

OFFICE OF THE CITY AUDITOR

PERFORMANCE AUDIT OF THE CITY'S PRICE AGREEMENTS



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September 3, 2004

Memorandum



CITY OF DALLAS

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Honorable Mayor and Members of the City Council
City of Dallas

We have conducted a performance audit of the City's Price Agreements (PAs) administered by the Business Development and Procurement Services Department (BDPS).

Our audit objectives were to determine whether bills and charges for items on PAs were at the appropriate rate and only items covered by the PAs were purchased.

We noted that vendor invoices were for approved goods and were at the prices specified by the PAs. However, we noted two instances where equipment purchases were not covered by the PAs. These two instances are discussed in the Opportunities for Improvement section of this report. An administrative item was reported to the Director of BDPS in a separate letter dated July 8, 2004.

We appreciate the cooperation of City staff during our examination.

Thomas M. Taylor

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c: Mary K. Suhm, Interim City Manager

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INTRODUCTION

Authorization

We have conducted a performance audit of the City's Price Agreements (PAs) administered by the Business Development and Procurement Services Department (BDPS). This audit was conducted under the authority of Chapter IX, Section 2 of the Dallas Charter and in accordance with the Annual Audit Plan approved by the City Council.

Scope and Methodology

Our audit was conducted in accordance with generally accepted government auditing standards and, accordingly, included inquiries, tests of the accounting and related records, and other procedures that we considered necessary in the circumstances.

Our audit objectives were to determine whether:

- Bills and charges for items on PAs were at the appropriate rate.
- Only items covered by the PAs were purchased.

Our audit period covered June 1, 2002, through December 31, 2003. However, we reviewed and tested certain transactions occurring before that period to the extent that those matters pertained to the audit objectives.

We obtained a copy of the open PAs report from the City's Intranet on February 9, 2004. This report indicated that 103 out of 494 (20.85%) open PAs, were authorized for more than \$1 million.

For our test, we judgmentally selected 10 of the 103 PAs that represented a variety of commodity codes. These are summarized in the table below.

Sampled Price Agreements					
	PA Code	Description/Commodity	PA Term	Authorized Limit	Remaining Balance (02/10/2004)
1.	BAO	Asphalt & Cold Patch	09/23/02 to 09/22/05	6,662,926.20	4,580,142.67
2.	Z01CIS01	Computer Lease/Purchase	03/23/01 to 03/22/04	5,050,000.00	64,315.41
3.	ZDSV51	IBM License & Support	01/08/92 to 01/07/05 ¹	9,659,888.00	4,270,107.60
4.	LMT	Electric/Switchgear and Motor Service	07/01/03 to 06/30/06	6,912,204.00	3,206,399.39
5.	BBE	Ferric Sulfate, Liquid	04/17/01 to 10/17/04	15,001,000.00	3,436,536.46
6.	CEW	Fuel Diesel & Gas	11/11/02 to 11/11/05	18,783,300.00	10,594,300.02
7.	BNC	Furniture	01/03/02 to 01/03/07	8,000,000.00	4,124,953.46
8.	LLR	Heavy Equipment Parts & Labor	12/01/01 to 11/30/04	2,253,802.80	235,508.91
9.	KJJ	Pavement Repairs	06/19/03 to 06/18/06	9,997,500.00	7,886,096.53
10.	JSW	Automobiles & Trucks	12/11/02 to 12/10/03	15,303,420.00	10,579,235.50

¹ Price Agreement was initially established in 1986 and has been continually extended.

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We reviewed the 10 PAs and the associated Council Resolutions, contract specifications, vendor bid packages, vendor product catalogs and price index, and other related documents. To complete our sample test, we selected three payments from the 10 PAs. We also reviewed 232 vendor invoices.

To obtain knowledge of the current procedures for the PA process, we reviewed related policies and procedural statements including Administrative Directives (ADs) and the RESOURCE Information Guide. We also made inquiries to BDPS management and staff and examined BDPS records, supporting documents, and related transactions.

Overall Conclusion

We noted that vendor invoices were for approved goods and were at the prices specified by the PAs. However, we noted two instances where equipment purchases were not covered by the PAs. These two instances are discussed in the Opportunities for Improvement section of this report. An administrative item was reported to the Director of BDPS in a separate letter dated July 8, 2004.

Background

AD 4-5, *Contracting for Goods and Services*, defines a price agreement as, "A contract to purchase goods as needed when needed by the City over a defined period of time at a fixed unit price, regardless of the quantity ordered by the City. Price agreements are only used for the purchase of goods."

PAs are designed for frequently used commodities. Each PA has an authorized total dollar limit. Agreements are awarded to vendors with the lowest responsive bids. A PA may be awarded to multiple vendors and a vendor may be awarded all line items in the PA or only certain line items. These agreements enable a department to order items directly from a vendor and avoid the requisition and purchase order process.

Prior to FY 2001, many purchasing functions were decentralized to City departments. The adopted budget for FY 2000-2001 approved the creation of the Office of Purchasing/Business Diversity Development by combining the Purchasing and Office of Minority Business Opportunity divisions. These divisions previously reported to the City Controller's Office. This combined department became responsible for administering the City's centralized purchasing system. This department was then renamed the Business Development and Procurement Services Department in the adopted budget for FY 2001-2002.

Within BDPS, the Procurement Services Division (PSD) is primarily responsible for managing and controlling all procurement operations. The PSD's responsibilities include:

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- Developing bid specifications jointly with all user departments.
- Obtaining bids through advertising or direct solicitation.
- Establishing and monitoring price agreement contracts.
- Issuing purchase orders.

There are 15 buyers in PSD and each buyer is assigned certain commodities. The buyers are responsible for overseeing the market trends and the City's usage volumes for their assigned commodities. However, the PSD does not review each individual PA purchase.

Each user department within the City is responsible for: (1) Verifying the availability of the needed product and the PA balance before placing an order and entering the transaction into RESOURCE; and (2) reviewing each invoice to ensure invoice prices for the items purchased match the prices on the PA.

Follow-up on Prior Audit

An audit report was issued on December 20, 2002, for the period October 1, 2001, through May 31, 2002. This report had three findings and seven recommendations. BDPS has implemented or taken alternate corrective actions on six of the recommendations; however, BDPS has not published an updated AD 4-5, *Contracting for Goods and Services*. This AD update has been pending since August 8, 2001, and is addressed in the Opportunities for Improvement section of this report.

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We identified certain policies, procedures, and practices that could be improved. Our audit was not designed or intended to be a detailed study of every relevant system, procedure, and transaction. Accordingly, the opportunities for improvement presented in this report may not include all areas where improvements may be needed.

1. A PA was improperly used to purchase equipment and to by-pass competitive bidding.

PA "LLR" (Sample 8, See Table on Page #1) is for heavy equipment parts and labor. The PA has an authorized limit of \$2,253,803 and is for the period of December 1, 2001, through November 30, 2004. Bid group number 13 (Detroit Diesel) is for parts, accessories, and labor related to diesel powered heavy equipment. Although there are multiple vendors for this PA, Stewart and Stevenson is the sole vendor approved for bid group 13. The City's Request for Bid (RFB) states in its scope that this bid is for the purchase of replacement parts and mechanical repair, welding, and painting of the City's fleet of heavy equipment. However, equipment was purchased from Stewart and Stevenson utilizing this PA instead of the authorized replacement parts and mechanical repair, welding and painting.

Dallas Water Utilities (DWU) purchased equipment utilizing this PA on two occasions, even though this PA was not authorized for the purchase of equipment. On February 10, 2003, DWU encumbered²and subsequently:

- Paid \$49,999 (net of a 25% discount) for a 350KW generator set mounted on a 16,000 pound trailer with options and accessories. This transaction was classified as a capital expenditure (object code 4720) for equipment. The equipment was received July 2, 2003.
- Paid \$46,000 (net of a 25% discount) for (1) 100KW skid mounted generator, (2) 4000 watt light tower, and (3) 30 HP 8" sewage and wastewater pump. This transaction was classified as a capital expenditure (object code 4720) for equipment. The equipment was received April 15, 2003.

The time period of at least two months between encumbrance of funds and receipt of equipment demonstrates that these were not emergency purchases. Therefore, they were ineligible for emergency purchase procedures.

We confirmed that:

- The equipment does exist and is located at the Southside Waste Water Treatment Plant (SWWTP).
- The equipment is not tagged to identify it as property of the City of Dallas.

² An encumbrance is approval to obligate funds for a purchase.

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- SWWTP did not take the required action to report the equipment into the fixed asset system and the equipment is not included in the City's fixed asset inventory.

Our follow-up audit revealed that PA "CCK" is for heavy equipment purchases. However, this PA, funded for \$1,884,423, was restricted to the Equipment and Building Services Department to control purchases identified to be procured via Equipment Acquisition Notes ³(i.e., fund the purchase of various types of capital equipment). The DWU equipment discussed above was not among the planned equipment acquisitions for PA "CCK" though it could have been.

The identified unauthorized use of PAs can be attributed to the following causes:

- BDPS primarily relies on City departments for compliance, but training for the use of PAs is not provided. BDPS responded in the prior audit that it attempted to conduct a training class, but the class was not held due to lack of participation.
- The PA for heavy equipment purchases was restricted and not available to DWU for their equipment purchases.
- BDPS administers the City's centralized purchasing function, but has not issued policy and procedures for PA management and administration since its creation as the Office of Purchasing/Business Diversity Development in October 2000. (See also Opportunity for Improvement number 2.)
- BDPS and DWU did not effectively monitor PA transactions to ensure that only authorized items were purchased. The BDPS PA Report (which reports encumbrances) does not disclose the object code or the actual cost of items received. The object code classifies the expenditures (i.e., salary, supplies and materials, equipment).

Council Resolution 01-3332, dated November 14, 2001, authorized a multiple award Price Agreement for heavy equipment parts and labor, not to exceed \$2,253,803.

Dallas City Code, Section 2.32 states, "No city expenditure exceeding \$15,000 may be made without advertising for competitive bids, except in cases of immediate emergency or where competitive bidding is not otherwise required by state law or the city charter."

Dallas City Code, Section 2.30 (d) (2) states in part that "The city manager is authorized to approve by administrative action, without further city council action

³ Planned equipment acquisitions are identified in the Capital Project Funds section of the Adopted Annual Budget.

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... a contract requiring a city expenditure exceeding \$15,000, but not exceeding \$50,000 for the purchase of goods or general services required by state law to be procured through competitive bid or competitive sealed proposal."

AD 4-5, *Contracting for Goods and Services*, 5.1.2, states in part that "It shall be the responsibility of all department directors to ensure that applicable State Laws, City Charter, Ordinances, Codes, the City Code of Ethics and the City Personnel Rules are complied with throughout the procurement and contracting process."

AD 6-1, *Control of City Property*, Section 4.2, states in part that "Each Department Director is responsible for establishing and maintaining adequate internal controls and security for all personal property charged to that department."

Management controls (i.e., ADs, City Code, review and approval authority) do not provide assurance for the enforcement of state law and City policy and are not sufficient to prevent misuse of the PA process. Departments can by-pass the competitive bidding process, City Manager's approval, and disregard procurement statutes.

- DWU negotiated its own procurement for equipment.
- DWU purchased equipment without a competitive bid.
- DWU purchased equipment without an Administrative Action approved by the City Manager.
- The purchases (from the same vendor and on the same date) appear to have been split to avoid the \$50,000 threshold that requires Council approval.

Additionally, equipment has not been accounted for as a fixed asset, and ineligible purchases will rapidly deplete the PA authorized amount. Our analysis revealed that equipment totaling \$276,038 was purchased utilizing PA "LLR."

We recommend the BDPS Director:

- Develop a Price Agreement User's Guide (independent of AD 45) and conduct mandatory (initial and recurring) related training. Procedures should clearly state responsibilities and requirements and should include incentives/penalties to ensure compliance. This approach was used in developing the Procurement Card (P-card) program. The P-Card User's Guide is independent of AD 4-15, *Purchasing Card Policy and Procedures*.
- Revise its PA Report to include the object code. This would provide an indicator as to whether the purchase is appropriate for the PA. An expenditure classified as equipment could readily be identified in a PA limited to parts and labor.

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- Develop procedures for the review of PA purchases, at least on a sample basis, (invoices and supporting documentation) to ensure that only authorized items are purchased.
- Establish a City-wide PA for heavy equipment purchases, unless otherwise prohibited by management.

We recommend the DWU Director ensure:

- Compliance with AD 6-1, AD 4-5, and the City Code; and
- Equipment is reported into the City's fixed asset system and properly tagged as City property.

BDPS Management's Response:

- Concur, BDPS will develop a Price Agreement User's Guide and conduct mandatory training on a quarterly basis.

BDPS previously advertised in the City's Quarterly Training manual, purchasing user training for moderate to advanced staff. BDPS did not conduct the training due to a lack of interest within the City. The proposed mandatory training will include the introduction of the User's Guide while providing another opportunity to educate the departmental purchasing staff. Additionally, we will introduce possible disciplinary actions approved by the City Attorney's Office.

- Concur, BDPS will include this reporting category on the established usage report to assist with departmental compliance. It should be noted that the City Controller's Office, by Administrative Directive 6-1, is currently responsible for a monthly examination of all capital expenditures.
 - Administrative Directive 6-1, Control of City Property, Section 4.1.3, states in part that: "The City Controller is responsible for examining each transaction included in the capital expenditure codes on a monthly basis to ascertain compliance as to receipt of forms from the appropriate departments."

While adding the object code to the current price agreement status report may assist with compliance, this report was not designed for that purpose. The price agreement report is a tool used by the Purchasing staff to ensure no lapse in coverage for the City.

- Concur, BDPS will develop procedures to review invoicing and supporting documentation to ensure authorized items are purchased.

However, the responsibility for compliance remains with the initiating departments. AD 4-5, 5.1.2, states in part: "It shall be the responsibility of

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all department directors to ensure that applicable State Laws, City Charter, Ordinances, Codes, the City Code of Ethics and the City Personnel Rules are complied with throughout the procurement and contracting process." BDPS solicits bids based on the specifications provided by the departments and lacks the technical expertise and resources to ensure all purchases are correctly charged to the correct price agreement or appropriate fund. BDPS currently notifies all departmental purchasing staff of new price agreements by email and places the successful bidders pricing in the City Financial system (RESOURCE) per the Council approved resolution. BDPS will discuss possible punitive actions with the City Attorney's office for abuse of the current process.

- Disagree, this price agreement is restricted to use not on the basis of funding, i.e., equipment notes, but instead restricted at the request of the Equipment and Building Services Department because they have primary responsibility for all heavy fleet. Allowing other departments to make heavy equipment purchases will severely handicap EBS's ability to monitor and adequately maintain the City's fleet. However, in some cases, the current administrative process does allow departments to request capital equipment with the approval by the City Manager's office before BDPS will process a transaction.

Auditor's Comments to BDPS Management's Responses:

BDPS proposed corrective actions are deemed appropriate if implemented and enforced.

In the final portion of its response, BDPS limited its response to heavy fleet and did not address operational equipment. Fleet pertains to rolling stock. Allowing other departments to purchase operational equipment (i.e. generators) would not affect EBS' ability to maintain the City's fleet since PA "LLR" is for the maintenance and repair of heavy equipment. See also DWU's management's response.

DWU Management's Responses:

Prior to purchasing the generators, DWU requested direction from Business Development and Procurement as to the method to use in acquiring the generators. Going on their recommendation DWU purchased the generators using the price agreement. Departmental practices were modified in May 2004 to require executive review of all purchases that exceed \$5,000. This practice will prevent inappropriate purchases in the future.

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DWU staff did unintentionally circumvent the Dallas City Code Section 2.32. and purchase items without advertising for competitive bids.

Prior to the centralization of accounts payable in the Business Procurement and Development Department, all Water Department payment vouchers were sent to DWU's Accounting and Financing Division to ensure property was properly tagged and entered into the fixed asset system. Procedures have since been modified to correct the notification procedures required to ensure all equipment is tagged and entered into the system.

DWU will ensure compliance with AD 6-1, AD 4-5, and the City Code by:

- Ensuring all purchases in excess of \$5,000, including emergency purchases be approved by the appropriate DWU Executive.
- Setting up training classes for personnel involved with the purchase of supplies, materials, parts and equipment to assure compliance with Administrative Directives, Price Agreements, and City Code.
- Ensuring all equipment is tagged and added to the City's fixed asset system by requiring purchasing divisions to submit a copy of the purchase order and invoice to the Accounting and Finance Division.

Auditor's Comment:

DWU has taken appropriate corrective action and should mitigate the reoccurrence of these reported exceptions, providing these corrective actions are implemented and enforced.

2. BDPS has not published an updated AD 4-5, *Contracting for Goods and Services* (Repeat Finding).

The previous audit (Report #376, dated December 20, 2002) recommended that AD 4-5 be updated to communicate requirements for management and control over PAs. Management responded that "publishing delays were due to ongoing changes in state law and pending changes to City Ordinance, but a final draft of AD 4-5 would be available by December 31, 2002." However, BDPS has not published an updated AD 4-5. The current AD 4-5, latest revision date of May 10, 1999, has been pending update and publication since August 2, 2001.

BDPS stated that the need to update the City Code and Ordinances has precluded approval and publishing of an updated AD 4-5.

AD 2-1, *Administrative Directives*, states in part that "ADs are issued to establish policy and procedures for the uniform administration and effective and efficient coordination of the functions of the City of Dallas ... ADs shall remain in force until officially revised, superseded or canceled in writing by the official authorized to issue the AD."

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AD 4-5, paragraph 2, states that "The AD was established to ensure that the City

- Complies with State law, City Ordinances, Dallas City Code, and Dallas City Charter requirements regulating the procurement of goods and services;
- Establishes general policies and procedures for contracting; and
- Describes the contracting process, including the general criteria to be used for selection of contractors that best meet the City requirements and comply with applicable laws."

AD 4-5 addresses, for City employees, all allowable procurement contract activity for the City and is the sole source on procedures for contracting, administrative actions, and competitive bidding. However, it does not address procedures for price agreements.

Management has conveyed the impression that there is no sense of urgency to provide policy guidance on a timely basis. Our observation is that departments are using the draft version(s) of AD 4-5 as official policy, contrary to AD 2-1, and there are no consequences for noncompliance.

Professional literature addressing internal controls emphasizes that management's philosophy and operating style provides clear signals to employees about the importance of internal controls. Failure to provide timely policy and guidance can lead to an erosion of internal control by not (1) establishing a control environment, (2) implementing control activities, and (3) exchanging information and communications on a timely basis.

We recommend the BDPS Director:

Publish policy and procedures that clearly communicate management's objectives and requirements for the contracting of goods and services. This could be accomplished in one of the following ways:

- Develop and issue User Guides for each type of procurement activity while awaiting approval and publication of an updated AD 4-5. These User Guides could serve as supplements to the AD and could be updated without revising the AD.
- Develop separate ADs for each type of procurement contract activity.

Management's Response:

- Concur, BDPS has incorporated the input from departments from the draft AD 4-5 published in February 2002. While the official AD 4-5 has not been updated, the draft does serve to guide the procurement procedures for the City and create a uniform administration in lieu of the final approved document. The City Auditor does not acknowledge the detailed

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procurement procedures published by BDPS which provide specific direction to BDPS personnel. Since the centralization of purchasing to one department, a broad AD 4-5 is less relevant to the adherence to state laws and City Code as departments no longer perform significant purchasing activity. BDPS has drafted a memo to the City Attorney's Office requesting a review of the final draft AD 45, and will await their response.

Additionally, the final draft AD 45 is structured by type of procurement, essentially breaking each type of procurement by activity.

Auditor's Comments to BDPS Management's Responses:

The auditor did acknowledge (in his follow-up on the prior audit, see page 3) the progress BDPS has made. However, this opportunity for improvement emphasizes again that BDPS has not developed specific directions/guidance for its customers; the City employees assigned purchasing responsibilities for their department. City departments are authorized to initiate and process purchasing activity through the use of PA and Administrative Actions. The multiple drafts of AD 4-5 have consistently only defined a PA. None of these drafts have addressed procedures, responsibilities, and limitations for a PA.