

June 6, 2024

City of Palo Alto

Office of City Auditor

Procurement Process Audit

Contents

EXECUTIVE SUMMARY	1
INTRODUCTION.....	4
DETAILED ANALYSIS	7
AUDIT RESULTS.....	12
APPENDIX	21



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Executive Summary

Purpose of the Audit

Baker Tilly US, LLP (Baker Tilly), in its capacity serving as the Office of the City Auditor (OCA) for the City of Palo Alto (the City), conducted a Procurement Process Audit based on the approved Task Order 4.20. The objectives of this audit were to:

- 1) Determine whether the needs assessment, budgeting, solicitation, and vendor selection processes are efficient, effective, and transparent to ensure value for money and fair competition.
- 2) Determine whether the procurement process is valid through proper approvals, adequate segregation of duties, and compliance with applicable laws, regulations, and the City's policies.
- 3) Determine whether technology is used appropriately and effectively to enhance integrity, efficiency, transparency of the procurement process and ensure consistency and validity of the relevant information and data.
- 4) Identify the opportunities to improve the efficiency and effectiveness in the procurement process.

Report Highlights

Finding 1: Supporting documentation for contract award (Page 13)

During the procurement process audit, the OCA requested a comprehensive list of contract awards spanning from fiscal year (FY) 2021 to FY2023, inclusive of solicitations. A sample of 50 contracts was selected for testing key controls, as identified during walkthroughs with the Purchasing Division.

Out of these 50 samples, 6 contracts exhibited exceptions. These exceptions were primarily due to the absence of supporting documentation, which resulted in compliance deficiencies, as mandated by the City's Purchasing Manual and Chapter 2.30 of the Palo Alto Municipal Code.

- 4 contracts did not include the Solicitation Plan Checklist or Appendix G
- 2 contracts did not include the Exemption From Competitive Solicitation Request Form or Appendix E

The expectation was that all the samples had the necessary supporting documents that were outlined in the City's Purchasing Manual and/or the City of Palo Alto Municipal Code (Section 2.30 - Contracting and Purchasing Procedures). Risks associated with lack of support include failure to meet contract specifications, loss of data, fraudulent activity, and noncompliance with laws, regulations, and provisions.

Key Recommendations

It is recommended that the City establish and incorporate a formal checklist that includes all supporting evidence that is to be retained during the entire procurement phase. The checklist should include the various documents that are mandatory for each contract, as well as all internal documentation that is referenced in the purchasing manual and municipal code. This checklist is supplemental to the Solicitation Plan Checklist and Exemption From Competitive Solicitation Request Form. A checklist that identifies necessary documents for retention would help mitigate the risk of noncompliance.

Finding 2: Purchasing manual (Page 15)

The City of Palo Alto engages in various contracts for goods and services, with distinct procurement procedures for each type. The OCA conducted walkthroughs to evaluate the procurement process's efficiency, effectiveness, and transparency. It was observed that the process for procuring a "Design Build" contract, although employed by the City, is not documented in the City's Purchasing Manual. This highlights the need for comprehensive documentation to ensure transparency and adherence to established procedures in all aspects of the City's procurement process.

Furthermore, it was determined when analyzing the City's Purchasing Manual that inconsistencies exist. It was noted that there was no table of contents, multiple chapters were outdated, a chapter was inconsistently labeled, chapter revisions were completed with existing versions of the chapters representing several different years, and appendices were missing.

The Purchasing Division management has informed the OCA that the City is currently in the process of updating their Purchasing Manual with a finalized version expected to be completed in FY2024. The "Design Build" contract type is expected to have a designated chapter in the updated version as well.

Key Recommendations

The City should complete adding in the City's Purchasing Manual a chapter that explains the necessary steps for processing a "Design Build" contract.

It is crucial that the City takes steps to document the process for procuring a "Design Build" contract. This could involve detailing each step of the process, from the initial solicitation to the final contract award. It would also be beneficial to include examples of best practices and potential pitfalls to avoid. By doing so, the City can ensure that its procurement process is robust, transparent, and in line with established procedures. This will ultimately contribute to more effective and efficient procurement operations within the City of Palo Alto.

It is also advisable that the City's management regularly update the Purchasing Manual to ensure that the procurement process remains in alignment with the City's evolving goals and needs. The Purchasing Manual should include a table of contents, frequently revised chapters, appropriate chapter titles, and all appendices. It is imperative that the City's Purchasing manual is relative to the current operations that are being conducted at the City.

Finding 3: Needs assessment and market analysis (Page 16)

Based on the results of needs assessment and market analysis, an organization develops the specifications, requirements, a statement of work, and award criteria to properly describe the organization's needs in the solicitation document and attract a sufficient number of qualified bidders

The OCA noted the following:

- The City currently lacks a formalized needs assessment process within its Purchasing Manual.
- The City departments perform their own needs assessments and market analyses before submitting budget requests.

- The Purchasing Division does not collect or review the needs assessments and market analyses conducted by the City departments.

As described in the Best Practices section of this report, it is important that an organization assesses needs and analyzes the market for thinking strategically and encouraging competition. Without them, the City may be exposed to some risks such as procurement of insufficient or inferior goods and services.

Key Recommendations

The City should incorporate a formal needs assessments and market analyses in the City's Purchasing Manual to provide expectations and guidance to all departments to enable the procurement professionals to gather and analyze the information. The procedures performed should also include detailed review by the appropriate Purchasing Division personnel to ensure the results are utilized to encourage bid competition, meet strategic goals, comply with laws and regulations, and to leverage a buying power.

Finding 4: Vendor record creation (Page 18)

The OCA examined whether technology is used appropriately and effectively to enhance integrity, efficiency, transparency of the procurement process and ensure consistency and validity of the relevant information and data. It was observed during inquiry and assessment of vendor listings that duplicate vendors can be created in SAP. Being allowed to create vendors or duplicate vendors can lead to many risks. Risks include making duplicate payments to the same vendor which may impact the City's financial position, fraudulent invoices can be paid to nonexistent vendors, noncompliance with laws, regulations and provisions, and data quality that is not accurate or complete.

The OCA noted that vendors are created by authorized personnel within the Accounting and Purchasing Divisions, the only Divisions that employ personnel that have the authority, have the ability to create a new vendor. Although duplicate vendors can be created without restrictions from the SAP system, mitigating controls exist to help decrease the likelihood of duplicating vendor submissions.

Key Recommendations

The City should implement application controls that help the City avoid creating duplicate vendor records unintentionally. Additionally, the City should implement a manual control where the creation and modification of new vendors are subject to appropriate independent reviews at the time of creation and modification to prevent duplicate or unauthorized entries and errors.

The City should also frequently validate and monitor vendor lists, and prioritize a structured approach to vendor management with regular reviews following City-developed procedures. This includes removing duplicate vendors that are in SAP currently, as well as old vendors that are no longer in-use.

Introduction

Objective

The objectives of this audit were to:

- 1) Determine whether needs assessment, budgeting, solicitation, and vendor selection processes are efficient, effective, and transparent to ensure value for money and fair competition.
- 2) Determine whether the procurement process is valid through proper approvals, adequate segregation of duties, and compliance with applicable laws, regulations, and the City's policies.
- 3) Determine whether technology is used appropriately and effectively to enhance integrity, efficiency, transparency of the procurement process and ensure consistency and validity of the relevant information and data.
- 4) Identify the opportunities to improve the efficiency and effectiveness in the procurement process.

Background

The Purchasing & Contract Administration (Purchasing) Division in the City of Palo Alto manages procurement processes and oversees contractual agreements. Its responsibilities include soliciting bids, purchasing goods and services, negotiating contracts, ensuring compliance with regulations, and managing vendor relationships. City departments play a primary role in contract administration once a contract is established, however, the Purchasing Division becomes involved if a contract needs to be modified. The division also provides support with other City departments to develop and execute contracts for these purchases. The department aims to acquire quality goods/services at competitive prices while maintaining transparency, efficiency, and adherence to City policies and procedures.

The Purchasing division operates in accordance with City of Palo Alto Municipal Code (Section 2.30 - Contracting and Purchasing Procedures) which establishes the contracting authority of the City Manager, the Chief Procurement Officer, designated employees, City Attorney, and City Council. The purpose of the Municipal Code for the Purchasing Division is “to foster and encourage the use of best management practices in contracting and purchasing; to ensure quality and efficiency in the procurement of goods, services, equipment, materials and supplies at the lowest cost commensurate with the quality needed; to provide for a fair and equitable procurement process utilizing standardized solicitation procedures; and to maintain honesty and integrity in the procurement process”¹.

The Administrative Services Department goals and key performance measures in the FY2024 Adopted Operating Budget include the following purchasing-related goal and key performance measure:

¹ Palo Alto Municipal Code Section 2.30.010 https://codelibrary.amlegal.com/codes/paloalto/latest/paloalto_ca/0-0-0-61798#JD_2.30.010

INTRODUCTION

Goal: Implement performance management programs to support and enhance communication, accountability, and positive outcomes.

Objectives: Continue developing and implementing Procurement and Inventory process improvements.

Key Performance Measure:

	FY2021 Actual	FY2022 Actual	FY2023 Estimated	FY2024 Adopted Budget
Average time from receipt of a Purchase Requisition to issuance of Purchase Order (Days)	26	21	25	25

The Purchasing division employees include a Chief Procurement Officer, 4 contract administrators, 2 senior buyers, and 2 buyers. All procurement activity is handled by 9 City employees plus staff in departments that initiate procurements and manage contracts. The list of contracts provided by Purchasing division shows that 2,201 contracts were active during the audit period, July 1, 2020, to June 30, 2023. The 2,201 contracts amounted to \$399,412,385.95 in total contract value.

The current City's Purchasing Manual is dated May 20, 2019, and consists of 22 chapters and Appendices A, B, G, and O. The City is currently in the process of updating their Purchasing Manual with a finalized version expected to be completed in FY2024.

Scope

The OCA evaluated the controls surrounding the City's procurement process and tested the selected controls by assessing a sample of contracts between July 1, 2020, to June 30, 2023 (audit period).

Methodology

To achieve the audit objectives, the OCA performed the following procedures:

- Assessed the pertinent laws, policies, and guidelines related to Procurement including the City's Purchasing Manual and City of Palo Alto Municipal Code (Section 2.30 - Contracting and Purchasing Procedures).
- Interviewed the appropriate individuals to understand the roles and responsibilities, processes, and controls related to Procurement activities.
- Selected a sample of contracts during the audit period, FY21 to FY23. The OCA stratified the population into smaller groupings by contract type ([Appendix A](#)). The percentages of counts for each contract type were multiplied by the sample size of 50 to select a representative number of contracts for each contract type for testing. The sample selected ultimately accounted for \$244,409,100.22, or 61% of total contract value.
- Assessed supporting documents for controls performed and approvals for the selected contracts and solicitations.
- Used State and Local Government Procurement" A Practical Guide by National Association of State Procurement Officials (NASPO), California Public Contract Code (PCC), and Auditing Procurement in the Public Sector by the Institute of Internal Auditors (IIA) as best practices.

INTRODUCTION

Compliance Statement

This audit activity was conducted from August 2023 to December 2023 in accordance with generally accepted government auditing standards, except for the requirement of an external peer review². Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings, observations, and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings, observations, and conclusions based on our audit objectives.

Organizational Strengths

During this audit activity, we noted the expertise and the responsiveness demonstrated by the Procurement team, notably the Chief Procurement Officer and Assistant Director. We also observed their willingness to provide and receive feedback regarding the procurement process flowcharts, which includes their receptiveness to process improvements.

The Office of the City Auditor greatly appreciates the support of the Purchasing & Contract Administrative Division of the Administrative Services Department in conducting this audit activity.

Thank you!

² Government auditing standards require an external peer review at least once every three (3) years. The last peer review of the Palo Alto Office of the City Auditor was conducted in 2017. The Palo Alto City Council approved a contract from October 2020 through June 2022 with Baker Tilly US, LLP (Baker Tilly) and appointed Kyle O'Rourke, Senior Consulting Manager in Baker Tilly's Public Sector practice, as City Auditor. Given the transition in the City Audit office, a peer review was not conducted in 2020 and will be conducted after the third year of Baker Tilly's contract.

Detailed Analysis

Best Practices

The National Association of State Procurement Officials (NASPO) offers guidance related to procurement in the public sector. The best practices highlighted by NASPO, within the publication of the *State & Local Government Procurement: A Practical Guide*, provides relative recommendations for the Purchasing Division and the overall procurement process. Additional key recommendations have been provided by the California Public Contract Code (PCC) and the Institute of Internal Auditors (IIA). The IIA offers audit guidance through its publication titled *Auditing Procurement in the Public Sector*, delineating a conceptual framework within the International Professional Practices Framework (IPPF) for procurement practices specific to the public sector.

National Association of State Procurement Officials (NASPO)³

The NASPO publication of the *State & Local Government Procurement: A Practical Guide*⁴ provides guidance for procurement in the public sector. This practical guide includes a comprehensive list of recommended best practices. Key recommendations that would positively impact the City, and are directly from the publication, are highlighted here:

- Governance
 - “The central procurement office and the Chief Procurement Officer should establish measurements for assessing the performance of the procurement process, such as processing times, supplier performance data, and client survey responses.”
 - The *Critical Success Area and Key Performance Indicators for State Central Procurement Offices*⁵ by NASPO provides a list of indicators such as “Dollar value of the negotiated hard savings or cost avoidance realized due to the efforts of procurement staff” and “Average internal customer satisfaction score from monthly or annual customer satisfaction surveys.”
- Strategies and Planning
 - “Public procurement officers must be encouraged to think strategically about each procurement and ensure that they have the right tools and data to make strategic decisions.”
- Competition
 - “Public procurement officers must have at hand a wide range of source selection methods in order to be able to meet user agencies' and users' needs.”
 - “Understand market conditions for every procurement.”
 - “Performing market research to understand the scope of the marketplace.”

³ <https://www.naspo.org/>

⁴ <https://county.milwaukee.gov/files/county/administrative-services/Procurement/PagesfromNASPOStateandLocalProcurementGuideCh1-10.pdf>

⁵ https://cdn.naspo.org/R&I%20Content%20Library/CriticalSuccessAreas_KeyPerformances_2023.pdf

- “Estimating prices and costs based on thorough market price and cost research.”
- “If prequalification of suppliers is used, prequalifying as many suppliers as exist in the current market; and if there are too few suppliers, broadening the geographic area of qualification.”
- “The procurement office should budget for supporting staff access to current market information, such as subscriptions to online market research tools and attendance at trade shows.”
- “The objective of a sound specifications-drafting process is to find a balance between what the user believes that it needs and a fair expression of those needs that is not too restrictive for the marketplace.”
- “The standard for contract award under competitive sealed bidding should not merely be lowest price but also lowest cost to the state or local government.”
- Contractor Performance
 - “Assess contract performance both during and at the end of the contract”
 - “Policies should be in place up front to insulate performance evaluations and contract disagreements from undue political influence. The contract should clearly identify milestones, expectations for service levels, output measures, and standards.”
 - Monitoring performance is an iterative process. Periodic reviews for high-value procurements foster collaboration, addressing challenges and identifying cost-saving opportunities.
 - Optimize with frequent technology-driven monitoring using diverse feedback sources, including contractors, citizens, consultants, and community groups.
 - Collect meaningful performance data, share it with stakeholders, and leverage information technology for efficient data collection and evaluation.
 - Finally, take advantage of less adversarial approaches to resolving disputes and handling performance issues, like mediation or arbitration.

California Public Contract Code (PCC)⁶

The PCC regulates the procurement process for public contracts in the state, setting forth guidelines, procedures, and requirements to govern the bidding, awarding, and execution of contracts for goods, services, and public works projects by state and local government entities. For consideration the California PCC includes the following elements:

6

<https://leginfo.legislature.ca.gov/faces/codesTOCSelected.xhtml?tocCode=PCC&tocTitle=+Public+Contract+Code+-+PCC>

- Every solicitation shall contain the statement “It is unlawful for any person engaged in business within this state to sell or use any article or product as a “loss leader.”⁷”
- The department shall adopt, publish and apply uniform standards of rating bidders.⁸
- Any state agency or department, which is subject to this code, shall follow this section in negotiating fees and executing a contract for professional consulting services.⁹
- Payments upon contracts shall be made as the department prescribes upon estimates made and approved by the department, but progress payments shall not be made in excess of 100 percent of the percentage of actual work completed.¹⁰

Auditing Procurement in the Public Sector - Assess Needs and Analyze Market¹¹

Assessing procurement typically begins by reviewing the organization's pre-tender planning policies and procedures. Effective risk mitigation in procurement hinges on well-designed strategies and proactive policies. Continuous monitoring and thorough follow-up assessments are essential to gauge the practical performance of these policies and procedures. Typically, this is performed by a procurement specialist who is separate from the manager who authorizes the procurement and performs the following:

- Assesses organizational need for goods or service.
- Assess the market for the requested good or service.
- Identify possible alternatives to external procurement.
- Identify gaps that may be filled by external procurement.
- Justify needs in terms of economy, effectiveness, and efficiency.

Auditing Procurement in the Public Sector - Plan and Budget⁹

During the pre-tendering phase, accurately estimating resources and devising a comprehensive budgeted plan is fundamental. Establishing precise selection criteria and budgeting guidelines is pivotal for successful procurement. Procurement managers bear the responsibility of minimizing the risk associated with budget inaccuracies, particularly when dealing with new acquisitions or intricate projects where complexities may arise. To ensure proper planning and budget the following should be performed:

- Forecast cost in each phase of procurement.
- Prepare a project specific procurement plan (i.e. business case or feasibility study).
- Procurement plan approval through senior hierarchy.
- Separating budget estimation duties from authorizations and approvals and establishing peer reviews.

⁷ https://leginfo.ca.gov/faces/codes_displaySection.xhtml?lawCode=PCC§ionNum=10302.

⁸ https://leginfo.ca.gov/faces/codes_displaySection.xhtml?sectionNum=10303.&nodeTreePath=3.2.3.3&lawCode=PCC

⁹ https://leginfo.ca.gov/faces/codes_displaySection.xhtml?lawCode=PCC§ionNum=6106.

¹⁰ https://leginfo.ca.gov/faces/codes_displaySection.xhtml?lawCode=PCC§ionNum=10261.

¹¹ The Institute of the Internal Auditors, Auditing Procurement in the Public Sector, Practice Guide, (November 2021)

Auditing Procurement in the Public Sector - Post Award⁹

To maximize the effectiveness of post-award contract administration, it is pivotal to clearly define the roles and responsibilities of contract managers and administrators, detailing their involvement in performance oversight, change management, document upkeep, dispute resolution, and contract finalization. Implementing robust monitoring systems with specific Key Performance Indicators (KPIs), fostering proactive adaptation to changes, maintaining centralized and accessible document repositories, establishing structured dispute resolution protocols, and outlining systematic contract closure processes are vital steps towards enhancing efficiency and ensuring compliance. Embracing these strategic measures will fortify the organization's ability to navigate post-award contract administration seamlessly. Implementation of the above and following can foster more favorable and successful contract outcomes:

- Developing a contract administration plan containing operational details of the contract to monitor contract performance.
- Segregating duties of individuals who are responsible for receiving, paying or providing program expertise.
- Allocating funds upon contract award and ensuring payments are issued promptly.

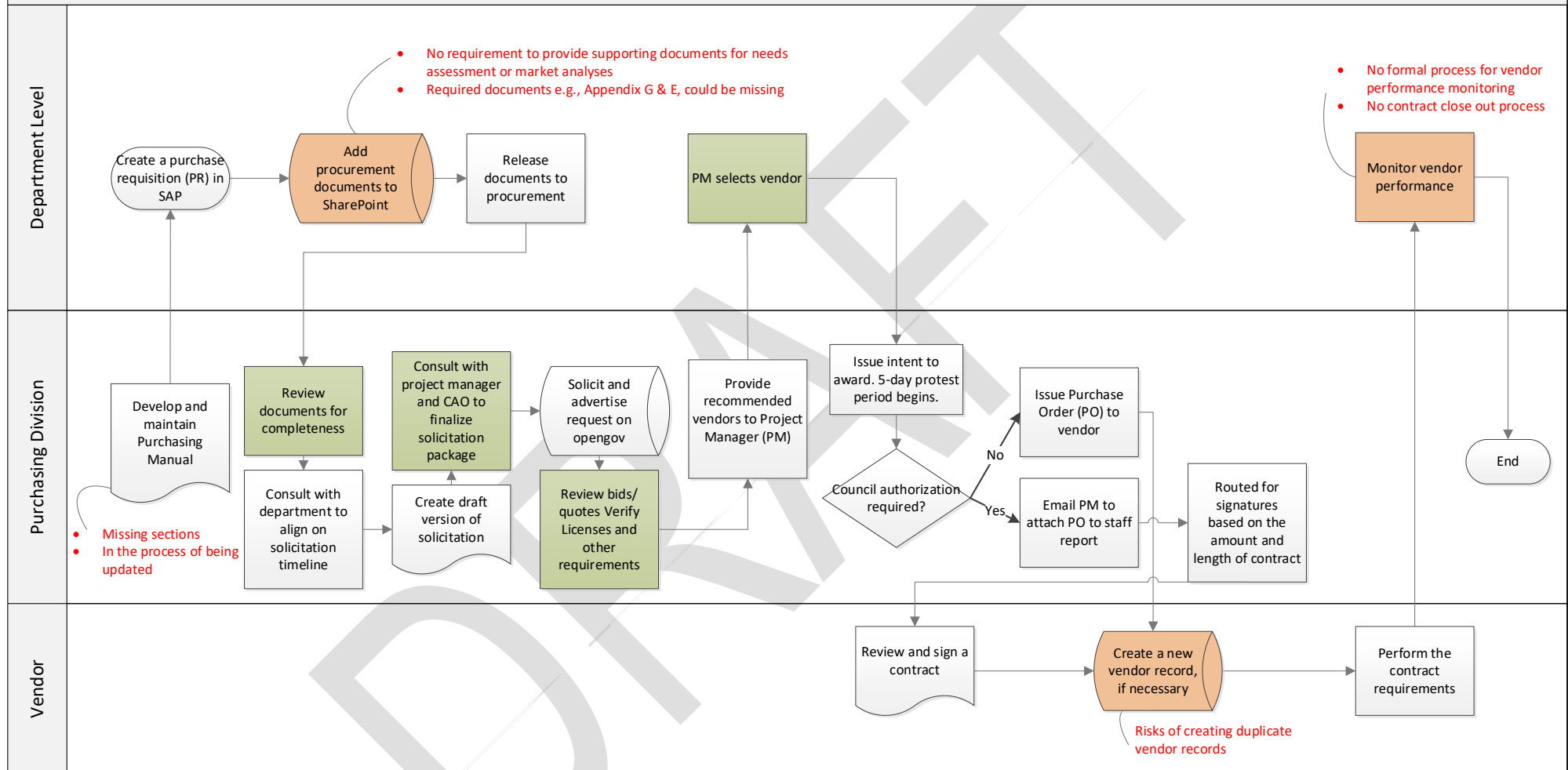
Auditing Procurement in the Public Sector - The Organization for Economic Co-operation and Development (OECD) Issued Guidance⁹

The OECD serves as a forum for governments worldwide to collaborate on economic policies and address global challenges. The OECD aims to promote economic growth, prosperity, and sustainable development through research, policy analysis, and the exchange of best practices. The OECD contains the following recommendations:

- Developing performance measurement systems with KPIs focused on the outcomes of procurement processes.
- Using the performance data to inform strategic policy-making and to develop strategic plans that articulate expectations and responsibilities.
- Ensuring the e-procurement system should be flexible, secure, and scalable, while the user interface should be simple yet effective. Strong access controls are crucial for data security and user privacy.

The following flowchart shows the abbreviated current processes and controls in place.

Abbreviated Procurement Process



Audit Results

Finding 1: Supporting documentation for contract award

During the audit of the procurement process, the OCA requested a comprehensive list of contract awards spanning from FY2021 to FY2023, inclusive of solicitations. A sample of 50 contracts was selected for testing key controls, as identified during walkthroughs with the Purchasing Division.

Out of these 50 samples, 6 contracts exhibited exceptions. These exceptions were primarily due to the absence of supporting documentation, which resulted in compliance deficiencies, as mandated by the City's Purchasing Manual and Chapter 2.30 of the Palo Alto Municipal Code.

- Four out of 50 contracts did not include the Solicitation Plan Checklist or Appendix G.
 - 1 out of 4 contracts that did not include the corresponding Solicitation Plan Checklist were purchased goods. Chapter 6 (page 5), of the City's Purchasing Manual - contracts for \$10,001-\$50,000 (Informal Solicitation) - states: "If desired, Purchasing can conduct the informal solicitation for the department. In these instances, departments must complete the "Solicitation Plan Checklist" of Appendix G, assemble a list of recommended sources with contact information, and provide a detailed specification, all saved to a designated location for Purchasing to process. This documentation must be referenced in the purchase requisition's "Header Note" screen as "Supporting documentation completed in the [location]." Chapter 6 (page 6), of the City's Purchasing Manual, for \$50,001 and above (Formal Solicitation), states "When utilizing a formal bid process for purchases of goods above \$50,000, City departments must create a fully funded purchase requisition (PR). Before releasing the PR for processing, a "bid ready" specification must be saved in MS Word format, along with a completed "Solicitation Plan Checklist" - Appendix G, to a designated location for Purchasing to process. This documentation must be referenced in the purchase requisition's "Header Note" screen as "Supporting documentation completed in the [location]."
 - 2 out of the 4 contracts that did not include the corresponding Solicitation Plan Checklist was a contract that was purchased professional services (informal proposal). Chapter 8 (page 5), of the City's Purchasing Manual, contracts for \$50,001-\$85,000 (Informal Proposal), states "Departments (Project Managers) must complete a Solicitation Plan Checklist - Appendix G, saved to a designated location for the department, or Purchasing, to process the contract. The checklist provides a road-map of direction for the requesting department and critical information needed by Purchasing & Contract Administration to process a procurement request. This documentation must be referenced in the supporting PR 'Header

Note' screen as "Supporting completed in the [LOCATION]" to advise Purchasing on where to obtain supporting electronic documentation."

- 1 out of the 4 contracts did not include the corresponding Solicitation Plan Checklist was a contract that was purchased professional services (formal proposal). Chapter 8 (page 8), of the City's Purchasing Manual, contracts for \$85,001 and above (Formal Proposal), states "Departments (Project Managers) must complete a "Solicitation Plan Checklist" - Appendix G, saved to a designated location for the department, or Purchasing, to process the contract. The checklist provides a road-map of direction for the requesting department and critical information needed by Purchasing & Contract Administration to process a procurement request. This documentation must be referenced in the supporting PR 'Header Note' screen as "Supporting completed in the [LOCATION]" to advise Purchasing on where to obtain supporting electronic documentation."
- Two out of 50 contracts did not include the Exemption From Competitive Solicitation Request Form or Appendix E.
 - 2 contracts tested, that were labeled as 'exemptions', did not include the Exemption From Competitive Solicitation Request Form or Appendix E. Per Chapter 4 (page 1), of the City's Purchasing Manual, "When a City department requires a specific products or services over \$10,000 that can only be furnished by a certain provider or that should be otherwise exempted from the competitive solicitation process (ref. PAMC 2.30.360), the requestor must complete an *Exemption From Competitive Solicitation Request Form* (Purchasing Manual Appendix E) via email. The exemption request requires a description of the unique need that necessitates an exemption from competitive solicitation, including actions taken to determine justification of why it may be impracticable, unavailing or impossible to solicit bids or proposals. For product standardization requests, the justification must demonstrate that standardization is necessary for the health, safety or welfare of the City or significant cost savings can be realized by standardizing on a single brand or trade name. These requests require Department Head, Purchasing Manager and City Manager approval. To be approved, the justification request must demonstrate a need that can only be satisfied by the selected supplier."

Risks associated with lack of support include failure to meet contract specifications, loss of data, fraudulent activity, and noncompliance with laws, regulations, and provisions.

Recommendation It is advisable for the City to establish and integrate a comprehensive checklist that encompasses all supporting evidence required to be retained throughout the entire procurement phase.

This checklist should include all mandatory documents for each contract, as well as all internal documentation referenced in the purchasing manual and municipal code. It should also provide space for commentary, enabling the

purchasing manager to offer detailed explanations in cases where certain supporting evidence may not be applicable.

This proposed checklist would serve as a supplement to the existing Solicitation Plan Checklist and Exemption From Competitive Solicitation Request Form. Its implementation would enhance the transparency and efficiency of the procurement process, ensuring that all necessary documentation is consistently maintained and easily accessible. This, in turn, would contribute to the overall effectiveness of the City's procurement operations. Lastly, a checklist that identifies necessary documents for retention would help mitigate the risk of noncompliance.

Management Response

Responsible Department(s): Administrative Services Department

Concurrence: Agree

Target Date: December 2024

Action Plan:

Staff agrees with the recommendation and to that end the Purchasing Division is currently implementing the intake process in the new procurement system provided by OpenGov. The OpenGov intake process will replace and automate Appendix G, the current checklist, and will be inclusive of all documents needed for the formal solicitation purposes. The new OpenGov intake process is designed to offer efficiencies through a streamlined interface and a single destination for communication replacing numerous emails and documents.

Staff is also finalizing new checklists that will cover the informal request for solicitations process as well for cooperative agreements. With the new OpenGov intake process and the new checklists, this will complete the checklist documentation needed to start any solicitation. Check lists already exist for professional service agreements, amendments to contracts, and general services agreements. With these tools, it will be clearly laid out what documents will be needed to complete a solicitation.

Summary:

Existing checklists: Appendix G (for most solicitations); professional services agreement; amendment to contract; general services.

New checklists to be changed/added: Appendix G to be integrated into OpenGov; new checklist for informal request for proposals.

Finding 2: Purchasing manual

The City of Palo Alto procures a variety of contracts for goods and services. The procurement process employed by the City varies, with distinct procedures in place depending on the type of contract and solicitation.

These types include the purchase of goods, general services, professional services, and public works contracts, among others. ([Appendix A](#))

The OCA undertook a series of walkthroughs to assess the efficiency, effectiveness, and transparency of the procurement process. These walkthroughs served to document the current state of the procurement process. The documented process was subsequently compared to the procedures outlined in the City's Purchasing.

During the walkthroughs, it was observed that the City employs a specific process when procuring a "Design Build" contract. This process, however, is not documented within the City's Purchasing Manual. As there was a Design Build contract with a contract value of \$4.2 M in the list of contracts for the audit period, the OCA added this contract to our previously selected 50 contracts for testing.

It was noted that, at present, the procedure for processing a Design Build contract is executed through a blend of various solicitation processes, leading to possible inconsistencies. To address this, it is imperative to document this process and ensure its inclusion in the updated manual. This will foster consistency and efficiency in the City's procurement operations as the procedures delineated in the purchasing manual will serve as a guide for City employees, enabling them to effectively evaluate and execute tasks when procuring a specific solicitation.

Furthermore, it was determined when assessing the City's Purchasing Manual that inconsistencies exist. It was noted that there was no table of contents, multiple chapters were outdated, a chapter was inconsistently labeled, chapter revisions were completed with existing versions of the chapters representing several different years, and appendices were missing. The Purchasing Division management has informed the OCA that the City is currently in the process of updating their Purchasing Manual with a finalized version expected to be completed in FY2025. The "Design Build" contract type is expected to have a designated chapter in the updated version as well. The absence of a well-documented purchasing manual can lead to inconsistencies and inefficiencies in the procurement process. A purchasing manual should provide clear guidelines for City employees to reduce ambiguity and ensure that all steps are followed correctly and consistently. This would also enhance transparency, allowing for better oversight and accountability.

Regular updates to the Purchasing Manual will facilitate the timely identification and addressing of any gaps or inefficiencies, thereby enhancing the overall effectiveness of the City's procurement strategy.

Recommendation The City should complete adding in the City's Purchasing Manual a chapter that explains the necessary steps for processing a "Design Build" contract.

It is crucial that the City takes steps to document the process for procuring a "Design Build" contract. This could involve detailing each step of the process, from the initial solicitation to the final contract award. It would also be beneficial to include examples of best practices and potential pitfalls to avoid. By doing so, the City can ensure that its procurement process is

robust, transparent, and in line with established procedures. This will ultimately contribute to more effective and efficient procurement operations within the City of Palo Alto. We recommend having a comprehensive and well-documented process for all types of solicitations within the City's Purchasing Manual. It is our recommendation that the manual should encompass all types of solicitations. This will provide the City with a clear roadmap to ensure all types of solicitations and contracts are processed as expected by management and in compliance with applicable laws and regulations.

Furthermore, it is advisable that the City's management regularly update the Purchasing Manual to ensure that the procurement process remains in alignment with the City's evolving goals and needs. The Purchasing Manual should include a table of contents, frequently revised chapters, appropriate chapter titles, and all appendices. It is imperative that the City's Purchasing manual matches the current operations that are being conducted at the City.

Management Response

Responsible Department(s): Administrative Services Department

Concurrence: Agree

Target Date: November 2024

Action Plan:

Staff agrees that updating the purchasing manual to include all solicitation processes is a good practice. This ensures that the manual is comprehensive and well documented of all processes and types of solicitations. This will provide the organization with a clear roadmap to ensure all types of solicitations and contracts are processed as expected and in compliance with the municipal code and applicable laws and regulations. Also, it is good practice to update the manual on a regular basis to ensure it has the most update to date information.

Staff will update the manual to include Design Build solicitations in a new chapter. It is relevant to note that design build solicitations occur roughly once per year. All other solicitation processes are captured in the current version of the manual.

The manual will be reviewed for necessary updates on a regular basis at least annually.

Finding 3: Needs assessment and market analysis

Before an organization invites providers of goods and services to bid on a contract, it is imperative for an organization to conduct a thorough needs assessment and market analysis to understand what is required to meet the organization's needs and obtain necessary information for successful procurement. Based on the results of needs assessment and market analyses, an organization develops the specifications, requirements, a statement of work, and award criteria to properly

describe the organization's needs in the solicitation document and attract a sufficient number of qualified bidders.

The OCA noted the following:

- The City currently lacks a formalized needs assessment process within its Purchasing Manual.
- The City departments perform their own needs assessments and market analyses before submitting budget requests.
- The Purchasing Division does not collect or review the needs assessments and market analyses conducted by the City departments.

As described in the Best Practices section of this report, the *State and Local Government Procurement: A Practice Guide* by NASPO, corroborates the importance of an organization assessing needs and analyzing the market for thinking strategically and encouraging competition. The *Auditing Procurement in the Public Sector's Practice Guide*, published by the IIA notes that risks exist when needs assessments and market analyses are not performed. Without them, the City may:

- Over- or under-estimates needs.
- Inadequately or unrealistically define specifications.
- Procure insufficient or inferior goods and services.
- Have insufficient capacity to assess needs and analyze market.
- Fail to attract a sufficient number of qualified bidders/reduced competition.

Recommendation It is recommended that the City integrate standardized needs assessment and market analysis procedures that are applicable across all departments to enable the procurement professionals to gather and analyze the information. The expectations and guidance should be formally documented in the City's Purchasing Manual.

The execution of these procedures should involve a comprehensive review by the appropriate Purchasing Division personnel, ensuring that and that the results are utilized to encourage bid competition, meet strategic goals, comply with laws and regulations, and to leverage a buying power.

Management Response

Responsible Department(s): Administrative Services Department

Concurrence: Partially Agree

Target Date: September 2024

Action Plan:

Currently, City departments handle needs assessments and market review with different degrees of formality where information gained from such reviews supports the solicitation process. On one end of the spectrum, a

department may have detailed specifications and a thorough understanding of the marketplace of vendors because the market is well defined. On the other side, a scope of services might exist but a formal process of seeking qualifications from the market is performed in what is called a request for information or RFI process to gain more specific market awareness. These two ends of the spectrum and those in between are currently believed to be sufficient while not burdening the solicitation process with added time.

The Purchasing Division can ask departments for the needs assessment and market analysis where it exists and include that in the solicitation documentation file going forward. This approach to addressing the recommendation builds on what is currently done by departments. This approach seems like a reasonable step that won't add significant time to the procurement process. However, creating a new City integrated standardized needs assessment and market analysis procedures across all departments would be more time consuming and costly for procurement transactions, likely exceeding the foreseeable potential benefits.

Finding 4: Vendor record creation

The OCA evaluated the use of technology in enhancing the integrity, efficiency, and transparency of the procurement process. This included ensuring the consistency and validity of all relevant information and data.

The OCA's walkthrough interview regarding creation of vendor records within the Enterprise Resource Planning (ERP) system revealed that the City's ERP system, SAP, permits the creation of duplicate vendors. This was determined during inquiry with the Purchasing Division, and corroborated when viewing a requested SAP system generated approved vendor listing. Per our analysis of the vendor listing (report called "Vendor Export SAP 2023"), there were 28 instances where the same vendors were included, throughout the report, with different "Supplier" numbers, or different vendor numbers.

It appears that the City has a mitigating control in place, where all vendors that are created are reviewed by appropriate personnel prior to being posted to SAP. However, since manual reviews are not designed to identify duplicate vendors and payments, risks still exist due to the lack of adequate application controls to prevent the City from creating duplicate vendor records.

Risks include the potential for making duplicate payments to the same vendor or making erroneous payments, which could negatively impact the city's financial standing. There is also a risk of fraud, where payments could be made against fraudulent invoices to internal and external fraudsters. Additionally, this could lead to noncompliance with laws, regulations, and provisions, and compromise the accuracy and completeness of data quality.

Recommendation The City should implement application controls that help the City avoid creating duplicate vendor records unintentionally. Additionally, the City should implement a manual control where the creation and modification of

new vendors are subject to appropriate independent reviews at the time of creation and modification to prevent duplicate or unauthorized entries and errors.

The City should implement procedures where vendor records in the ERP system are periodically validated and monitored. The City should remove any duplicate and invalid vendor records. The quality control process should be completed annually.

Management Response

Responsible Department(s): Administrative Services Department

Concurrence: Partially Agree

Target Date: August 2024

Action Plan:

Staff agrees to pursue with the SAP ERP team in the future the possibility of implementing application controls that would create a hard stop to creating a duplicate vendor or similar available options. As it currently stands SAP does not offer this capability now according to the ERP team. While it is useful to create duplicate vendor records, in instances of needing a second vendor address, for example, no other options exist other than to create duplicate vendors. The SAP ERP system does not allow for multiple address per vendor. Sometimes vendors have one corporate address, for instance, and a separate payment address. An application hard stop could further inhibit the creation of duplicate vendors beyond the current use cases. Staff currently operates under a procedure that requires staff to check for duplicate vendors before creating a new vendor. If a duplicate vendor is identified, it is eliminated from being usable unless it is needed as a second address.

Additional Observation: Vendor performance and contract close-out process

In the current procurement process, a project manager, who is a department-level analyst, is assigned to each individual contract. The project manager's responsibilities include managing vendor relations, overseeing activities and transactions, and monitoring and concluding the contract.

However, it was observed that there is no formalized procedure in place for the contract closeout process. The close-out process, which is initiated when a contract is finalized and completed, is typically handled at the department level by a department administrator or the project manager.

The *Auditing Procurement in the Public Sector Practice Guide*¹² notes having a contract close-out process as a best practice, including reconciliation of planned against delivery budgets, evaluation of vendor performance, incorporation of public feedback and oversight by a central authority. The City might consider whether a more formal close-out process would be beneficial.

¹² *Auditing Procurement in the Public Sector*, November 21, 2021, The Institute of Internal Auditors [Auditing Procurement in the Public Sector \(theiia.org\)](https://theiia.org)

We noted that post-contract tracking and monitoring of vendor performance is currently not being conducted in a formalized manner. According to purchasing staff, vendor performance is not a function of the purchasing process. However, monitoring vendor performance and determining where this function should reside is important for the City to consider when developing formal contract close-out procedures.

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Appendices

Appendix A: City of Palo Alto Contract Types

The City of Palo Alto's procures various contract and solicitation types. The City's Purchasing Manual provides City departments with a practical step-by-step guide through the various stages of the purchasing process. The Purchasing Manual identifies the contract types and discusses each process separately in detail. Below is a chart of the contract types that are currently being procured by the City, as well as the solicitation types that can be utilized for each contract.

Contract Type	RFI ¹ (Y/N)	RFP ² (Y/N)	RFQ ³ (Y/N)	IFB ⁴ (Y/N)	COOP ⁵ and/or Informal Bid ⁶	Included in Purchasing Manual (Y/N)
Purchase of Goods	N	N	Y	N	COOP / Informal Bid	Y
Purchase of General Services	N	Y	Y	N	COOP / N/A	Y
Purchase of General Services – IT only	N	Y	Y	N	COOP / Informal Bid	Y
Professional Services	Y	Y	N	N	COOP / Informal Bid	Y
Public Works	N	N	N	Y	COOP / Informal Bid	Y
Design Builds	N	Y	N	N	N/A / N/A	N

Solicitation Types:

¹ Request for Information (RFI) – document that is used to gather information about goods or services. Information is used to compare potential suppliers.

² Request for Proposal (RFP) – document that invites potential suppliers to submit bids for a project or service.

³ Request for Quotation (RFQ) – document that an organization sends to selected suppliers to get prices quotes for a project or service.

⁴ Invitation for Bid (IFB) – document that invites potential suppliers to submit bids for a project or service, based mainly on price.

⁵ Cooperative Purchasing (COOP) – buying goods or services together with buyers to get the lowest price and best terms.

⁶ Informal Bids – type of solicitation that includes bidding from suppliers for goods or services that are not subject to public notice.

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