



WENDY GREUEL
CONTROLLER

September 30, 2009

Tony M. Royster, General Manager and City Purchasing Agent
Department of General Services
Room 701, City Hall South

Dear Mr. Royster:

**SUBJECT: EVALUATION OF RESPONSE TO THE PERFORMANCE AUDIT
OF THE CITY'S COMMODITY PROCUREMENT PRACTICES**

My Audit Division, in coordination with our consultant Harvey M. Rose Associates, LLC, evaluated your response dated August 20, 2009 to the report entitled, "Performance Audit of the City of Los Angeles' Commodity Procurement Practices."

The purpose of a performance audit is to identify areas that can be improved, and present recommendations to promote efficiencies, increase accountability, and have a financial impact in the form of costs avoided or increased revenue. Especially in light of the City's current financial difficulties, I expect General Managers to embrace the opportunity to seek positive change.

Your letter notes that GSD welcomed the audit and will look to the recommendations as a means to achieve savings and efficiencies. However, rather than presenting an action plan with target dates on how you will implement the recommendations, as requested by my Director of Auditing, your letter includes a lengthy narrative that contradicts the auditors' findings.

Your letter reflects a continued attitude to defend GSD's current, less than fully effective practices, and limit this Office's independent assessment of your operations, not only on this project, but for other audits as well. Issues on which your staff disagreed with the auditors were discussed throughout the process, most notably at the point sheet stage and at a later exit conference. GSD's



position and additional documentation were considered by audit staff, and all findings noted in the report are clearly supported. GSD's disagreement with some of the report's conclusions is also noted in the final report.

Though you assert that the report includes inaccuracies, these are simply not based in fact. The Attachment presents my auditors' position on your staff's faulty assertions.

I expect to receive your action plan on how your department will implement the audit's recommendations, including estimated dates, by October 15, 2009. My staff will forward an electronic version of the table of recommendations that will facilitate this request.

I encourage you to be more receptive to the audit process, including accepting that there are shortcomings in your operations that call for change, and implementing new strategies to effect that change, and ultimately ensuring that the City's scarce resources are spent wisely in procuring commodities for City Departments.

If you have any questions or comments, please contact Farid Saffar, Director of Auditing, at (213) 978-7392.

Sincerely,



WENDY GREUEL
City Controller

Attachment

- c: Reverend Jeff Carr, Chief of Staff, Office of the Mayor
Jimmy Blackman, Deputy Chief of Staff, Office of the Mayor
Ben Ceja, Office of the Mayor
Eduardo Hewitt, Legislative Deputy, Council District 6
Miguel A. Santana, City Administrative Officer
June A. Lagmay, City Clerk
Gerry F. Miller, Chief Legislative Analyst
Deborah J. Ramos, Assistant General Manager, General Services

CONTROLLER REBUTTAL TO GSD'S COMMENTS CHALLENGING THE AUDIT DATA OR CONCLUSIONS

Department welcomed audit

GSD states that it welcomed the opportunity to review their processes with the hope of identifying areas for continued improvement. This was not the Department's message prior to and as the audit was initiated. The Department asked that the audit be deferred due to the SMS upgrade. At the entrance conference, GSD staff questioned the credentials of the auditors. Management insisted that their representatives sit in on every staff interview. The auditors objected to this attempt for management to monitor what GSD staff said in their confidential interviews and the Department did relent on this requirement. The Department was not always cooperative; for example, it took months for the Department to provide basic management information such as a list of all commodity purchase orders issued in the most recent fiscal year and all suppliers currently under contract to the City.

End Users Role in the Commodity Procurement Process

GSD's response to Section 1 reported during management and staff interviews in included in the body of the report. As noted in the report, while end user departments do have specialized expertise, the Class Specifications for GSD Procurement Analysts (1859) and Supervisors (1852) expressly require knowledge of the "principles and requirements of editing, writing, and revising specifications" and list "preparing specifications" as a minimum requirement for employment. As such, while GSD asserts that their staff "is not qualified" to do so, they are in fact required to perform such functions according to their Class Specifications. Further, Sections 9.21 (b) and (c) of the City's Administrative Code states that the purchasing Agent's responsibilities include:

Consistent with the efficient and economical operation of City Government, it shall be the duty of the Purchasing Agent

Standardization. To establish written standards for all such purchases. Such standards shall include standards specifying desired characteristics to be included in various products and services purchased by or used by the City which would assist and enable the City to enhance its environmental quality.

Specifications. To prepare and adopt written specifications of all such standardized purchases. All such specifications shall be definite and certain and shall permit competition.

GSD states in their response that many departments employ experts who research and develop recommended specifications and that GSD procurement staff is not qualified to modify or make suggested changes to their specifications. While we recognize that City departments buy many specialized and complex commodities,

we do not believe it is sufficient for GSD to rely on the end user departments and their experts to prepare specifications.

A key role of procurement staff is conducting independent reviews of department-prepared specifications to ensure that they have not been written in such a way as to favor a particular supplier or to limit competition. In certain cases where the items to be purchased are particularly complex or specialized and carry high prices, we recommended that GSD retain the services of its own experts to conduct independent reviews of departmental specifications.

Regarding GSD's reference to the benefits of staff market research conducted by procurement staff, we did review randomly selected examples of staff market research and did not find examples of the research resulting in cost savings.

Factors Undermining Competition

GSD says its supplier solicitation requirements are guidelines, not requirements. Section 5.1.1. of the Department's Procurement Procedures Manual states:

“Minimum potential bidder list *requirements* have been developed to assist procurement staff to meet City goals:

- Under \$25,000- five bids should be solicited
- Between \$25,000 and \$100,000 – ten bids should be solicited
- Over \$100,000 – fifteen bids should be solicited”

Benchmarking survey results:

GSD reports that the Commonwealth of Massachusetts has 150 procurement staff, not the 15 staff commodity buyers that reported in the results of the audit survey of other jurisdictions. As reconfirmed by the Deputy State Purchasing Agent for the Commonwealth of Massachusetts on August 31, 2009, that department had 15 staff commodity buyers and 3 supervisors at the time of the survey, as stated in the audit report, and they have only 12 at the present time.

We had obtained these staff numbers originally from the same source and confirmed them at the time through a review of their procurement department's budget and staff directory. GSD's source for staffing information, the Procurement Manager for Vehicles and Highway Maintenance, reported 150 “procurement staff” positions which is not the same as the number of “staff commodity buyer positions” that we asked for in our survey. The 150 positions cited by GSD appears to include other positions such as support staff in addition to the number of staff commodity buyers that we had requested in our survey for comparison purposes.

As shown in Appendix II, we do not report the number of staff commodity buyers in the City of New York, as GSD states in its response. City staff did not provide

the total number of commodity procurement buyers Citywide and their response to that question (Question 4.a. in Appendix II) is listed as “N/A”, or No Answer. The City’s Law Department responded to our survey, at the direction of the Mayor’s Office, and did report that they have three buyers in their own department, but this number is not included in the final report based on our discussion about this with GSD at the audit exit conference. As explained in Appendix II, Table 1, Footnote 1, commodity procurement is decentralized in New York City for items with a value of \$100,000 or less, so there are many positions in end user departments involved in the commodity procurement function.

It should be noted that the staffing numbers obtained from our survey of other jurisdictions were reported in the Appendix but were not used for comparison to commodity buyers in the City of Los Angeles due to differences in the nature of the duties performed and the degree of procurement decentralization between jurisdictions.

Contract and Supplier Management

We do report that GSD has reduced the number of contracts since 1998 and we recommend that the principle behind those reductions be continued to reduce City costs by further reducing the number of suppliers with multiple contracts, which accounted for between \$95 - \$152 million in commodity purchases between FYs 2005-06 and 2007-08. We also recommend that GSD staff begin routinely identifying suppliers awarded a combination of multiple contracts and One-Time Purchase Orders to leverage those procurements to obtain lower volume-based prices.

GSD’s states in their response that contract consolidation opportunities are limited as they now have to consider offsets to consolidating contracts such as local revenue vs. better overall prices and giving opportunities to small local businesses and minority- and woman-owned businesses. However, there is no specific City code section or GSD written procedure that addresses this issue or gives staff guidance on how they are to address this concern when they are establishing or re-negotiating contracts. Further, in our audit interviews, no GSD managers or staff reported that this principle was used to guide their work administering contracts.

The Department says that the auditors should have delved deeper into the contracts reviewed to find out why certain vendors had multiple contracts. Our point was that many suppliers have multiple contracts that should be consolidated to achieve greater price discounts. If the Department believes maintaining multiple contracts with the same vendor is justified, as management stated at the exit conference, we believe the Department should perform this analysis at the time the additional contract is executed, and maintain documentation showing how the City is benefiting from such arrangements.

Finally, as reported in Section 8, only 16 of the 576 contract suppliers engaged by GSD in FY 2007-08 were certified minority- or woman-owned, disadvantaged or small local businesses, indicating that GSD's reported intentional decline in contract consolidation efforts has not resulted in a significant rate of participation by such firms, the reason given for not consolidating contracts.

The Department reports contract savings of \$1.5 million in FY 2007-08 through unspecified strategic sourcing and \$1.6 million in rebates from the Office Depot. While the Department includes these and other measures in its regular management reports, they are not covered in an audit report unless they are germane to the findings. It should be noted, however, that a separate Controller review of the City's contract with Office Depot found problems related to unfavorable and undisclosed pricing provisions that resulted in new terms being adopted. Also, the fact that Office Depot offered rebates when purchases exceeded dollar thresholds should not be considered a success attributed to GSD. Rather, this was a term that was voluntarily added by the vendor and was incorporated into the contract, and is an interesting comment considering the audit's findings that GSD has not pursued obtaining volume-based discounts from all vendors.

The Department questions why the audit team did not report a letter to the Department from a supplier indicating its unwillingness to provide volume based discounts. There are many documents we review as part of an audit that are not presented in our final report. The letter indicating that one supplier is unwilling to provide volume discounts does not convince us that Department procurement staff should attempt to obtain volume based discounts for all contracts and report on the results of such efforts to management, as we recommended.

Confirming Purchase Orders

GSD is wrong in its assertion that the auditors did not actually review "the ordering document and made assumptions based on the word 'confirming' in the various PO fields in SMS." As noted in the report, review of documentation for 47 randomly selected One-Time Purchase Orders found 10, or approximately 21.3 percent of the files reviewed, that were Confirming Orders. These Confirming Order files were reviewed and no documentation was found detailing the reason why the purchases were not competitively bid as otherwise required.

The electronic confirming order reports obtained from GSD were used to supplement findings already established by the hard copy review. Further, as shown below, the audit team estimated the potential fiscal impact of inappropriate use of confirming orders by assuming that only half of all confirming orders identified in the electronic data were inappropriately processed by GSD. After reviewing our draft audit report, GSD conducted its own review of the confirming purchase orders and independently identified a fiscal impact very similar to ours, as shown in the table below.

The audit team did receive and review GSD's confirming order analysis and their results are summarized in our report but not used as the definitive analysis of this issue since: (a) the analysis was not independently conducted by our audit team and (b) the results obtained by GSD did not change our underlying audit findings or significantly change our estimated potential impact. As shown, the GSD analysis results in potentially inappropriate use confirming purchase orders amounting to \$331,442 as compared to our estimate of \$416,000. In either case, we believe the potential impact is significant and represents a deficiency in management controls over confirming purchase orders at GSD.

**Results of Analysis of Potential Impact of
Inappropriate Confirming Purchase Orders
as Estimated by GSD and Auditors**

	GSD results		Auditor results	
	Possible Violations	Total	Possible Violations	Total
# of Confirming POs	492	854	444	887
\$ of Confirming POs	\$2.1 million	\$5.3 million	\$2.6 million	\$5.2 million
Estimated Overspent \$*	\$331,442	\$848,000	\$416,000	\$832,000

* Based on an estimated 16 percent cost savings due to competitive bidding

Additionally, an email from GSD dated October 29, 2008 contains the following paragraph provided by Department management. Our finding that GSD processes confirming orders as emergency orders is based on these representations by GSD management. Further, as noted below, as of October 29, 2008, GSD management was unaware that they were in fact tracking the number of confirming order requests.

We have a legal obligation to process these orders since goods have been received. So our assumption is that all orders received under these circumstances are emergency orders. It is the responsibility of a department to determine whether an emergency exists.

We do not track "confirming orders"...not sure there is a way to do so in SMS. We do not send letters to end users or department heads that submit confirming order requests... they will still submit them when their staff gets materials without our approval.

Blanket Purchase Order Splitting by End User Departments

During the audit field work, GSD reported to the audit team that they have a process in place to review Blanket Purchase Orders that end user departments execute themselves, without competitive bidding, for small dollar value items. The purpose of these reviews are to ensure that departments are not splitting orders to avoid the dollar threshold that then requires that GSD process their purchase. City regulations limit individual Blanket Purchase Orders to \$1,000 per order and no more than \$50,000 cumulatively per month. The audit team subsequently reviewed 8,979 Blanket Purchase Orders and found 1,200 potentially split orders many of which were, for example, issued by the same department to the same vendor on the same day.

GSD disputes our finding that 1,200 of the 8,979 Blanket Purchase Orders reviewed represent potentially split orders. However, in spite of their Blanket Purchase Order review process that should have been performed on these 1,200 procurements, GSD has not produced any records or documentation to show that these 1,200 procurements were legitimate uses of the Blanket Purchase Order authority.

The Department instead researched the first 100 of the 1,200 potential violations identified and reported that the majority were legitimate. These 100 records were not randomly selected and the Department did not research or present any records or evidence for the other 1,100 blanket purchase orders, or 92 percent of those identified as potential violations in the audit report. We acknowledge the results of GSD's review of the 100 blanket purchase orders in our report but the Department's conclusions and methods do not convince us that their results can necessarily be applied to the 1,100 other questionable records.

The Department repeatedly states that the audit report should not present our results as true violations without further research. We consistently refer to the 1,200 questionable records as *potential* violations in our report. However, with explanations for only 100 of the 1,200 records from the Department, in spite of the Department's reported previous review of all 1,200 blanket purchase orders for legitimacy, we are not convinced that the Department has adequate controls in place in this area and recommend improvements in this regard.

Stakeholder input

GSD states that end user department concern about "lack of or slow response from Help Desk staff" should have been followed by the explanation that the SMS upgrade was the cause. We are making the point here that end user feedback is not systematically collected by the Department and we provide examples of the types of concerns we heard from end users while conducting the audit. We believe GSD management should be regularly hearing these type of concerns from end users, regardless of the explanations for the problems. We do report the

Department's explanation that the SMS upgrade caused limitations in training efforts elsewhere in the section.

Use of BAVN by GSD

According to a memorandum dated September 16, 2008 from an ITA staff member, as of September 10, 2008, there were 25,536 active registered vendors on BAVN. An Excel spreadsheet, also provided by the staff person, lists a total of 10,926 BAVN-registered self-identified commodity vendors.

GSD states that bid posting requirements are all written and therefore it was unnecessary to state that some staff members are unclear about them. We report the disparity between written procedures and staff understanding of those procedures as reported to us since we believe this represents a management problem.

Good Faith Efforts and other Administrative Requirements

Regarding administrative requirements not being delineated in the Procurement Procedures Manual, GSD states that they distribute all these requirements through administrative bulletins. In our review of a sample of supplier files, we found that most requirements are complied with by suppliers but that documentation is inconsistent. For that reason, we recommend that GSD management develop clear procedures regarding documentation to show compliance with the requirements.

Management Oversight: Commodity Procurement

GSD states that they reviewed the same sample contract files that we reviewed during audit field work and found many of the documents that we reported missing. They then conclude that we must not have conducted a detailed review of the files.

We reviewed 50 files, many containing hundreds of pages of documents in multiple binders, to verify the presence of certain documents that demonstrate compliance with various procurement requirements. We reviewed each tabbed section in each binder for the 50 selected contracts. In our opinion, the absence of a uniform method of organizing these files indicates a problem to us in that a GSD supervisor or manager reviewing staff files would not be able to find the documents that serve as confirmation that GSD procurement staff adhered to all applicable regulations and policies and procedures in establishing or amending a contract. We do report in our final report that GSD claims to have found the documents we reported missing after we concluded our review but stand by our statement that we did not find them after conducting a review that was much more than cursory. The Department does agree with our recommendation to keep all contract files organized in a standard format.

GSD states that the deficiencies we list in the Strategic Plan for Supply Services are incorrect and that the Department has another strategic plan for the whole department that we never saw. We do not consider this other document relevant to our audit findings.

At the outset of the audit, we formally requested the Supply Services Division's written mission, goals and objectives. In response, GSD management provided its Supply Services Five Year Strategic Plan. This was thus the source document we used to compare to GSD management's methods of monitoring and measuring the Division's success in accomplishing its mission, goals and objectives.

We found deficiencies in the Supply Services plan and cited them in the audit report. The primary focus and scope of the audit was the Supply Services Division, not GSD as a whole, and our comments were specifically geared to the Department's accomplishment of its stated goals and objectives.

Ethics

The audit team was not informed that Supply Services managers review all annual contracts in order to avoid ethical violations. As such, this information was not intentionally omitted from the report as asserted by GSD. Moreover, it is unclear how this would be done given GSD management's acknowledgement that they are not aware of staff conflicts as disclosed on the annually submitted Form 700.

Supplier Performance

As noted in the report, the audit team makes a clear distinction between the contractually required Supplier Performance Feedback meetings and the Supplier Responsibility meetings conducted by GSD in response to significant complaints filed by end user departments. GSD staff informed the audit team that supplier performance information was not stored in SMS and not electronically available to all end user departments. Moreover, as noted in the report, GSD staff had to manually count the number of supplier performance feedback forms and meetings held in FY 2006-2007 and FY 2007-2008. However, whether such information is available electronically or not, the larger issue is that very few suppliers are subject to any type of performance evaluation by GSD.