



## **Internal Audit Report for February 2016**

### **Summary**

One report was issued during the month:

- **Purchasing – Nonprofessional Service Contracts Audit Report**

### **Discussion Section**

This report highlights the significant activities of the Internal Audit Department during February 2016. In addition to presenting background information and the opinion expressed in the audit report, a discussion of findings noted during the examination is also provided.

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## **Purchasing – Nonprofessional Service Contracts Audit Report**

### **Background**

The Audit Department has completed a review of the accounting and administrative controls over Purchasing - Nonprofessional Service Contracts, as of June 30, 2015. Our review consisted of evaluating the requisition and procurement process, contractor evaluation, selection practices, and tracking and reporting activities. We also verified the validity and propriety of payments to contractors for compliance with contractual terms and conditions, and assurance that amounts billed were properly calculated and adequately supported.

The Contracting Services Unit, Administrative Services Section in the Business Technology Group is responsible for procurement of nonprofessional services. These contracts are made through solicitation of proposals or bids in a competitive process, or made as sole-source noncompetitive assignments. They are awarded with a one-year term, with the option to renew for up to four additional years at Metropolitan's discretion.

The contracting process is initiated by an approved purchase requisition, which results in proposals and bids from qualifying contractors. Competing proposals are evaluated against predetermined criteria, and a service contract is awarded. In sole-source noncompetitive assignments, a contract may be awarded by the best-value method of procurement as provided by the Administrative Code. The Administrative Code Sections that serve as guidelines for nonprofessional service contracts are 2720(e)(2), 8122(g)(2), and 8140:

1. Administrative Code Section 2720(e)(2) requires the General Manager to report quarterly to the Organization, Personnel, and Technology Committee the employment of any professional and technical consultant, the extension of any professional and technical consulting agreement, on the Exercise of Authority under Sections 8121(c) and 8122(h), and the execution of any contract authorized pursuant to Section 8122(g) during the preceding calendar quarter.

The report covering the last calendar quarter of the year may be combined with, and included in the annual report. Each such report shall indicate when a consultant is a former employee of the District.

2. Administrative Code Section 8122(g)(2) grants authority to the General Manager to execute contracts for the purchase of materials, supplies, other consumable items such as fuels, water treatment chemicals, materials for construction projects and other bulk items, and for routine services such as waste disposal and maintenance services which are generally identified in the budget regardless of dollar value, provided that sufficient funds are available within the adopted budget for such materials, supplies, and routine services.
3. Administrative Code Section 8140 requires that all contracts estimated to cost \$75,000 or more shall be made upon a competitive procurement method of either competitive sealed bidding or best value procurement, as provided in this Chapter.

Finally, Operating Policy G-05: Procurement of Goods and Services establishes the policies for Metropolitan written agreements, including purchase orders for the procurement of materials and services excluding construction agreements under the General Manager. Procurement activities are processed and tracked through the Oracle E-Business Suite purchasing application. From July 2012 through June 2015, Purchasing processed 8,802 transactions and paid \$91.8 million to 1,404 contractors.

### **Opinion**

In our opinion, the accounting and administrative procedures over Purchasing - Nonprofessional Service Contracts include those practices usually necessary to provide for a generally satisfactory internal control structure. The degree of compliance with such policies and procedures provided effective controls from July 1, 2012 through June 30, 2015.

### **Comments and Recommendations**

#### **POLICIES AND PROCEDURES**

Policies and procedures should be established and documented to provide a framework for achieving Metropolitan's goals and objectives. Policies and procedures provide management with guidelines for consistent performance of daily operations, assist management in the training of new employees, and provide a source of reference for experienced personnel. The Purchasing Manual, along with the Purchasing and Professional Services Contracting Procedures Manual, explain the policies and procedures for acquisition of goods and services. Our review of 40 nonprofessional service contracts revealed the following inconsistencies (details provided to management):

1. Metropolitan executed multiple one-year contracts with seven contractors, up to 12 contracts for each contractor each year, to provide janitorial and landscape maintenance services. We also noted that these contracts were renewed up to four additional one-year periods, with contract pricing adjusted in accordance with the contract. These contractors include:

- a. DMS Facility Services, Incorporated (DMS INC).
  - b. DMS Facility Services LLC (DMS LLC).
  - c. Lawnscape Systems, Incorporated.
  - d. Mariposa Landscapes, Incorporated.
  - e. Orozco Landscape.
  - f. Ron Ubrun Farms.
  - g. TrueGreen Landcare.
2. Monthly overhead and flat-fee profit markups of \$2,824.64 were billed on Contracts 27910 and 127910-02 with DMS INC, which were inconsistent with the contract terms of other janitorial service contractors. The DMS INC contract was the only contract that had charges for overhead, and a flat fee for profit.
  3. Workers Compensation insurance coverage for DMS INC and DMS LLC was provided by Strategic Outsourcing, Incorporated which handles their payroll, taxes, and benefit packages. Further, we noted that this coverage was limited to leased employees of DMS INC and DMS LLC. However, the contracts did not identify leased or non-leased employees.
  4. Documentation could not be located that evidenced a requester's attempt to locate a responsive and responsible Small Business and Disabled Veteran Business Enterprise (SB/DVBE) for six contracts reviewed. This is in contrast to the Purchasing and Professional Services Contracting Procedures Manual, which requires the requester to locate a responsive and responsible SB/DVBE when acquiring nonprofessional services costing less than \$25,000. These contractors include:
    - a. M&K Services Purchase Order 124503-02.
    - b. P.F. Services, Incorporated Purchase Order 148618.
    - c. Prudential Overall Supply Purchase Orders 117762-02 and 131254-02.
    - d. Ultimate Cleaning Services Purchase Orders 125451-01 and 12545102.
  5. There were no standard reports that identified and described the status or activities for nonprofessional service contracts. It should be noted that some contracts for routine services of \$250,000 and above were included in the quarterly report to the Board titled Contracts for Equipment, Materials, Supplies, and Routine Services of \$250,000 or Above with limited information.

We recommend that Contracting Services Unit management consider combining vendors' multiple contracts, and extending contract terms to satisfy the operational needs. Further, we recommend that management review the DMS INC contract to ensure that the terms and conditions are consistent with other vendors providing similar services. We also recommend that Agreement Administrators require DMS INC and DMS LLC to procure Workers Compensation Insurance policies that cover all their employees. Lastly, we recommend management develop standard reports for nonprofessional service contracts.

## REVIEW AND APPROVAL

Review and approval controls are designed to verify billing accuracies for goods and services, provide assurance to propriety of transactions, confirm compliance with contractual terms and conditions, and ensure that follow-up procedures exist for exception processing. Our review of 58 invoices totaling \$1 million revealed the following discrepancies (details provided to management):

1. Two invoices were overpaid by \$810.83 due to sales taxes billed, on top of contract price. Total overpaid taxes were approximately \$2,198.70 (bid price of \$251,280 x 10% x 8.75%) for five 113756 Series contracts executed with Full Spectrum.
2. Seven invoices were not signed and certified by the vendors and were incomplete for required billing information such as maximum amount payable and total amount previously invoiced, in contrast to agreement billing requirements.
3. Nine invoices were paid late from three to 58 days.
4. Vendor charges on eight invoices totaling \$86,789.69 reviewed were coded with incorrect subaccounts.
5. Analysis of charges billed on janitorial and maintenance service contracts with 11 vendors reviewed were coded with incorrect expense subaccounts. We noted that some charges were coded in error to Maintenance Subaccount 4550040 (Maintenance 4550040) or Service Contracts Subaccount 4550050 (Service 4550050), rather than Janitorial Subaccount 4550030. We also noted that some charges were coded in error to Service 4550050 or Others Subaccount 455060, rather than to Maintenance 4550040.

We recommend the agreement administrator resolve the noted overpayments to Full Spectrum, and perform a review of Full Spectrum's other paid invoices. We also recommend that Contracting Services Unit management remind agreement administrators to comply with the terms and conditions of contracts. Lastly, we recommend agreement administrators use subaccount codes that are appropriate for the nature of services provided, under their respective contracts.

## PURCHASING ACCESS CONTROLS

Access controls should be established to protect against the unauthorized destruction, disclosure, or modification of computer stored data. This control is achieved by limiting access to computer systems, based on an analysis of staff duties and responsibilities. In this regard, management should differentiate between functions allowed ranging from an inquiry capability for most users, to an override and correction capability for a few supervisory personnel. In addition, user profiles should create segregation of duties that validate data accuracy via multiple levels of review and approval of data.

Our review revealed that three administrative employees in the Contracting Services Unit were assigned with administrative and approval responsibilities that enabled them to set up vendors, and approve purchase orders in the Oracle E-Business Suite Purchasing System.

We recommend that Contracting Services Unit management revisit and redefine roles and responsibilities for administrative employees, to avoid conflicting duties.

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