunities for competition is a collaborative effort between Supply Management and the business units;
- business units are strongly advised to contact Supply Management as soon as a need for contracting goods/services arises; and
- the buyer will set up a contract strategy.

Although business units are encouraged to work collaboratively with Supply Management to ensure their procurement activities are aligned with best practices, and many do, there is no mandatory requirement to contact Supply Management. As a result, we found that Supply Management was not actively involved in all procurement activities.

As part of the administration of contract awards, basic controls should be in place to ensure that the contract has been properly awarded prior to the start of work and that there is documented acceptance of the contract terms by both parties.

The City's procurement processes use a PO document to evidence the final award of contract and the contract terms. The issuance of a PO requires business units to submit a requisition to Supply Management, who will issue a purchase order to the vendor providing the best value. Under the ERP system, no vendor invoices can be paid without a purchase order.

We reviewed purchases over the period January 2006 to April 30, 2009 to identify any transactions which may indicate a by-passing of the procurement process. Where the invoice and/or receipt of goods pre-dated the PO date, we concluded that the contract award was not administered in compliance with City processes.

Our review identified 1,933 purchases orders, totaling more than \$122 million, where the invoices had pre-dated the purchase order. As shown in Table 4, almost 70% of these purchase orders were for less than \$10,000, 1,030 of which were for less than \$5,000.

<b>Table 4: Summary of Purchase Orders pre-dated by Invoice</b>			
<b>Value of POs</b>	<b># of POs</b>	<b>% of POs</b>	<b>Total (\$)</b>
Less than \$10,000	1,340	69.32%	3,683,289
\$10,000 to \$19,999	221	11.43%	3,078,933
\$20,000 - \$29,999	101	5.23%	2,432,952
\$30,000 - \$39,999	44	2.28%	1,522,462
\$40,000 - \$50,000	41	2.12%	1,877,883
Greater than \$50,000	186	9.62%	109,623,307
<b>Totals</b>	<b>1,933</b>	<b>100.00%</b>	<b>122,218,825</b>

We further reviewed 50 of these purchase orders and determined that:

- 75% were issued after the fact to pay for goods/services ordered by a business unit;
- 5% of the purchase orders related to construction work that was allowed to proceed before all required contract documentation was in place. This unnecessarily increased The City's exposure to liabilities on these projects;
- 20% were issued after the fact to support payments for existing separate agreements (e.g. software license/maintenance fees, lease, and development agreements).

In 80% of the contracts, work had begun or goods had been received prior to the issue of the contract. This practice increases the risks that all of the contract terms and conditions may not be met and that deliverables will not fully satisfy The City's requirements. This can impact the effective delivery of services and programs. Further, with respect to the 5% that consisted of construction-related work, there may also be health and safety issues and work should not start until Law has formally confirmed that work can proceed.

We noted from our analysis that there are three main factors that contribute to work beginning prior to the contract having been issued:

- Lack of understanding of what constitutes notification of contract award and thereby authority to start work;
- Lack of clear guidance that either requires business units to involve Supply Management in their procurements or clear delegation of this responsibility to business units below a dollar threshold. We note this second option would likely involve using mechanisms other than the PO document to award the contract;
- Delays in issuing the PO document that delay the planned start of work. In order to effectively act as the notification of the award of contract, the PO document must be processed on a timely basis. This does not always occur, based on workloads in Supply Management.

For the 20% relating to payment for existing agreements, we question the value of issuing a PO in these instances. Our review indicated that many are in the nature of annual fees or subscriptions.

There is a need to review these processes and make them more efficient and effective.

**Recommendation**

5. We recommend that the Director, Finance & Supply review and, where necessary, strengthen processes and controls to ensure that work does not start until the contract has been issued.

**Management Response**

5. Agree.

<b>Action Plan</b>	<b>Responsibility</b>
<p>a) Effective April 12<sup>th</sup>, 2010, Finance &amp; Supply monitor all invoice dates against Project Purchase Order dates. Instances of invoices pre-dating purchase order creation are investigated and reported weekly by Accounts Payable. Issues are documented and reported to the business unit Director for action.</p> <p>b) Finance &amp; Supply have implemented the required monitoring process and will complete the SOP documentation.</p> <p>Policies and LFME content will be updated as required.</p>	<p><b><u>Lead:</u></b> Manager, Finance, Corporate Financial Services</p> <p><b><u>Support:</u></b> Directors for all business units</p> <p><b><u>Completion Date:</u></b></p> <p>a) Completed April 2010            b) Q3, 2010</p>

**3.5 Reporting of Procurement Activities**

The City must be accountable to Calgarians for the use of public funds. It must be able to demonstrate that it conducts its procurement activities in an open, fair and transparent manner.

**Reporting to Council and the public is needed**

The City should report on the results of its procurement activities to demonstrate that it conducts these activities in an open, fair and transparent manner.

The AIT requires that senior levels of government report publically on their contracting activities. To comply with this requirement, information is provided on

both competitive and non-competitive contract awards and change orders. Although the AIT did not establish a similar requirement for municipalities, such reporting would be a leading practice for local government.

We found that there is no process in place for public reporting to Committee and Council on the results of procurement activities. The following information is provided electronically to the individual members of Council:

- A list of consultant contracts exceeding \$100,000 and tenders exceeding \$500,000 awarded is circulated on a quarterly basis.
- Proposed appointments of professional service providers over \$250,000 are circulated for information, for 10 working days prior to award as required by Council Policy FCS015.

Although these information circulations may meet Council's needs in this area, they do not achieve open and transparent public reporting and accountability. Prior to 2005, Council received a quarterly contract award report for information. However, in January 2005 Council approved discontinuing this report and replacing it with information on contract awards posted to the Supply Management website.

We reviewed the information posted on the website and found it to be incomplete. Information on awarded contracts was only available under the construction opportunities header and it did not include the value of the contract.

The City should consider implementing public reporting of both its competitive and non-competitive procurement activities that exceed a minimum monetary threshold, such as those in AIT/TILMA, as a best practice for demonstrating public accountability and transparency.

### **Compliance with FOIP access requirements can be enhanced**

Under section 89 of the FOIP Act, The City as a public body, must provide facilities "where the public may inspect any manual, handbook or other guideline used in the decision-making processes that affect the public by employees of the public body in administering or carrying out programs or activities of the public body". The facility can be a room housing paper material, access through a computer terminal or via the Internet. The City commonly refers to this facility as "the reading room".

In our view, the procurement processes are a decision-making process that affects the public and, therefore, information should be available for inspection. Accordingly, we contacted The City's "reading room" to determine what was made available for inspection under section 89 of FOIP.

We were referred by the FOIP Office to information on Calgary.ca. The Finance & Supply pages include a section titled Vendor Resources. These pages provide information to vendors including: The City standard terms and conditions used to support various procurement contract types, how to respond to procurement opportunities and list tenders that are open, closed or were awarded in the last quarter.

We found that the information provided was limited to competitive procurement opportunities. There was no information on contracts awarded through 'sole sourcing' or to pre-qualified bidders, nor were procurement policies available.

We concluded that while The City did provide a lot of information regarding its procurement practices, this information was not comprehensive. The City could improve the transparency of its procurement processes by including information about non-competitive procurements.

### **A mechanism for resolving disputes should be established**

As part of ensuring the openness and fairness of its procurement activities, we expected that The City would have established a mechanism to ensure complaints about procurement processes are received and evaluated in a timely and objective manner.

In addition, the AIT requires The City to have a documented process for resolving disputes under that agreement that may arise during the contracting process and to provide it to bidders upon request.

We found that The City does not have a documented process for resolving disputes around its procurement practices. We noted that informal mechanisms do exist to address issues that arise during the contract award process.

These mechanisms are communicated as part of the bid solicitation documents and consist of naming a contact within Supply Management to whom questions and concerns about the bidding process are to be directed. Based on our review of 100 Supply Management contract files, we concluded these mechanisms were reasonably effective in addressing informational and procedural matters around the bid processes.

We concluded, however, that these practices were not sufficient to address concerns that arose regarding fairness and appropriateness of the contracting process. There was no mechanism to escalate or report complaints regarding fairness of the procurement process to more senior levels within Finance & Supply for resolution.

We were unable to determine the frequency and nature of complaints received about City procurements due to the lack of management reporting in this area. However, as a result of publicity during the course of the audit, The City Auditor was contacted by a few individuals to register their complaints regarding The City's procurement activities. A number of these related to questions about process. However, in two particular cases, concerns were raised about the fairness and appropriateness of the bid process selected for the procurement. The first of these related to the procurement of materials. The complainant indicated that the bid specifications were too narrow. Our review found the specifications were not based on the generic performance requirement but instead identified a certain type of material. Specifications that identify a type of material rather than establish the performance requirements may exclude potential suppliers. We also noted that an RFP process was used rather than the tender process expected for the acquisition of materials.

The second related to a Notice of Intent issued regarding The City's intent to sole sourcing from an existing supplier on the basis of only one known supplier. The complainant indicated that they were capable of providing the requested services. Further, they were concerned about the requirement to file a formal objection and the lack of information provided in the notice on which to base an objection. Our review of the Notice of Intent found it did not contain sufficient information to allow other potential suppliers to make an informed decision regarding this opportunity. Further, the use of a Notice of Intent and resulting requirement to file an objection rather than the use of an Expression of Interest may deter potential suppliers.

We concluded, based on our review of the bid documents, that there may be merit to both complaints. As of the date of this report, both cases were under evaluation within Supply Management.

In our opinion, a mechanism for dispute resolution that is independent of the parties responsible for the bid process would be an effective control to help ensure the openness, fairness and transparency of the contract awards process. The mechanisms should include appropriate management reporting of complaints.

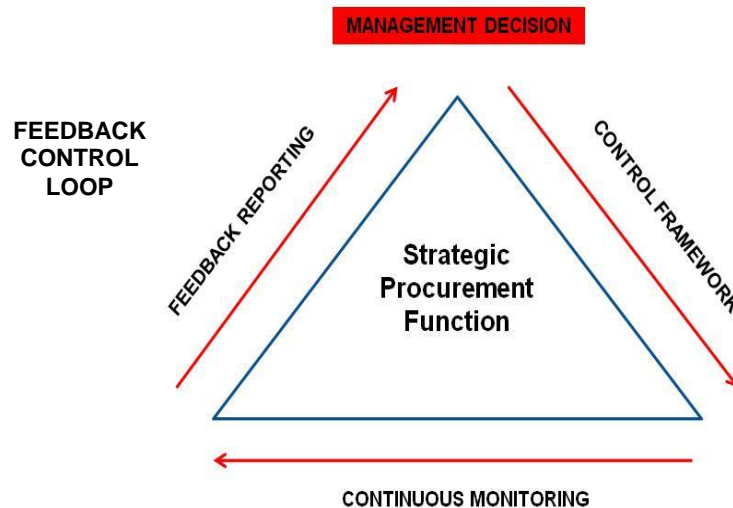
### **Management reports should be developed**

Metrics and other processing information (e.g. exception reports) are the foundation for evaluating performance, detecting and correcting process control breakdowns, and identifying opportunities for improvement.

Continuous monitoring and feedback reporting are key components needed for management to effectively oversee and control operations. The feedback reporting provides management with the basis for assessing its operations and



making decisions to initiate corrective action, including modifying the management control framework.



Although The City's ERP has report-writer and query functionality that is capable of providing reports to meet specific requirements, management failed to specify its procurement information needs and have any reports systematically generated by the system. This effectively left management working in an information vacuum for years which limited the ability to effectively manage and control The City's procurement activities.

We noted that Supply Management manually compiled and sent quarterly reports about contract awards over \$100,000 to the CFO. However, because they were manually compiled and not generated from FSCM data, they were prone to errors and omissions.

Apart from information provided in this report, there is no other reporting to management on The City's procurement activities. More specifically, we determined that the ERP system was not used to generate:

- Any metrics related to The City's procurement activities. These metrics would include, among others, the total volume and value of POs issued during a period, whether the POs were for goods, services, or construction, and if the PO resulted from a tender, request for proposal (RFP) or was awarded without competition.
- Any exception reports which would enable management to detect any control breakdowns and to implement appropriate corrective actions (e.g., business units bypassing the purchasing process to acquire goods and services).
- Any reports concerning The City's spending trends with various vendors, which would enable management to identify

opportunities to exploit The City’s buying power and to reduce processing costs.

**Recommendation**

- 6. We recommend that the Manager, Supply Management develop processes to systematically collect and report procurement information from the ERP system that will enable responsible officials to effectively manage and control The City’s procurement activities

**Management Response**

- 6. Agree.

Action Plan	Responsibility
a) The City’s Supply Chain Governance Policy has been approved. This policy clearly defines accountability for City spending, contracting and approval authorities.	<b><u>Lead:</u></b> Manager, Supply Management  <b><u>Support:</u></b> ESS, IT, Finance
b) The development of standard automated spend analysis reporting is in progress. Two PeopleSoft spend analysis reports have been defined and will be implemented in Q2 2010.	<b><u>Completion Date:</u></b> a) Completed April 2010 b) Q2, 2010 c) Completed April 2010
c) In addition, Supply Management currently uses The City’s corporate credit card spend analysis report for spend control management.	

**3.6 Reduction of Costs through Improved Strategic Procurement**

Opportunities to leverage The City’s buying power and reduce processing costs are being missed because information concerning The City’s spending trends was not available and existing procurement processes were not periodically reviewed and analyzed to ensure the use of resources was being optimized.

### 3.6.1 Use of Exclusive Vendor and Standing Offer Agreements

Our analysis of transactions less than \$75,000 identified 391 vendors who received more than \$200,000 in business from The City over three years. On average, these 391 vendors received 18,800 POs worth \$77 million each year.

We determined that some of the 391 vendors had contracts with optional renewal clauses to extend the life of the contract. These contracts establish an exclusive vendor arrangement whereby The City has contracted to make all of its purchases of a specific item or service from the selected vendor. The City receives significant price discounts in return. These contracts, which are competitively awarded, are based on price lists that may be adjusted from time to time based on the contract terms. The City, however, did not have a comprehensive listing or repository of its exclusive vendors.

We found limited evidence that The City had processes in place to identify other areas where The City could benefit from either an exclusive vendor agreement or other strategic procurement mechanism. With a Standing Offer Agreement (SOA), vendors agree to supply a range of goods and services to the organization at pre-determined prices, under set terms, *“as and when required”*. An SOA can also be issued to more than one vendor for the same goods or services. We were advised by senior staff in Supply Management that it is usually possible to obtain a price advantage (i.e. price discount or cash rebate) of 5% to 10% from vendors of frequently supplied goods and services under an SOA.

In addition to price advantages, SOAs and exclusive vendor arrangements can streamline the ordering process and reduce the processing costs. With well-developed processes to support these arrangements:

- Every business unit can place an order against an exclusive vendor contract or SOA, thus reducing the need to obtain quotes/bids and go through the vendor selection process;
- A single purchase order can be established with a vendor, often referred to as a “bulk” or “blanket” purchase order that every business unit draws against. This reduces the number of purchase orders that need to be processed, reduces the lead time for purchasing and therefore reduces costs.

- Payment processes would be streamlined, with payments based on certification of receipt of goods/services.
- Improved information would be available to Supply Management that can be used to achieve better prices based on predicted volume of purchases.

We also determined that a purchase order was currently issued for each purchase against an exclusive vendor arrangement instead of using a bulk or blanket purchase order. This inefficiency resulted in thousands of unnecessary purchase orders being processed each year.

Had processes been in place to issue only one purchase order or SOA to each of these 391 vendors instead of issuing a purchase order for each purchase, approximately 18,000 purchase orders could have been eliminated. This could have reduced The City's processing costs by an estimated \$1.6 to \$2.7 million a year in productivity savings.

We noted that Supply Management recently listed two SOAs on its intranet site with instructions for placing orders against them. An analysis of the instructions related to these two SOAs, however, determined that the process was specifically designed to meet the needs of one business unit and was not flexible enough for other business units to effectively use them, thereby minimizing the benefits of the two SOAs.

### **3.6.2 Evaluated Receipt Settlement System**

An evaluated receipt settlement (ERS) system does not require vendors to submit an invoice to receive payment. Instead, payments are based on contracts with accepted price lists and the quantities received. The key elements of an ERS system are:

- a pricing agreement between the buyer and vendor (i.e., a contract based on price lists that may be updated from time to time);
- a process for placing orders with the vendor;
- a process for updating approved changes to vendor price lists;
- accurate shipping information from the vendor; and
- verification and prompt entry of the goods received.

The City's ERS system, which was carried over from the Legacy system, was designed for purchasing inventory items valued at less than \$5,000. Over the period of January 2006 to April 2009, we determined that The City issued almost 35,000 POs totaling more than \$22 million to 25 ERS

vendors. As shown in Table 5, more than 98% of these POs were for less than \$5,000, which included almost 5,000 POs per year under \$100.

<b>Table 5: Summary of ERS Transactions</b>			
<b>PO Value (\$)</b>	<b># of POs</b>	<b>% of Count</b>	<b>Total Value</b>
0 to 999	30,246	86.93%	6,354,595
1,000 to 1,999	2,742	7.88%	3,861,295
2,000 to 2,999	868	2.49%	2,068,615
3,000 to 3,999	309	0.89%	1,063,215
4,000 to 5,000	187	0.54%	830,408
Greater than 5,000	441	1.27%	8,035,536
<b>Totals</b>	<b>34,793</b>	<b>100%</b>	<b>22,213,664</b>
<b>NOTE: Almost 5,000 POs for less than \$100 issued to make purchases that totaled less than \$200,000 each year.</b>			

Our review determined that:

- Contractual agreements were not in place for all ERS vendors
- The City's ERS ordering process was inefficient as a PO was issued for each purchase instead of having one PO for each ERS vendor that references each order to that PO. As a result, The City was needlessly processing, on average, more than 11,500 POs per year.

### **Recommendation**

7. We recommend that the Manager, Supply Management review and make recommendations to the CFO regarding:
  - Developing and implementing processes and controls to enhance the use of strategic purchasing alternatives, such as exclusive and standing order arrangements.
  - Enhancement to the ERS system to ensure that resources are being optimized.

### **Management Response**

7. Agree.

Action Plan	Responsibility
<p>a) Effective evaluation and implementation of strategic procurement alternatives, including request for standing offer agreements (RFSO) will be evaluated.</p> <p>b) Exclusive vendor contracts are in place for specific programs and commodities and undergo regular reviews to ensure The City continues to receive best value.</p> <p>Business unit education will continue on new procurement policies and supply chain governance policy to ensure all City business units understand procurement is a strategic activity which is the responsibility of Supply Management.            FA-033 Guiding Principles.            FA-037 Vendor Classification.</p> <p>c) Evaluated Receipt Settlement (ERS) was expanded in 2010 with all fuel purchases moved to ERS process. Additional opportunities for ERS use are under evaluation. Findings and recommendations on expended ERS use by Q4 2010.</p>	<p><b>Lead:</b> Manager, Supply Management</p> <p><b>Support:</b> Directors of all business units</p> <p><b>Completion Date:</b></p> <p>a) Q4 2011            b) Completed Q4 2009            c) Q4 2010</p>

### 3.7 The Use of Field Buyers should be Re-evaluated

Historically, the role and ability of Field Buyers to make purchases stems from the use of local purchase orders (LPOs), which allowed authorized employees to make purchases under \$1,000 to cover any immediate business needs. Over time, the LPO was phased out and replaced by the P-card, which in turn was later replaced by the corporate credit card (CCC).

The CEO's November 2003 Confirmation of Delegation provided Field Buyers with a \$15,000 financial signing limit to approve the release of a field purchase order.

We found there were 62 employees with Field Buyer authority as part of their FSCM user profile.

Over the period January 2006 to April 2009, Field Buyers initiated more than 9,700 POs totaling \$147 million as shown in Table 6.

<b>Table 6: Summary of Field Buyer Transactions</b>			
<b>PO Amount (\$)</b>	<b># of POs</b>	<b>% of Count</b>	<b>Total (\$)</b>
0 to 4,999	7,008	71.8%	8,285,973
5,000 to 9,999	1,082	11.1%	7,441,822
10,000 to 15,000	460	4.7%	5,686,503
Greater than 15,000	1,214	12.4%	125,780,532
<b>Totals</b>	<b>9,764</b>	<b>100.0%</b>	<b>147,194,830</b>

We found, on further analysis, that purchase orders over \$15,000 were routed by FSCM to Supply Management for further review and approval through the workbench feature. Although the automated system control was effective in ensuring the purchase orders were properly authorized prior to release, they do point to a need to inform field buyers of their non-compliance with the limits of their purchasing authority.

We also determined that:

- 24 Field Buyers had no transactions and that one of these Field Buyers is no longer employed by The City;
- 8 Field Buyers averaged less than 4 transactions a year that resulted in purchases totaling only \$35,000 a year.

Supply Management should perform regular reviews, at minimum annually, to ensure field buyer privileges are still necessary. Where the usage does not support the continuing need for this profile, it should be discontinued.

Our analysis determined that 72% of the purchase orders issued by field buyers were less than \$5,000. The City has identified the CCC is the preferred method of procuring and paying for goods and services under \$5,000.

We did not find any evidence that these small-value items had been reviewed to determine whether the CCC or other procurement mechanism could be used to make this process more efficient.

Had the Field Buyers been able to use their CCC to make these purchases instead of issuing POs, The City could have eliminated up to 2,850 small-value purchase orders, which would reduce processing costs by an estimated \$142,500 to \$325,000 annually and potentially realize some price discounts.

**Recommendation**

- 8. We recommend that the Manager, Supply Management, review the role of Field Buyers and make recommendations to the CFO to either optimize this role or eliminate it.

**Management Response**

- 8. Agree

Action Plan	Responsibility
a) December 2009 - Supply Management reviewed all field buyer IDs, deleted all inactive accounts, and validated remaining field buyers as active users. A regular review will be completed quarterly.  b) We will initiate the review of need for field buyer role, and make recommendations to the Director, Finance & Supply on future role application.	<b><u>Lead:</u></b> Manager, Supply Management  <b><u>Support:</u></b>  <b><u>Completion Date:</u></b> a) Completed Q4 2009 b) End Q4 2010

**3.8 Computer Processing and Controls can Streamline Processes**

The City uses the Financial and Supply Chain Management (FSCM) modules that are part of its PeopleSoft Enterprise Resource Planning (ERP) system to support and facilitate its procurement activities.

FSCM provides extensive functionality that can be used to streamline processes and automate key control functions to ensure their ongoing effectiveness.

We found The City has not optimized its use of FSCM and still uses manual procedures in areas that can be enhanced and streamlined through automation.



### 3.8.1 Budgetary Control Check

The ERP system functionality, for conducting either budgetary control checks to ensure sufficient funds are available for the contract and to encumber funds when the contract is awarded, has not been enabled by The City. These control procedures continue to be performed manually.

A budgetary control check and encumbrance accounting are especially important for procurement transactions, which result in legal obligations to pay for goods/services at some future point in time. The budgetary control check and encumbrance accounting prevents overspending by:

- first, checking if there are sufficient funds available to pay for the transaction and preventing the contract award where available funds are insufficient;
- then, setting aside funds in the budget to cover the future financial obligation (i.e. encumbrance or commitment); and
- ensuring the uncommitted budget available or “free balance” is accurate in management reports. Accurate reporting of the free balance can assist line managers to efficiently monitor their budgets.

The ERP system, acquired by The City in 2001, came with budgetary control and encumbrance accounting features. However, because of problems experienced during implementation, these features were not activated.

The lack of an upfront budgetary control check is illustrated by the following incident where a \$73,500 change order was erroneously entered as \$73.5 million, which resulted in a significant unfavorable budget variance for the business unit. Although the error was readily apparent in the financial reports for more than six months, it was never questioned or acted on by the business unit or finance staff. An upfront budgetary control check by the ERP system would have prevented this transaction from being processed. This error, which was detected by Audit, has since been corrected by Supply Management.

Because the available functionality in FSCM has not been configured and enabled, Supply Management obtains representations from business units that sufficient funds are available to cover a purchase. These representations are obtained using a manual form, with procedures used to collect the information varying between buyers.

Manual procedures are inherently inefficient as they are prone to error, inconsistent application and consume staff resources to process. This can result in delays in awarding the contract. Supply Management should automate these controls using the functionality available in FSCM.

### **3.8.2 Transaction Approvals**

The FSCM also has functionality to automate the processing of transactions and approvals, known as “work flow”; however, The City does not fully take advantage of this feature. Work flow functionality, where properly implemented, is an effective control to ensure transactions are approved by the proper authority.

We found that while some work flow has been implemented in FSCM for the contracting/purchasing process, it is incomplete and not fully used. We identified the following areas that should be addressed by management.

Under The City’s Dept ID structure, designated managers are responsible and accountable for managing their budgets. This has been implemented in the work flow process as a requirement for manager approval of any purchase requisition valued at greater than \$5,000, to the limit of their budget. However, the work flow does not include any secondary management approvals, such as those based on monetary thresholds or type of procurement. This is not consistent with the City Manager’s 2003 delegations of authority. Review and approval of significant purchasing decisions by senior management is an important internal control that should be included in the work flow.

Staff at Supply Management have responsibility and authority for processing and issuing purchase orders. The delegated monetary approval limits of Supply Management staff are set up under their user profiles within the ERP, which automatically directs the purchase order to the appropriate signing authority.

We determined that user profiles in the FSCM for Supply Management staff have not been set-up in accordance with the City Manager’s November 2003 Confirmation of Delegation as shown in Table 7. As a result, the work flow did not automatically direct purchase orders over \$250,000 to the appropriate signing authority for review and approval.

<b>Table 7: Comparison of Delegation by City Manager to ERP User Profile Signing Limits</b>		
<b>Confirmation of Delegation</b>		<b>ERP User Profile</b>
<b>Position Title</b>	<b>Limit</b>	<b>Limit</b>
Field Staff/Inventory Analysts	15,000	15,000
Buyer Assistant	30,000	30,000
Buyer	50,000	50,000
Senior Buyer	99,999	99,999
Purchasing Agent <b>(Note)</b>	250,000	Over 100,000
Strategic Procurement Coordinator <b>(Note)</b>	500,000	Over 100,000
Manager, Supply Management	Unlimited	Over 100,000
<b>Note: ERP User Profile incongruent with CEO Confirmation of Delegation</b>		

We found that, in practice, Supply Management is using manual processes to obtain approval from senior staff in the Division. Supply Management staff prepare an Award Recommendation Summary (Award Summary) for all major contracts, which is routed through various levels for review and approval before it reaches the appropriate signing authority. Once the form is approved, a Purchasing Agent will electronically approve and dispatch the purchase in the FSCM. This practice delays approvals, increases the time to award the contract and bypasses the automatic routing capabilities of the FSCM system.

The use of work flow to route documents for approval should be reviewed, optimized and made mandatory.

**Recommendation**

9. We recommend that the Director, Finance & Supply take steps to improve process efficiency by enhancing the use of available FSCM/ERP functionality, including:
  - Implementing the budgetary control and encumbrance accounting functionality that came with the ERP system;
  - Optimizing the use of work flow to ensure processes are efficient and controls effective; and
  - Ensuring FSCM user profiles of Supply Management staff correctly align with the authority delegated by the City Manager.

**Management Response**

9. Agree.

Action Plan	Responsibility
<p>a) Supply Management intends to review these processes when The City completes the PeopleSoft system upgrade to version 9.1 in 2011. Feasibility will be determined including costs and benefits of implementing the delivered budgetary control, encumbrance accounting and work flow processes that come with the ERP suite of systems.</p> <p>b) In the interim period, existing budgeting and financial spend monitoring processes, aligned as part of the DeptID structure, serve to ensure strict compliance to budget.</p> <p>Supply Management have reviewed the Supply FSCM user profiles and ensured alignment with City delegated procurement authority.</p>	<p><b>Lead:</b> Manager, Supply Management</p> <p><b>Support:</b> ESS, Finance</p> <p><b>Completion Date:</b></p> <p>a) End Q3 2011            b) Completed April 2010</p>

### 3.8.3 Vendor File Maintenance

A purchase order or payment cannot be issued until the vendor has been set up in the ERP's Vendor File. This is an effective control feature.

Responsibility for maintaining the Vendor File rests with Corporate Accounts Payable (CAP). The ability to update the Vendor File must be carefully restricted and all changes must be properly substantiated.

We determined that:

- Authority to update the Vendor File is restricted to a few Vendor Clerks in CAP and that management at CAP carefully monitors the user profiles of its employees to ensure Vendor Clerks do not also have the ability to process any vouchers.
- Documentation requirements and processes have been established for updating the Vendor File as well as ensuring the updates are properly substantiated. More

specifically, the process includes the review and approval of a Vendor Audit Report that is generated daily by the ERP system, which itemizes the changes made by each Vendor Clerk to the Vendor File.

Although access was properly restricted and there were documentation requirements and processes for updating the Vendor File, we identified the following weaknesses related to Vendor File maintenance.

### **Inactive Vendors**

Best practices indicate that the Vendor File should be periodically reviewed and that inactive vendors be removed to mitigate the risk of fraudulent activity and inadvertent processing errors.

We determined that processes have not been established to systematically remove inactive vendors from the Vendor File.

Our analysis determined that 38% of the 64,083 vendors in the Vendor File had not received any payments since January 2006. In discussions with staff, we learned that the Vendor File has not been purged since information was converted from the old Legacy system to the ERP system in 2001. Purging of inactive vendors on a periodic basis is a control that helps prevent errors such as purchase orders or payments issued to incorrect vendors.

### **Vendor File Information**

Processes have not been established to ensure that all pertinent vendor information is in the Vendor File.

Our review of the Vendor File identified 1,797 vendors that had no postal code and 35,348 vendors that had no GST Registration Number. We were informed by staff that the majority of these information gaps were carried over from the old the Legacy system in 2001.

### **Vendor Audit Report**

CAP procedures require that the vendor audit report be reviewed and approved on a periodic basis. Such reviews can help prevent transaction errors and identify unusual vendors for further investigation.

Although we found evidence of these reviews, it often just consisted of check marks and the initials of the reviewing officer. There was no date to indicate when the review had been performed. As a result, there was no

management trail indicating when the Vendor File changes were approved and by whom.

**Recommendation**

10. We recommend that the Manager, Supply Management ensure effective processes are developed to maintain the vendor file, including:

- deactivation and/or purging of inactive vendors from the Vendor File;
- capturing all pertinent vendor information in the Vendor File; and
- having the Vendor Audit Report signed and dated by the reviewing officer.

**Management Response**

10. Agree

Action Plan	Responsibility
<p>Work plans are in place to purge inactive vendors and capture relevant vendor data in the Vendor File. Finance &amp; Supply expect the project will be completed by the end of Q4 2010.</p> <p>The Vendor Audit Report sign off process is in place.</p>	<p><b><u>Lead:</u></b> Manager, Finance            Corporate Finance Services</p> <p><b><u>Support:</u></b></p> <p><b><u>Completion Date:</u></b>            End Q4 2010</p>

**3.8.4 Purchase Order Terms and Conditions**

The City requires the use of a PO to evidence award of all procurement contracts. A single PO template has been set up for all procurements. This template is copied and/or adjusted for each use. This increases the risk of errors and omissions in this key document.

We found that the PO terms and conditions for minor construction contracts did not contain any provisions concerning insurance requirements, right to audit and assignment of contract.

By comparison, POs for large construction contracts reference the Standard General Conditions and related bid documents. Similarly, POs for consulting contracts reference the Master Consultants Agreement (MCA) and related bid documents.

The use of a single PO document series also limits the ability to determine the type of contract on-line as well as limits the use of FSCM data and reports to analyze spending patterns and to optimize the work flow by type of procurement. Traditionally, a PO is only used in most procurement systems to order goods.

The FSCM system can be configured to assign unique document identifiers to different types of procurement contracts. Each set of unique identifiers can then be matched to a document template that contains the appropriate contract requirements and a work flow that routes to the proper approval authority. This streamlines the approval process.

Further, with unique document identifiers by procurement, the ERP system report writer functionality can be used to develop specific reports and exceptions by contract type.

Supply Management should review and fully implement available functionality within FSCM to streamline the processing of various types of procurement documents.

### **Recommendation**

11. We recommend that the Manager, Supply Management take steps to improve process efficiency by enhancing the use of available FSCM/ERP functionality, including developing an agreement similar to MCA for minor construction and repair work contracts to better protect the interests of The City.

### **Management Response**

11. Agree

Action Plan	Responsibility
<p>We will review and examine opportunities to contract minor construction and repair work including the use of agreements similar to the MCA, non-exclusive contracts and other methods.</p>	<p><b>Lead:</b> Manager, Supply Management</p> <p><b>Support:</b> ESS, Finance</p> <p><b>Completion Date:</b> End Q2 2011</p>

### 3.8.5 Closing Purchase Orders

Purchase orders should be closed as soon as possible after the final invoice for the goods or services is received from the vendor. Promptly closing the purchase order:

- releases any unspent funds and, reduces the encumbrance recorded in the financial system by a corresponding amount;
- reduces the number of active purchase orders, which in turn improves system performance and decreases the time required to find a purchase order that actually needs to be modified;
- reduces the number of issues related to older purchase orders that were coded to superseded 'Chartfields'; and
- makes archiving of data easier

The FSCM system has been configured to automatically close any purchase order that meets certain pre-set criteria and parameters. If the criteria and parameters for automated closing are not met, a form must be submitted to Supply Management to initiate the process to reconcile and close the purchase order.

However, there was no clear direction to business units assigning responsibility for initiating this process. The only information related to the purchase order reconciliation process that we found is located on the Enterprise Support System intranet site under Supply Chain Management Online Help.

Although the site clearly indicates that business units should be running certain reports and reconciling purchase orders on a regular basis, we concluded that there is no effective process in place to ensure purchase orders are closed when the work is completed/goods received.



The effect of this is shown in Table 8, which shows there were 6,010 open POs worth more than \$652 million that predated January 1, 2009 at the end of 2009.

<b>Table 8: Summary of Open Purchase Orders</b>				
<b>Year</b>	<b># of POs</b>	<b>Fund 20 (\$)</b>	<b>Fund 40 (\$)</b>	<b>Total (\$)</b>
2004	272	1,228,010	19,244,137	20,472,147
2005	619	5,741,682	13,098,757	18,840,439
2006	1,222	82,690,866	92,539,934	175,230,800
2007	1,526	27,140,938	88,122,473	115,263,411
2008	2,371	48,655,129	274,246,358	322,901,487
<b>TOTAL</b>	<b>6,010</b>	<b>165,456,625</b>	<b>487,251,659</b>	<b>652,708,284</b>

System analysis determined that criteria and parameters in the ERP system for automated purchase order closing were too narrow and could be expanded. In this respect, our analysis determined that each purchase order has a “*due date*” recorded in the ERP system (i.e. the expected date that goods will be delivered or services will be completed).

Using the recorded ‘*due date*’ as one of the primary drivers to close a purchase order would significantly reduce the administrative efforts of staff to reconcile and close a purchase order, especially at year-end when the only open purchase orders should be for:

- goods that will be delivered or services that will be completed in the new year; and
- multi-year capital construction projects.

Another possibility that would take advantage of the ERP system is a simple data entry screen, which would enable the business unit to issue an instruction that permits the ERP system to automatically reconcile and close an open purchase order. For example, a business unit could issue an instruction to automatically close a completed purchase order that has an unspent balance of \$500 instead of preparing and submitting a manual form that Supply Management staff must enter.

Of the over \$652 million in open POs, our analysis determined that purchase orders with due dates after December 31, 2008 totaled \$335 million. This indicates that the other \$317 million, of which \$136 million relates to the Operating Fund and \$181 million relates to the Capital Fund, should have been reviewed for potential closure. Our detailed testing confirmed that over 50% of the open POs that pre-date 2009 should have been reconciled and closed.

The ERP system is also not configured to effectively deal with holdbacks or non-resident withholding taxes (NRWT). In practice, a line for \$0.01 is added to these purchase orders to flag them as being subject to holdbacks or NRWT. These purchase orders require special handling when complete and must be routed to ESS staff who force-reconcile and close these purchase orders. This special handling need could be eliminated if the ERP can be configured to effectively deal with these situations.

**Recommendation**

12. We recommend that the Director, Finance & Supply:

- clearly assigns and communicates responsibilities for purchase order reconciliation;
- establishes the PO “due date” as a primary driver in the ERP to systematically close open POs;
- investigates ERP functional capabilities and feasibility of allowing business units to trigger automated purchase order closing;
- investigates the ERP functional capabilities to better handle purchase orders subject to holdback and NRWT;
- establishes an effective and efficient process to close purchase orders that are no longer needed.

**Management Response**

12. Agree

Action Plan	Responsibility
<p>a) Supply Management will assign PO reconciliation to project managers consistent with business unit accountability specified in procurement policies, following the principles and responsibilities of DeptID ownership. Stakeholder compliance will be monitored by Supply Management using recently created PeopleSoft automated reporting tools.</p> <p>b) Supply Management will evaluate the use of the purchase order “due</p>	<p><b><u>Lead:</u></b> Manager, Supply Management</p> <p><b><u>Support:</u></b></p> <p><b><u>Completion Date:</u></b></p> <p>a) Q3 2011            b) Q2 2011            c) Q2 2011</p>

<p>date” or other methods to establish an effective and efficient process to systematically close open purchase orders (POs) that are no longer active.</p> <p>c) Supply Management will research with the PeopleSoft team to investigate feasibility of using existing ERP functional capabilities to better handle PO holdback and Non Resident Withholding Tax (NRWT).</p>	
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### 3.9 Contract File Maintenance

Each contract should support the decision making process and clearly demonstrate that the procurement process was open, fair and transparent, and that The City obtained the best value with public funds.

In this regard, each contract file should provide a complete chronological record of all options, decisions, and actions taken over the life of the contract. The file should also identify the officials who made decisions and/or approved the action taken. The records that should be on file, as applicable, range from contract justification and approval forms, contract specifications, vendor bid documents, and bid evaluations to proofs of security, signed contract documents, change orders; correspondence, and contractor performance evaluations.

We determined that Supply Management staff had developed a checklist of records that should be in the file. However, processes were not in place for using this checklist to ensure the files were complete.

Our review of the contract files determined that they did not always provide a complete chronological history of events and actions over the life of the contract and who made decisions. For example, our review determined that:

- Copies of change orders issued by Supply Management and/or the related supporting documentation were missing from many of the larger files;
- Performance evaluations are not always on file. In this respect, an independent consulting report determined performance evaluations were missing from 73% of the files; and

- Evidence of obtaining quotes was missing from many lower value contract files.

**Recommendation**

13. We recommend that the Manager, Supply Management develop administrative processes to ensure contract files are complete and contain sufficient documentation to clearly substantiate the decision-making process.

**Management Response**

13. Agree

Action Plan	Responsibility
a) Supply Management will review existing file content maintenance, and content management processes and practices. A random internal file content audit will be implemented.  b) The timing for completion and implementation will align with the go live date for the Upside Contract Management System.	<b><u>Lead:</u></b> Manager, Supply Management  <b><u>Support:</u></b>  <b><u>Completion Date:</u></b> a) End Q3 2010 b) Q3 2010

## 4. About the Audit

The audit work for this project was substantially completed on 2009 February 20.

### Audit Team

Deputy City Auditor: W. Markowski  
Audit Associates: E. Gutland  
C. Salazar  
Auditor: J. Norris

### Report Milestones

Preliminary audit report issued: 2010 March 26  
Final audit report issued: 2010 May 05

Audit Report issued to: E. Sawyer, Chief Financial Officer

cc: O. Tobert, City Manager  
B. Koay, Director, Finance & Supply/ City Treasurer