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OFFICE OF THE CITY AUDITOR
Audit Report

PERFORMANCE AUDIT: PURCHASING

November 2008



Stockton, California

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CITY OF STOCKTON

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Stockton City Council

AUDIT SUMMARY - PERFORMANCE AUDIT: PURCHASING

We have completed our performance audit of the City's Purchasing process in accordance with our 2007-2008 audit plan.

Our audit objectives were to assess compliance with City Charter, Stockton Municipal Code, and City policy. In addition, we worked to answer questions regarding the purpose of the City Manager expenditure threshold, whether the City receives benefits of a centralized purchasing function, whether the City's use of sole source and cooperative purchase agreements appeared reasonable, and to identify the timeline for the purchasing process. Below is a summary of our observations and conclusions.

We conclude that in general, the City complied with the rules and regulations related to the purchasing process. The use of sole source and cooperative purchase agreements appeared reasonable. In addition, we conclude that the City can benefit more from a centralized purchasing function if the Financial Management Department, Purchasing Division (Purchasing) takes a more proactive role in improving communication with procuring departments, and responding to instances of non-compliance or poor procurement planning.

We did note areas where controls could be improved as listed below:

- The expenditure threshold for requiring Council approval is not clearly defined and is subject to inconsistent interpretation.
- Agreements with retired City employees returning to work as independent contractors are not being submitted to the California Public Employee Retirement System for review to ensure that an employer/employee relationship does not exist.
- Compliance monitoring of Authorization for Payment transactions, which are processed outside the purchase requisition system, is not occurring.
- Purchasing does not control access and content of the Bid Flash web page, which can put the City at risk if inaccurate or incomplete information is posted.

- If management elects to use elapsed time as a measurement of procurement performance, changes are needed to capture the information.

Additional information is presented in the Audit Report.



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PERFORMANCE AUDIT: PURCHASING

In accordance with our 2007-2008 audit plan, we have completed a performance audit of the City's Purchasing process.

BACKGROUND

The City's Financial Management Department, Purchasing Division (Purchasing) is responsible for the procurement of all supplies and services necessary for the operation of the City. Purchasing is responsible for centralized purchasing processes, which includes administration of the City's electronic purchase requisition system, purchase card system, maintenance of the City's purchasing manual and related forms, and operation of Central Stores. Purchasing also oversees the reprographic and mail room activities.

Although the City maintains a centralized purchasing system, individual departments play a significant role in ensuring an effective and efficient process. Each City department is assigned a Buyer, who facilitates procurement. Departments are often called on to establish order specifications, and/or identify potential vendors. Cooperation and good communication between Purchasing and the procuring department is essential to efficient and effective operations.

Within the last few years, Purchasing has experienced significant change. Of the five City employees assigned to Buyer activities, three senior level buyers retired, including the Purchasing Agent. In addition, with the termination of the OMI Thames municipal utilities contract, Purchasing facilitated the transition and return to City control of procurement and inventory stores activities related to utility operations.

During Council Budget/Finance/Economic Development Committee meetings in August and October 2006, there were discussions about current Charter procurement requirements that are inconsistent with best practices, and the impact these requirements have on the policy setting authority of the Council. The Committee heard that by removing language from the Charter, Council could set the City Manager's expenditure authority, and establish the controls needed to ensure adequate fiscal oversight. It was noted that any change to the Charter would require a vote of the people.

The authority for the City to purchase supplies, equipment, and services is granted in the Charter. Additional guidance is provided in the Stockton Municipal Code (SMC), and City policies and procedures. The Charter establishes an expenditure threshold (initially \$20,000), below which the City Manager may contract without prior City Council action. Purchases involving expenditures in excess of the threshold must be awarded by the City Council, and require a competitive bidding process. Beginning in 1993, the expenditure threshold could be increased by Council Resolution in an amount not exceeding a specified consumer price index. For the fiscal year ending June 2008, the expenditure threshold was \$28,737.

The Charter and SMC provide exceptions to the competitive bidding requirements, including emergencies, negotiated contracts following solicitation of competitive proposals, sole source vendors, and cooperative purchase agreements through other governmental agencies. The Council must approve the justification for using one of these exceptions. The Committee was informed that in the case of Request for Proposals (RFP), which must be approved by Council before the RFP is issued, projects are delayed between two and four weeks waiting for approval to proceed.

OBJECTIVES AND SCOPE

An objective of our audit was to assess compliance with Charter, SMC, and City policies and procedures. In addition, we worked to answer questions regarding the purpose of the City Manager expenditure threshold, whether the City receives benefits of a centralized purchasing function, whether the City's use of sole source and cooperative purchase agreements appeared reasonable, and to identify the timeline for the purchasing process.

The scope of our audit focused on procurement activity flowing through the centralized system. Compliance testing focused on transactions during the period January 2006 through December 2007. We did not review the purchase card system, or the operations of central stores, as our office has issued reports related to recent work in each of these areas.

METHODOLOGY

To gain an understanding of the purchasing process, we reviewed applicable Charter, SMC, and City policy documents. We reviewed prior audit work papers, and work flow studies. We met with management to gain an understanding of their concerns. Based on this preliminary work, we developed a list of audit issues or questions that became our audit objectives. We provided the list of questions to management for concurrence. Using each audit question as a testing objective, we identified the applicable criteria, evaluated controls, documented our procedures, and summarized our results. Where issues of non-compliance were observed, we communicated them to City management with our recommendations for improvement.

We provided management with suggestions for system improvements under a separate memorandum. Suggestions for improvement are those conditions deemed by the auditor to be of less significance than audit findings. Generally, these are areas where procedures could be more efficient or where opportunities exist to make minor improvements. No follow-up work is performed on suggestions for improvement.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

RESULTS

Based on the results of our work, we conclude that in general, the City is complying with the rules and regulations related to the purchasing process. Below are the results of our efforts to answer specific purchasing process questions, the resulting audit findings, and management's plans for corrective action:

What is the purpose of the City Manager expenditure threshold?

In general, the expenditure threshold is intended to provide a level of fiscal oversight and control. First, the threshold requires Council review and approval of larger contracts and expenditures. Second, the threshold requires that larger contracts be procured through a competitive bidding process, with some exceptions as previously described in the Background section of this report (page 2).

The City Auditor conducted an informal survey of other local government entities, and based on the results, Stockton's expenditure threshold is low. Of the 26 government entities that responded to the City Auditor's inquiry, 12 listed an expenditure threshold of \$100,000 or higher. Two respondents had no expenditure threshold. Only five agencies had thresholds lower than Stockton's, most of these were cities a fraction of the size of Stockton. We noted that some agencies had two thresholds, one to trigger the need for a competitive bidding process, and another for requiring Council action.

Dollar Threshold Range	Agencies Responding
\$15,000 to \$29,999	6
\$30,000 to \$99,999	6
\$100,000 to \$199,999	8
\$200,000 and over	4
No expenditure threshold	2
Total Responses	26

Raising the expenditure threshold could free resources allowing for increased focus on larger, more complex transactions. Of the 12,000 Purchase Orders (POs) created between January 2005 and December 2007, two percent (2%) had order costs (unit cost x quantity) over \$100,000. However, these transactions represented eighty-eight percent (88%) of the total order costs. The City's need for fiscal oversight may be better

served by empowering staff to act on transactions below \$100,000, while focusing greater attention on larger transactions.

Are purchase transactions processed in compliance with Charter, SMC, and written City policy?

During the period December 2005 through December 2007, we identified the creation of just over 12,000 POs. From this population of transactions, we selected samples of various types of purchases for compliance testing, including emergency purchases, sole source procurements, and cooperative purchase agreements. In addition, we scanned the total population of POs sorted by date, dollar amount, vendor, and purchase location to identify trends or non-compliance issues. Except for the items described below, we noted no significant compliance issues during our testing of selected purchasing transactions.

Management Comment:

In May 2005, Purchasing staff evaluated and analyzed the Charter of the City of Stockton, Article XX Public Contracts and Supplies Section 2000 Letting of Certain Contracts.

The California Government Code procurement threshold is currently \$100,000, which provides flexibility to the General Law Government Cities and Counties. Purchasing staff surveyed selected Charter Cities for their council limits for their City Manager: San Diego \$1,000,000; Sacramento \$100,000; and San Jose \$100,000.

Increasing the limit to \$100,000 would not eliminate the competitive method of awarding contracts for Public Works services and the purchase of materials, supplies, and services, there is an ordinance and City Manager Administrative Directives which addresses the method. The increase would provide the City Manager, Public Works Director and City Purchasing Agent the flexibility to meet the increased activities of projects within the \$29,685 limit to \$100,000 levels.

Purchasing staff made a Charter Amendment recommendation with the assistance of the City Attorney's Office to increase the Charter limit for contracts approved by the City Manager to \$100,000. At that time it was determined to postpone the amendment to another time.

FINDING: The expenditure threshold for requiring City Council approval is not clearly defined.

Charter and SMC state that the City Manager may make and execute contracts and authorize expenditures of less than \$20,000 (indexed). Contracts involving expenditures of more than \$20,000 (indexed) shall be awarded by the City Council.

The expenditure threshold for requiring City Council approval is not clearly defined in the Charter, SMC, or City policies and procedures. Transactions can be structured to avoid the requirements of the threshold, and the question of whether this violates the Charter is subject to inconsistent interpretation. In addition, there is no specific prohibition against structuring transactions to avoid the threshold.

As an example, a remodeling project required similar work in different locations within the department's facilities. The vendor provided a single document to bid on the work, and received payment for all work in a single check. Yet, the project was entered as five (5) separate purchase requisitions that exceed the expenditure threshold in the aggregate. The decision to structure the purchase in this way occurred before the contract or expenditure, and served no apparent business purpose other than to avoid the threshold.

Management Action Plan:

The Purchasing Manual will be revised to more clearly define the City Charter, section 2000 and SMC section 3-103, 3-104 to ensure compliance in the procurement process, and prevent any action that might violate the Charter, or appear to be circumventing purchasing policies or threshold requirements.

Target Date for Corrective Action: June 1, 2009

FINDING: Agreements with retired City employees returning to work as independent contractors are not being submitted to the California Public Employee Retirement System (CalPERS) for review.

CalPERS requires agencies to submit for review any agreements with retired agency employees returning to work as "independent contractors" prior to the commencement of work to ensure that it is not an employer/employee relationship. While contracting with retired employees can be a reasonable means of obtaining needed services, there are regulatory issues that must be addressed.

We noted four (4) instances of retired employees returning to work as independent contractors. None of the agreements were submitted to CalPERS for review to verify the "independent contractor" status. In addition, there was no mechanism in place to ensure the agreements are submitted for review. Both the City and retired employee are at risk if the arrangement is deemed to be an employer/employee relationship.

Management Action Plan:

Human Resources Department is identifying and submitting to CalPERS the necessary agreements for their review. Purchasing will revise the Purchasing Manual to ensure future retired employees' agreements are reviewed by Human Resources.

Target Date for Corrective Action: June 1, 2009

FINDING: Compliance monitoring of Authorization for Payments is not occurring.

In order to expedite payment of certain claims, and at the same time eliminate unnecessary paper work, certain types of goods and services have been approved for payment by the department head without the necessity of initiating a requisition and subsequent PO. This can be accomplished by submitting an Authorization for Payment form.

City policy requires the Financial Management Department to take random samplings of Authorization for Payment transactions to monitor compliance. Currently, there is no process in place to systematically select random samples of Authorization for Payment transactions for compliance monitoring.

Management Action Plan:

Purchasing will work with Accounting to formalize a process/procedure for sampling Authorization for Payment transactions. The Directive will include a process for reporting exceptions, corrective action, and follow-up.

Target Date for Corrective Action: June 1, 2009

Is the City benefiting from a centralized purchasing function?

Some of the benefits of a centralized purchasing function are streamlined administrative processes, tighter control of policies and procedures, and leveraging knowledgeable and experienced buyers. Based on our discussions with Purchasing and procuring department staff, we concluded that this is an area where there is opportunity for improvement, especially in light of recent staff turnover in Purchasing.

Although the City has centralized processes and procedures, Purchasing can do more to strengthen its role as a control point. When compliance issues or evidence of poor procurement planning are identified, Purchasing should take a more proactive role in communicating these issues to the appropriate level to ensure that corrective action is taken, to identify issues common to multiple departments, and to ensure that any needed training is provided.

Purchasing can do more to improve communication with procuring departments. This could go a long way in reducing the expectation gap between what procuring departments require and what Purchasing can provide. Purchasing can provide periodic training, publish general processing timelines, and schedule routine meetings with high demand departments to anticipate their needs.

FINDING: Purchasing does not control access and content of the Bid Flash web page.

No single department or functional area is responsible for authorizing access to and monitoring the content of the Bid Flash web page. The City posts bid requests, project specification and timelines, questions from vendors, and other process related information on the site. Although clearly connected to the procurement function of the City, the Purchasing Division is not the “owner” of the site, and does not control access or content. Having access to add content to the Bid Flash page gives the user access to make changes to all posted projects. Posting incorrect information could put the City at risk.

Management Action Plan:

Purchasing has worked with the Webmaster and has authorized only Purchasing, Public Works, and Municipal Utilities to add and delete content to the Bid Flash page. An Administrative Directive will be written for this activity.

Target Date for Corrective Action: June 1, 2009

Is the volume and justification for sole source contracts reasonable?

Sole source transactions are an exception to the competitive bidding requirement, and are used when only one vendor is positioned to provide the needed equipment or service. Justification for using the exception must be approved by Council. In our selected population of over 12,000 POs, we identified fifty-five (55) coded as sole source transactions. Based on our review of a selected sample, we concluded that the volume and justifications appeared reasonable.

Does the City’s use of cooperative purchase agreements appear reasonable?

Cooperative purchase agreements are an exception to the competitive bidding process in that the City relies on the bidding process used by other public agencies. This can represent a substantial savings by reducing the time spent by City staff in developing and evaluating bid specifications. Justification for using the exception must be approved by Council. The risk is to ensure that what is purchased is the best fit for the City’s needs.

We identified 330 transactions coded as cooperative purchase agreements in the selected population of 12,000 POs. Eighty-three percent (83%) of these transactions were below the Council threshold. In addition we noted that ninety-two percent (92%) of the transactions related to two types of products; information technology equipment (84%), and vehicles (8%). Based on our review, the volume and justification for using cooperative purchase agreements appeared reasonable.

What is the timeline for the purchase requisition process?

Although each transaction is different depending on the complexity of the purchase, we wanted to quantify processing timeframes to identify trends, and assess the impact of the Charter requirements. We worked to identify documented processing milestones in the purchase requisition system as a basis for measurement to quantify the processing timeline for a selected sample of transactions. However, we found that there is no mechanism in place to fully capture the elapsed time in the purchasing process.

Using information entered in the purchase requisition system for a sample of over 2,600 POs, the average elapsed days from entry of the purchase requisition by the procuring department to creation of the PO by Purchasing, was 14 days. Although a small number of transactions took more than 100 days for the creation of a PO, seventy-three percent (73%) resulted in a PO within 14 days.

In reviewing Purchasing's transaction files, we noted that the purchase requisition system often does not capture when work on the procurement began. In the more complex procurements, dates of procurement planning performed by departments and the preliminary contacts with Purchasing are not documented. Relying solely on the milestone dates captured in the system would be misleading. If elapsed time is to be used as a measurement of performance, management may want to assess the value of developing a process to fully capture the needed information.

CITY AUDITOR MISSION STATEMENT

The Office of the City Auditor independently promotes ethical, efficient and effective governance for the citizens of Stockton. We provide the City Council, management, and employees with objective analyses, appraisals, and recommendations for improvements to City systems and activities. The department maintains independence and objectivity by reporting directly to the City Council and by not exercising direct authority over any department, system, or activity subject to audit.

