

Single Source/Sole Source/Emergency Procurement Audit

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Authorization

We have conducted an audit of Single Source/Sole Source/Emergency Procurements (SSEP). This audit was conducted under the authority of Article VII, Section 5 of the Garland City Charter and in accordance with the Annual Audit Plan approved by the Garland City Council.

Objective

To adequately address the audit objectives and to describe the scope of our work on internal controls, specific audit objectives were established that included the following:

- 1. Determine if SSEP processed through Purchasing are in compliance with the local government code and city directives.
- 2. Determine if City departments process potential SSEP through the Purchasing Department.
- 3. Verify the reliability of computer generated data relating to SSEP.

Scope and Methodology

The scope of the audit is calendar year 2012 and Internal Audit (IA) audited purchase orders related to SSEP and not P-cards. (See Exhibit A for reliability of computer generated data and sampling methodology.)

To adequately address the audit objectives and to describe the scope of our work on internal controls, we reviewed the following:

Single/Sole Source

- There was justification for purchasing as a Single/Sole source under the Texas Local Government Code, Title 8, Subtitle A, Chapter 252 Sec. 252.022 and by-passing the bidding process
- Appropriate approvals were obtained
- Requisition was forwarded to the Purchasing Department timely
- Requisition and Single/Sole Source Form state "Single" or "Sole"

Emergency Purchases

- Purchasing Department was notified immediately
- The purchase meets the definition of an emergency
- The Council is informed if the purchase is greater than \$100K and it was included in the Minutes

- The Certification of Emergency Form was completed within one business day
- Appropriate approvals were obtained
- The requisition was forwarded to purchasing timely
- Insurance verification was obtained before work began or within one business day

IA audited to Purchasing Directive #1 which was revised 5/21/10. A new revision was issued after our fieldwork was completed. The new revision had no impact on our findings.

Any deficiencies in internal control that are significant within the context of the audit objectives and based upon the audit work performed are stated in the Opportunities for Improvement section starting on page 7.

Overall Conclusion

- 1. Some SSEP were not in compliance with city directives. (Obj. 1)
- SSEP have been processed without going through the Purchasing Department. (Obj. 2)
- 3. Since not all SSEP are processed through Purchasing, the ad hoc reports generated out of the Purchasing module of the Finance system are not complete. (Obj. 3)

Background

SSEP are high risk transactions because they forgo the bidding process. The practice of considering just one company for a job when they need urgent action, when a vendor has specialized expertise or when they want to keep working with a proven supplier may save time in procuring equipment and service, however, it lacks the competitive bidding that can drive down prices. Non-competitive bids carry a risk of overspending because they have been negotiated without the benefit of a direct market mechanism. It is prudent to consider mitigating that risk by limiting the length of awards, ensuring fair prices and regularly assessing contractor performance.

The purchasing department's mission statement states, "Purchasing's mission is to manage a strategic procurement operation that (1) purchases all goods and services, (2) provides professional management of Citywide initiatives, (3) directs investment recovery through sale or disposal of salvage and surplus materials, and (4) applies professional procurement skills resulting in high quality, cost-effective services for all City departments, thereby partnering to deliver first class services to the citizens."

The Procurement Card is the preferred method of payment for purchases up to \$3,000. For all purchases greater than \$3,000; the Purchasing Department Buyers comply with the procedures set forth in Title 8, Subtitle A, Chapter 252, Section 252.0215 of the Texas Local Government Code regarding competitive bidding in relation to Historically Underutilized Business (HUB) vendors. For informal bids for \$3,000 to \$50,000, at least two HUBS' must be contacted.

City of Garland Purchasing Directive # 3 for SSEP defines the following:

"<u>Emergency</u>: The delegated purchase of supplies or services which are so badly needed that the City will suffer financial loss, operational damage, or endangerment to the citizenry of Garland if supplies or services are not secured immediately. Normal purchasing procedures are modified.

Sole Source: Items available from only one source because of patents, copyrights, secret processes, or natural monopolies.

Single Source: Items available from more than one viable source, but there is a justifiable reason to purchase from a specific single source."

Section 252 of the Texas Statutes provides exemptions to the bidding laws for emergencies. Title 8, Subtitle A, Chapter 252, Section 252.022 of the Texas Local Government Code states, "the following items are exemptions:

- 1. A procurement made because of a public calamity that requires the immediate appropriation of money to relieve the necessity of the municipality's residents or to preserve the property of the municipality.
- 2. A procurement necessary to preserve or protect the public health or safety of the municipality's residents;
- 3. A procurement necessary because of unforeseen damage to public machinery, equipment, or other property."

Purchasing Directive #3, Section 1.5.3 states "For emergency purchases of \$100,000 or more, the Purchasing Department and using department prepares the documentation necessary, informs the City Council that the purchase was made, and approval entered into the Minutes of the Council meeting. Lesser dollar amounts follow the signature authority of Administration Directive #1 - Authorization for Expenditures".

Purchasing Directive #3, 2.1 states, "Sole/Single Source purchases must include sufficient rationale to justify the selection of the sole/single source and be approved by the appropriate expenditure authorization level. Both the requisition and the completed Sole/Single Source information form must indicate whether the purchase has been designated as a "Sole" or "Single" purchase."

Purchasing Directive #3, 1.4.1, 1.4.2 and 1.4.3 states, "The responsible department notifies the Purchasing Department by telephone immediately with as much information as possible so the purchasing action can be initiated immediately. Simultaneously, if possible, but no later than the next working day, a purchase requisition should be prepared, entered, and approved in the Finance system. The Purchasing Department or using department's responsible official (designee) contacts as many vendors as necessary and takes whatever steps are necessary to arrange the emergency purchase. If time permits, the Purchase Order is completed. Otherwise, the purchase is completed by telephone and the Purchase Order is completed after the fact. If insurance is required, proof of insurance must be obtained from the vendor as soon as possible, preferably before work begins."

Purchase Orders are an accounting and budgetary internal control. Accounting controls facilitates good internal controls:

- Proper approvals
- Segregation of duties
- Adequate documentation
- Supports matching of source documents
- Tracks what was purchased

The CAFR states, "Budgetary control is maintained at the fund level, and encumbrances are entered at the time a purchase order is issued."

Management Accomplishments *

In a 2012 Public Procurement Benchmark Report, Sole Source purchases represented 14% of total procurement spending while Emergency purchases represented 20%. The City of Garland's SSEP purchases represented approximately 1% of total procurement spend. While Sole Source and Emergency Purchases are a legitimate and often critical business need, Purchasing has worked cooperatively with requesting departments to reduce the number of SSEP purchases. The total number of SSEPs for 2012 was 81 compared to 139 in 2011, resulting in a 42% decrease.

The Purchasing Department appreciates the opportunity to work with Internal Audit to identify areas for improvement. The SSEP Audit brought more transparency to not only SSEP purchases, but also other purchases in excess of \$3,000. As a result of the SSEP Audit, Purchasing and Finance are working more closely to monitor those purchases to identify areas for improvement.

^{*} Please note that "Management Accomplishments" are written by the audited entity and that Internal Audit did not audit or verify its accuracy.

Opportunities for Improvement

During our audit we identified certain areas for improvement. Our audit was not designed or intended to be a detailed study of every relevant system, procedure, and transaction. Accordingly, the Opportunities for Improvement section presented in this report may not be all-inclusive of areas where improvement might be needed.

Finding #1 (Obj. 2)

Condition (The way it is)

Internal audit's review of procurement payments processed through the City Finance system revealed that not all procurements are processed through the Purchasing Department. A review of a data dump for the calendar year 2012 for payments over \$3,000 disclosed 87,001 payments totaling \$335,304,442.49 were made in calendar year 2012. Internal Audit sorted the dump to determine those which did not have a P.O. There were 73,927 payments totaling \$262,928,606.47 which did not have a P.O. A cursory review with the Director of Materials Management disclosed 1,046 potential exceptions totaling \$19,806,068.67. Further investigation by the Finance Department disclosed the 1,046 payments dropped to 430 and later to 255 which would require further investigation. Internal Audit is unable to determine how many SSEP's have not gone through Purchasing. A P.O. is not written for all payments greater than \$3,000 and it is difficult to determine when a P.O. should be written.

Since these procurements did not go through the Purchasing Department:

- A third party review of SSEP justification may not have occurred.
- Purchase orders for accounting and budgetary controls were not generated.
- City's reporting of the total number and amount of SSEP will not be accurate.

Single/Sole purchases which went through purchasing and had a P.O. written represented .76% (\$956,289.74) of the total purchases and emergency purchases represented .28% (\$344,722.27).

Criteria (The way it should be)

- Purchasing Directive #1, Section 2.1.1 states, "The authority of the Purchasing Director to administer all purchases for all departments, with the exception of purchases under \$3,000, **shall not be circumvented**."
- Purchasing Directive #3, Section 2 states, "Sole/Single Source purchases must include sufficient rationale to justify the selection of the sole/single source and be approved by the appropriate expenditure authorization level."
- Purchasing Directive #3, Section 1.5.2 states, "On or before the first working day following the emergency, the responsible official completes the "Certification of Emergency" form; prepares, enters, and approves the

- requisition in the Finance system; and forwards both to the Purchasing Department. Attach any other documents related to the purchase that may be needed for a full justification."
- Prudent business practices dictate that purchase orders are created for accounting and budgetary controls.
- The City should be able to produce an accurate number and dollar amount of SSEP.

Effect (So what?)

- SSEP are high risk because they forgo the bidding process. There is a
 possibility that SSEP are included in the potential exceptions not reviewed
 by purchasing to determine if sufficient rationale exists to justify the
 purchase as a SSEP. Since an independent review was not conducted, IA
 cannot ensure that these purchases would be justified as a SSEP.
- The City may expend more than required because there may have been other vendors which charged less for the same product or service.
- Management may rely on inaccurate data coming from the Finance system because it is not complete.

Cause (Difference between condition & criteria)

- The department(s) failed to comply with Purchasing Directive # 1 and 3.
- There is confusion as to when a purchase order should be written because not all SSEP are processed on a P.O. and go through the Purchasing Department.

Recommendation

- City Management should ensure that all departments process SSEP through the Purchasing Department to ensure that a third party review of justification is conducted, accounting and budgetary controls are in place and an accurate report is produced.
- City Management should generate a mechanism to detect any SSEP payments which did not go through the Purchasing Department. Follow-up of payments with no P.O.'s should be performed and documented.
- A matrix defining when a P.O. should be written would assist departments in abiding by the Directive.

Management Response

- Management concurs. All SSEP that either exceed \$3,000 or require insurance should be processed through the Purchasing Department.
- Management concurs. This will be a joint effort by Purchasing and Finance.
- Management concurs. A more detailed list of exempt purchases would assist the departments in determining when a P.O. is required.

Action Plan

- Purchasing will place more emphasis on SSEPs in New Manager Orientation and Department Purchasing Coordinator training.
- Purchasing and Finance will regularly review the Payments Over \$3,000
 Report to detect and address potential SSEPs and other payments being
 made without an approved P.O.
- Purchasing will include a more comprehensive list of commonly exempt purchases to the Purchasing Policies and Procedures Directive.

Implementation Date

Immediate

Finding #2 (Obj. 1)

Condition (The way it is)

IA's review of all 26 emergency purchases processed through the Purchasing Department in calendar year 2012 revealed the following issues:

- 2 out of 9 (22%) instances in which insurance was required there was not a proof of insurance in the file. (17 out of 26 did not need insurance)
- 10 out of 26 (38%) of requisitions for emergency purchases were not input in the system within the next working day. It ranged from 7 to 52 days.

Criteria (The way it should be)

- Purchasing Directive #3, 1.4.3 pertaining to emergency procurements states, "If insurance is required, proof of insurance must be obtained from the vendor as soon as possible, preferably before work begins."
- Purchasing Directive #3, 1.4.2 states, "Simultaneously if possible, but no later than the next working day, a purchase requisition is prepared, entered, and approved in the Finance System."

Effect (So what?)

- The City may be liable if injuries or damages occur.
- Purchasing may not be able to proceed with other procurement processes in a timely manner, (for example, setting up the vendor in the system, writing the P.O. etc.)

Cause (Difference between condition & criteria)

- Lack of requirements pertaining to proof of insurance. A copy of the proof of insurance should have been put in the file because the Excel spreadsheet used only contained current insurance information.
- It was undetermined why departments were not sending the requisition to the Purchasing Department timely. We noted one situation where the invoice was received before the requisition was put into the finance system. Encumbrances are entered at the time a purchase order is issued. Without a P.O. they did not have a P.O. number to charge against.

Recommendation

- A copy of proof of insurance should be put in the file.
- A systematic review of items listed in Purchasing Directive #3 should be performed to alert management of potential issues.

Management Response

- Management concurs.
- Management concurs.

Action Plan

- While it is preferable to obtain insurance before work begins, in a true emergency situation it may not always be feasible. When proof of insurance is available, a copy will be placed in the bid file.
- Purchasing will continue to systematically review the Payments Over \$3,000
 Report to detect and address potential conflicts with the Directive.
 Documentation will be maintained in the Purchasing files.

Implementation Date

Immediate

EXHIBIT A

Reliability of Computer Generated Data and Sampling Methodology

No P.O. Report (Obj. 2, Finding #1)

- 1. An Access report was run which listed all payments processed in FY2012. The report was sorted by P.O. number and IA deleted anything which had a P.O. and anything under \$3,000. To verify accuracy (Vendor Name, P.O. Amount, P.O. Number and P.O. Date), IA selected a judgmental sample of 25 of the "no P.O." payments and traced back to the source documents to verify that data entry and the report were accurate. A judgmental test was performed to sample a good cross section of dollar and payment amounts. No exceptions were noted, therefore, we believe the report was accurate.
- 2. The reliability of computer generated data was reviewed by comparing two intermediary software reports, Access and Crystal, to determine they were pulling complete and accurate payment information from the Finance system. IA compared the total counts and total value for the calendar year 2012 and found no exceptions. We found the reliability of computer generated data to be accurate and complete.

Finance System Ad Hoc Reports (Single/Sole and Emergency) (Obj. 2, Finding #1)

The completeness and accuracy of the reports generated from the Finance system for CY 2012 for SSEP were reviewed by selecting a random sample of 50 bid files, four from each month with two extra pulled from December to make a sample of 50. A random sample was chosen because SSEP are comingled with other files in the Purchasing filing system. The sample was reviewed to determine if any of the samples were a SSEP. If they were SSEP, they were cross-referenced to the ad hoc reports to determine if the reports included this information. 1 out of 6 (17%) SSEP randomly pulled from the file was not on the ad hoc report. 5 out of 6 (83%) were documented accurately. However, since IA identified that not all SSEP are processed through Purchasing, the ad hoc reports generated out of the Finance system are not complete.