



**OFFICE OF THE
CITY AUDITOR**

**AN AUDIT OF THE
CITY OF SAN JOSE'S
OPEN PURCHASE ORDER PROCESS**

- THE CITY'S OPEN PURCHASE ORDER PROCESS CAN BE MORE IN COMPLIANCE WITH THE MUNICIPAL CODE AS WELL AS MORE EFFICIENT AND VALUE ADDED
- OPPORTUNITIES EXIST TO FURTHER IMPROVE THE OPEN PURCHASE ORDER PROCESS
- ADMINISTRATIVE IMPROVEMENTS ARE NEEDED IN ORDER TO STANDARDIZE AND SPEED UP CITY DEPARTMENT PAYMENTS TO THOSE VENDORS AWARDED OPEN PURCHASE ORDERS
- THE QUALITY AND USABILITY OF OPEN PURCHASE ORDER INFORMATION IN THE CITY'S FINANCIAL MANAGEMENT SYSTEM NEEDS IMPROVING

**A REPORT TO THE
SAN JOSE
CITY COUNCIL**

DECEMBER 1996

96-07



CITY OF SAN JOSÉ, CALIFORNIA

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December 6, 1996

Honorable Mayor and Members
of the City Council
801 North First Street, Room 600
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Transmitted herewith is a report on *An Audit Of The City Of San Jose's Open Purchase Order Process*. This report is in accordance with City Charter Section 805.

An Executive Summary is presented on the blue pages in the front of this report while an Administration response is shown on the yellow page(s) before the Appendices.

I will present this report to the Finance Committee at its December 11, 1996, meeting. If you need additional information in the interim, please let me know. The City Auditor's staff members who participated in the preparation of this report are Mike Edmonds, Ruth Garcia Merino, and Cynthia Chin.

Respectfully submitted,

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EXECUTIVE SUMMARY

In accordance with the City Auditor's 1995-96 Audit Workplan, we have audited the General Services Purchasing Division's (Purchasing) open purchase order process. We conducted this audit in accordance with generally accepted government auditing standards and limited our work to those areas specified in the Scope and Methodology section of this report.

THE CITY'S OPEN PURCHASE ORDER PROCESS CAN BE MORE IN COMPLIANCE WITH THE MUNICIPAL CODE AS WELL AS MORE EFFICIENT AND VALUE ADDED

The City of San Jose (City) Municipal Code (Code) authorizes the use of open purchase orders to acquire goods and services. Buyers in the City's Purchasing are responsible for issuing open purchase orders. In 1995-96, the City awarded approximately 2,000 open purchase order contracts worth approximately \$40.3 million. The City Auditor's Office selected and tested for compliance with the Code and Purchasing's policies and procedures, 221 open purchase orders worth approximately \$24.7 million that Purchasing awarded in 1995-96. The results of our open purchase order tests were that 38 percent of the vendors selected and 26 percent of the dollars awarded did not appear to be in compliance with the Code and/or Purchasing's own policies and procedures.

Specifically, we identified that,

- buyers did not always obtain or adequately document that they solicited three quotations when practicable;
- the City could have saved about \$200,000 if buyers had selected the lowest quote vendor;

- buyers did not perform any product or service usage analysis when vendor selection was based upon that criteria;
- Purchasing needs to document its compliance with the Code; and
- buyers issued some open purchase orders for purposes that did not fall under the Code definition for open purchase orders.

In our opinion, the above noncompliance with Code or policy requirements is a function of the short period of time buyers have each year to process open purchase orders. This constricted time frame also causes the open purchase order process to be labor intensive paper shuffling that is not as value added as it could be.

During our audit, we also surveyed several other cities that were comparable in size to San Jose. Our survey revealed that some of these cities issue multi-year open purchase orders. Should Purchasing use multi-year open purchase orders, we estimate that the time required for Purchasing to process an open purchase order would be reduced by 86 percent. As a result, compliance with Code and policy requirements should improve and buyers should be able to concentrate on those open purchase orders that have the highest value added potential.

**OPPORTUNITIES EXIST TO FURTHER IMPROVE
THE OPEN PURCHASE ORDER PROCESS**

During our review of the open purchase order process, we identified several areas where additional improvements are possible. Specifically, we noted that:

- The Code is unclear regarding public works type of maintenance projects;

- Purchasing needs to provide assurance that the use of specific cooperative purchasing agreements provide the City with the best value;
- Purchasing does not always combine open purchase orders to determine reporting or approval requirements;
- Purchasing does not monitor leases or advise City departments regarding expiration dates;
- Buyers' workloads are inequitably distributed;
- Purchasing issued as many as 100 open purchase orders to the same vendor for the same commodity; and
- Purchasing's vendor lists were not current.

Purchasing can improve the efficiency and effectiveness of the open purchase order process by (1) working together with Public Works and the City Attorney's Office to clarify the distinction between public works projects and general services, (2) developing procedures for cooperative purchasing agreements and leases, (3) improving its open purchase order reporting and approval process, (4) developing buyer workload management information, (5) issuing only one open purchase order for the same commodity or service purchases from the same vendor, and (6) automating its vendor lists.

ADMINISTRATIVE IMPROVEMENTS ARE NEEDED IN ORDER TO STANDARDIZE AND SPEED UP CITY DEPARTMENT PAYMENTS TO THOSE VENDORS AWARDED OPEN PURCHASE ORDERS

Each City department is responsible for ordering goods and services off open purchase orders and processing for payment vendor invoices for open purchase order purchases. However, our audit revealed that administrative controls over the payment of open purchase order vendor invoices need improvement. Specifically,

- vendor invoice terms could not be compared to the terms stipulated in the open purchase order award;
- City departments made unauthorized purchases;
- mathematical errors on vendor invoices went undetected;
- departments lacked adequate information to properly review invoices before making payment; and
- the City lost discounts on vendor invoices because of slow department payment processes.

We also noted that the Purchasing Chapter of the City Administrative Manual (CAM) has not been updated since 1987 and the Finance Administrative Manual (FAM) - Accounts Payable Section is out of date. In our opinion, Purchasing and Finance should update the Purchasing Chapter of the CAM. In addition, Purchasing should reduce the volume of invoices sent to the City by requiring vendors to submit summary invoices. Furthermore, the Finance Department should update the Accounts Payable section of the FAM. These improvements should facilitate the consistent, efficient and proper payment of open purchase order vendor invoices.

**THE QUALITY AND USABILITY
OF OPEN PURCHASE ORDER INFORMATION
IN THE CITY'S FINANCIAL MANAGEMENT
SYSTEM NEEDS IMPROVING**

An organization's computerized management information system should provide management and system users with reliable information to perform daily operations and assess organizational performance. The City installed its computerized Financial Management System (FMS) in 1989 and subsequently enhanced the FMS several times. The City's Department of Information

Technology (IT) is responsible for operating and maintaining the FMS. During our audit of open purchase orders, we noted a number of deficiencies that were the direct result of the FMS' limitations. Specifically, we identified that the FMS:

- does not produce enough management information to allow the General Services Purchasing Division (Purchasing) to measure the performance of its buyers or the cost effectiveness of the open purchase order process;
- produces open purchase order reports that contain so many discrepancies and are so unreliable that Purchasing does not allow City departments to have access to these reports;
- does not produce open purchase order management reports on Minority and Women Business Enterprises (M/WBE) purchases, recycled products, multi-year contracts, goods versus services, and lost payment discounts;
- does not produce management reports that summarize City department open purchase order activity; and
- is perceived by City departments as not being user friendly and is unresponsive to their processing and information needs.

As a result, Purchasing's ability to manage the open purchase order process is impaired and City departments spend unnecessary time on open purchase order activities. Accordingly, Purchasing should (1) input City department codes into the FMS and (2) instruct those users of open purchase orders who review and approve vendor invoices to indicate "final payment" on the final invoice or receiving document. Further, IT should (1) evaluate upgrading the FMS purchasing module, (2) program the FMS to generate a report that extracts open purchase orders by department, (3) allow departments to have access to such

reports, and (4) evaluate programming the FMS to generate a report which details purchase discount information. In addition, Purchasing and IT should train City department personnel who enter, retrieve, or process the FMS open purchase order information. Finally, City departments should input purchase discount information into the FMS subject to IT successfully programming the FMS to generate purchase discount reports.

RECOMMENDATIONS

We recommend that the General Services Purchasing Division:

Recommendation #1:

Develop documentation standards for its buyers. These standards should address the following:

- number of bids or quotes solicited;
- the number of bids or quotes received;
- other factors considered in the award decision; and
- written justification for awarding business to other than the lowest bidder.

(Priority 3)

Recommendation #2:

Document the reasons for the amount of each petroleum open purchase order. (Priority 3)

Recommendation #3:

Request the City Council to authorize the Director of General Services to adjust the amount of approved open purchase orders for petroleum purchases to ensure that the City purchases petroleum from the lowest weekly quoted vendor. (Priority 2)

Recommendation #4:

Annually perform a competitive selection of temporary service agencies for frequently used position classifications. (Priority 3)

Recommendation #5:

Develop guidelines requiring buyers to document vendor selection criteria when:

- price and/or location are not the primary factors for vendor selection or
- bidding multiple rates for services or supplies on a single open purchase order.

(Priority 3)

Recommendation #6:

Pursue changing the FMS designation for those transactions which do not fall under the Municipal Code open purchase order definition. (Priority 3)

Recommendation #7:

Require buyers to use an approval of awards form for all open purchase orders over \$20,000. (Priority 3)

Recommendation #8:

Coordinate with Finance and IT to facilitate departments entering encumbrance adjustments into the FMS. (Priority 3)

Recommendation #9:

Develop and implement policies and procedures regarding the issuance of multi-year open purchase orders and analyze commodities and services to determine:

- open purchase orders that can be set up on a multi-year basis, subject to annual City Council appropriation and
- the frequency with which commodities and services should be bid or quoted.

(Priority 3)

In addition, we recommend that the Human Resources Department:

Recommendation #10:

Develop a temporary employee policy for City Council approval in conjunction with the New Realities Task Force recommendation on Civil Service Reform. (Priority 2)

Further, we recommend that Purchasing and the Finance Department:

Recommendation #11:

Establish a procedure for liquidating encumbrances on multi-year renewals of open purchase orders. (Priority 3)

We also recommend that the General Services Purchasing Division, Public Works, and the City Attorney's Office:

Recommendation #12:

Work together to clarify the distinction between public works projects and general services. (Priority 3)

In addition, we recommend that the Purchasing Division:

Recommendation #13:

Document that the use of specific cooperative agreement(s) provide the City with the best value and consider competitively bidding several computer open purchase orders and/or using cooperative purchasing agreements. (Priority 3)

Recommendation #14:

When appropriate, combine multiple open purchase order dollar amounts to the same vendor for the same commodity or service to determine City Council approval or reporting requirements. (Priority 3)

Recommendation #15:

Develop and implement procedures to ensure buyers include on the face of open purchase orders for equipment lease contracts the lease start date; lease number and lease expiration date; and communicate to departments that they are responsible for monitoring lease contracts. (Priority 3)

Recommendation #16:

Develop and use buyer workload management information to monitor buyer open purchase order workloads. (Priority 3)

Recommendation #17:

When practical, issue one open purchase order for the same commodity or service with the same vendor. (Priority 3)

Recommendation #18:

Automate and periodically review and update vendor lists. (Priority 3)

We recommend that Purchasing and the Finance Department:

Recommendation #19:

Develop and implement invoice review and approval procedures to be included in the City Administrative Manual. The procedures should provide assurance that:

- goods or services were authorized under the open purchase order;
- goods or services were received;

- on open purchase orders over \$5,000, invoiced quantities, prices/rates and terms are in accordance with the terms of the open purchase order;
- invoices are mathematically correct;
- departments receive the pricing and rate documentation necessary to properly review invoices; and
- receiving documents are forwarded to accounting units to match to the invoices.

(Priority 2)

We also recommend that Purchasing:

Recommendation #20:

When appropriate, reduce the volume of invoices sent to the City by requiring vendors to submit summary invoices. (Priority 3)

In addition, we recommend that the Finance Department:

Recommendation #21:

Finalize revisions to the Finance Administrative Manual Accounts Payable Section. (Priority 3)

We recommend that Purchasing:

Recommendation #22:

Instruct those users of open purchase orders who review and approve vendor invoices to indicate "final payment" on the final invoice or receiving document. (Priority 3)

Also, we recommend that the Department of Information Technology:

Recommendation #23:

Evaluate upgrading the FMS purchasing module to improve the module's management reporting capability. (Priority 3)

Recommendation #24:

Upon implementation of Recommendation #26, program the FMS to generate a report that extracts open purchase order information by department and allow departments to have access to such reports. (Priority 3)

Recommendation #25:

Evaluate programming the FMS to generate a report which details purchase discounts information. (Priority 3)

In addition, we recommend Purchasing:

Recommendation #26:

Input department codes at the time it processes an open purchase order. (Priority 3)

Further, we recommend that Purchasing and the Department of Information Technology:

Recommendation #27:

Train City department personnel who enter, retrieve or process the FMS open purchase order information. (Priority 3)

Finally, we recommend that City departments:

Recommendation #28:

Input purchase discount information into the FMS subject to the Department of Information Technology successfully programming the FMS to generate purchase discount reports. (Priority 3)

INTRODUCTION

In accordance with the City Auditor's 1995-96 Audit Workplan, we audited the General Services Purchasing Division's (Purchasing) open purchase order process. We conducted this audit in accordance with generally accepted government auditing standards and limited our work to those areas specified in the Scope and Methodology section of this report.

The City Auditor's Office thanks Purchasing for their time, information, insight and cooperation during the audit. Specifically, we thank the Procurement Manager for her outstanding responsiveness to our requests for information.

BACKGROUND

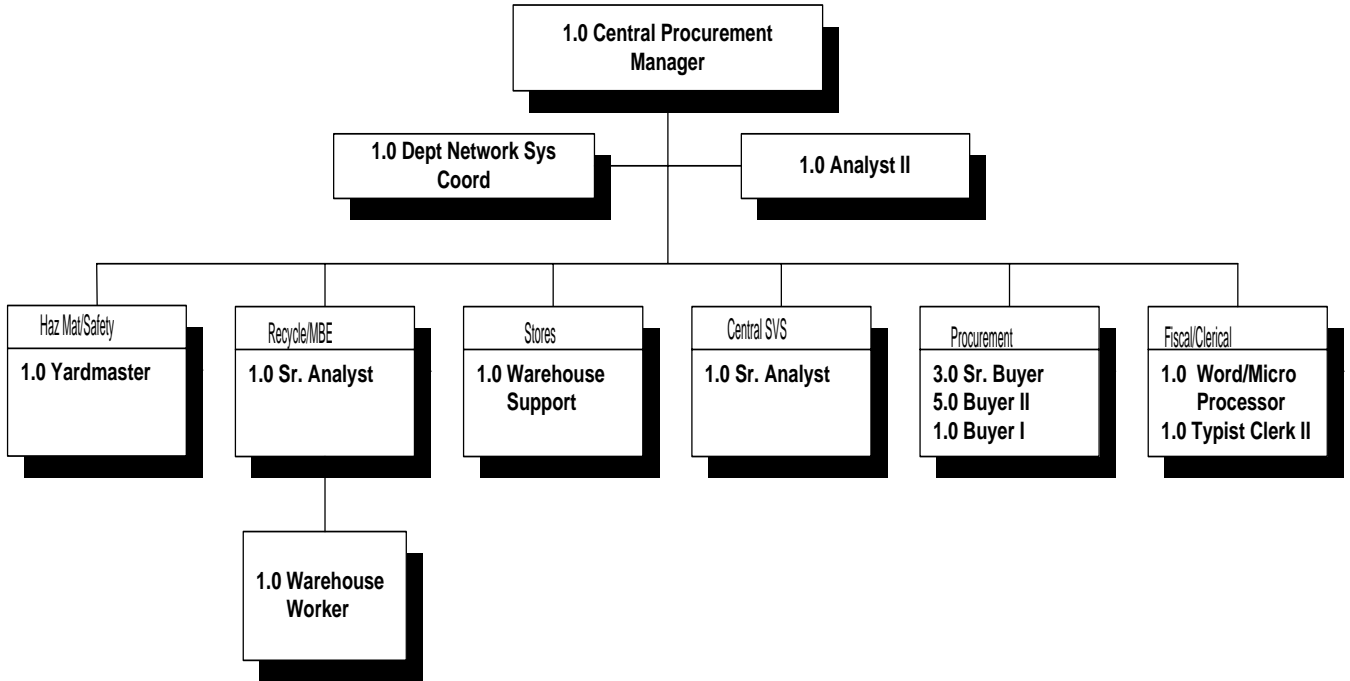
The San Jose Municipal Code Sections 4.12.010 and 4.13.030 assign functional responsibility for the procurement of all supplies, materials, equipment and general services to the Director of General Services. In turn, this responsibility has been delegated to the Procurement Manager who may delegate to other specific individuals the responsibility for the performance of some of the procurement duties.

The objective of the procurement function is to ensure that the City receives the needed quality and quantity of supplies, materials, equipment, and general services at the least expense. To achieve this objective, the Purchasing Division (Purchasing) applies various procurement techniques to purchase supplies, services, and equipment. Specifically, Purchasing develops a supply of vendors, solicits quotes, develops specifications, and obtains and evaluates formal and informal bids.

To administer the procurement function, Purchasing has the following resources:

CHART I

GENERAL SERVICES DEPARTMENT PURCHASING DIVISION ORGANIZATIONAL CHART



Major Accomplishments

In Appendix B, Purchasing management informs us of its major accomplishments. According to the Director of General Services, it has:

- Developed a credit card program for small dollar purchases. The program was tested on a pilot basis for six months and has proven to be successful. All City departments can now apply for a credit card.
- Established Citywide contracts for office supplies and computers. This has greatly reduced delivery times and the Information Technology Department's workload.
- Increased the quote limit to \$5,000 and obtained administrative approval authority toward purchases up to \$75,000. This accomplishment has significantly decreased the turnaround time on purchases.

- Developed and implemented a bid hot line for all purchases over \$20,000 and recently widened the scope to include all competitively bid contracts. This is the first time there has been a centralized database of City contract opportunities.
- Developed presentations on how to do business with the City, revised its vendor brochure and attended various minority business shows to discuss doing business with the City to improve outreach.
- Developed a Request for Proposal Manual for use Citywide.
- Developed a Specification Writing Handbook for use Citywide.

SCOPE AND METHODOLOGY

We reviewed the open purchase order issuance process the General Services Department Purchasing Division (Purchasing) administers. Our audit objectives were to determine whether controls and procedures are documented, adequate and actually in place to ensure:

- open purchase orders are issued in compliance with the City's Municipal Code (Code) and Charter;
- open purchase orders are properly authorized;
- the economy, efficiency, and effectiveness of the open purchase order vendor selection process; and
- the economy, efficiency, and effectiveness of the open purchase order payment process.

We reviewed all open purchase orders over \$75,000 issued during the 12 months ended December 1995. We also reviewed a sample of open purchase orders over \$5,000 issued during the six months ended December 1995. Our audit sample represents approximately 60 percent of the total dollar amount issued during that six-month period. Our review consisted of ensuring:

- Purchasing issued open purchase orders for the purposes specified in the Code;
- Purchasing reported open purchase orders to the City Council for approval in accordance with the Code;
- Purchasing solicited three or more quotes when practicable on purchases over \$5,000;
- departmental purchases made on open purchase orders did not exceed the maximum limit of \$20,000;

- Purchasing awarded the vendor with the lowest quote the open purchase order;
- if Purchasing did not select the lowest quote vendor, Purchasing adequately justified and documented its selection decision; and
- Purchasing adequately documented its open purchase order activities.

Our audit also included a series of surveys, interviews and reviews of other audits or studies of other cities. Specifically, we interviewed officials from Purchasing, Finance Department, City Attorney's Office and Information Technology. We also interviewed the City's computer and office supplies vendors. We surveyed officials and/or staff of the eight departments with open purchase orders totaling more than \$1 million as of February 1996. These departments were: General Services; Airport; Conventions, Arts and Entertainment; Streets and Traffic; Parks, Recreation and Neighborhood Services; Police; Fire; and the Water Pollution Control Plant Division of the Environmental Services Department. We also surveyed other jurisdictions including the cities of: Portland, Oregon; Seattle, Washington; Oakland, California; Phoenix, Arizona; Sacramento, California; San Diego, California; and the City and County of San Francisco. We also reviewed an audit of the City of San Diego's Purchasing function and a study of the City of Los Angeles' Procurement and Materials Management Process.

Our audit also included a limited review of the departmental invoice review and approval process and the invoice payment cycle. To determine the departmental controls for reviewing and approving invoices, we surveyed the eight departments with open purchase orders totaling more than \$1 million as of February 1996. We also selected and tested a judgmental sample of invoices from the eight departments. In our review, we:

- tested whether invoices were approved by appropriate departmental personnel;
- tested whether purchases were authorized under the terms of the open purchase order;
- tested that prices or rates being charged by the vendor were the quoted/bid prices under the terms of the open purchase order; and
- reviewed the timeliness of payments under open purchase orders.

We performed only limited testing to determine the accuracy and reliability of information in the various computer reports used. Such testing included system use, walk-through, and comparison of Purchasing's internal management reports. We met with Purchasing and Department of Information Technology officials to review information regarding the accuracy and reliability of the computer-generated information. Finding IV discusses our test results. We did not review the general and specific application controls for the computer systems used in compiling the various computer reports we reviewed.

FINDING I

THE CITY'S OPEN PURCHASE ORDER PROCESS CAN BE MORE IN COMPLIANCE WITH THE MUNICIPAL CODE AS WELL AS MORE EFFICIENT AND VALUE ADDED

The City of San Jose (City) Municipal Code (Code) authorizes the use of open purchase orders to acquire goods and services. Buyers in the City's General Services Purchasing Division (Purchasing) are responsible for issuing open purchase orders. In 1995-96, the City awarded approximately 2,000 open purchase order contracts worth approximately \$40.3 million. The City Auditor's Office selected and tested for compliance with the Code and Purchasing's policies and procedures, 221 open purchase orders worth approximately \$24.7 million that Purchasing awarded in 1995-96. The results of our open purchase order tests were that 38 percent of the vendors selected and 26 percent of the dollars awarded did not appear to be in compliance with the Code and/or Purchasing's own policies and procedures.

Specifically, we identified that,

- buyers did not always obtain or adequately document that they solicited three quotations when practicable;
- the City could have saved about \$200,000 if buyers had selected the lowest quote vendor;
- buyers did not perform any product or service usage analysis when vendor selection was based upon that criteria;
- Purchasing needs to document its compliance with the Code; and
- buyers issued some open purchase orders for purposes that did not fall under the Code definition for open purchase orders.

In our opinion, the above noncompliance with Code or policy requirements is a function of the short period of time buyers have each year to process open purchase orders. This constricted time frame also causes the open purchase order process to be labor intensive paper shuffling that is not as value added as it could be.

During our audit, we also surveyed several other cities that were comparable in size to San Jose. Our survey revealed that some of these cities issue multi-year open purchase orders. Should Purchasing use multi-year open purchase orders, we estimate that the time required for Purchasing to process an open purchase order would be reduced by 86 percent. As a result, compliance with Code and policy requirements should improve and buyers should be able to concentrate on those open purchase orders that have the highest value added potential.

San Jose Municipal Code Open Purchase Orders

Section 4.12 of the Code governs the use and procurement requirements for open purchase orders. The Code requirements are as follows:

Open purchase orders (Section 4.12.146)

- A. *Use. Open purchase orders may be used as a means of procuring supplies, materials, equipment, or services when the amount or nature of the specific items or services cannot be predicted before they are needed, or where it is necessary that the place from which the items are purchased is strategically located. More than one vendor may be issued an open purchase order for the same item.*
- B. *Amount of Open Purchase Order. Open purchase orders shall be established for the full estimated annual amount to be expended with the vendor by the city department for which the open purchase order is established. An open purchase order may remain valid for a period up to but not to exceed twelve calendar months from date of issue.*
- C. *Maximum Purchase Limit. No single purchase utilizing an open purchase order for supplies, materials or equipment shall exceed twenty thousand*

dollars or the state bid requirement for a public project, whichever is higher. The director of general services shall establish a line item purchase maximum wherever practical.

- D. Formal Bidding Not Required. Formal bidding is not required in order to establish an open purchase order for supplies, materials or equipment regardless of its total dollar amount. The open market purchasing procedure set forth in Section 4.12.135 shall apply to open purchase orders of supplies, materials or equipment. For purposes of Section 4.12.135, the total annual dollar amount of the open purchase order shall be considered as the amount of the purchase or award under that section. An open purchase order with a total amount not exceeding seventy five thousand dollars shall be executed by the city manager. An open purchase order with a total amount exceeding seventy five thousand dollars shall be approved by the city council. An addition to an open purchase order which brings the cumulative total amount of the open purchase order to over seventy five thousand dollars shall also require council approval.*
- E. Additional Factors in Awards. Since open purchase orders are established in order to obtain the most cost-effective purchasing arrangements for the city, the following factors may be considered in addition to the factors set forth in Sections 4.12.115, 4.12.117 and 4.12.135.B., in determining the most advantageous price quotations to the city:*
- 1. Vendor proximity to the using department;*
 - 2. Completeness of inventory;*
 - 3. Quality of past service;*
 - 4. Most favorable price discounts;*
 - 5. Vendor that has consistently offered the lowest price during the previous twelve-month period.*

Open market purchases authorized when (Section 4.12.130)

Purchases of supplies, materials and equipment which are not subject to the bidding requirements of the Charter or this code may be made in the open market, without formal bidding, subject to the procedure set out in Section 4.12.135.

Section 4.12.135--open market purchasing procedure requires the following:

- A. Open market purchases of supplies, materials and equipment which exceed five thousand dollars shall, whenever practicable, be based on at least*

three price quotations and shall be awarded on the basis of the price quotation most advantageous to the city. Price quotations may be solicited by direct mail requests to prospective vendors or by telephone. A record of open market purchases and price quotations shall be maintained by the director of general services.

- B. In addition to the factors set out in Sections 4.12.115 and 4.12.117, the most advantageous price quotations to the city for an open market purchase shall be based on consideration of:*
- 1. Quality and performance of the supplies, materials and equipment;*
 - 2. Ability of the vendor to perform the transaction;*
 - 3. Ability of the vendor to complete the transaction within the time specified;*
 - 4. Quality of the vendor's performance on prior purchase by the city or others;*
 - 5. Ability of the vendor to provide future maintenance, repair parts and service;*
 - 6. Capacity and experience of the vendor;*
 - 7. The amount of sales tax revenue to be received by the city as a result of the purchase, as applicable pursuant to city council policy;*
 - 8. Status of the vendor as a local business enterprise, as applicable pursuant to city council policy.*
- C. If an award in excess of five thousand dollars is made to a vendor other than the vendor submitting the lowest price quotation, written reasons for the award decision shall be prepared and will be kept as a part of the record of the transaction.*
- D. Purchases which do not exceed five thousand dollars may be made without price quotations, if such procedure is determined by the city manager to be in the best interest of the city.*

General Service Department--Purchasing Division

The open purchase order process is an annual process beginning in the Spring. Purchasing instructs City departments to assess their needs for the upcoming fiscal year and submit purchase requisitions electronically through the City's Financial Management System (FMS). The FMS automatically assigns the requisitions to buyers by the type of commodity or service. The buyers evaluate the requisitions and determine whether the product or service should be quoted, formally bid, or subjected to a Request For Proposal (RFP) process. Once the selection process is complete, Purchasing must obtain the necessary authorization to issue the open purchase order. The following authorization limits apply: (1) \$20,000 or less, Procurement Manager's or delegate's signature, (2) more than \$20,000 to \$75,000, City Manager's or delegate's signature, and (3) more than \$75,000, City Council approval. Once authorization is obtained, Purchasing enters the open purchase orders into the FMS. Finally, the Procurement Manager reviews and approves all the open purchase orders and issues them to the vendors and distributes copies to Purchasing, Finance, and the requesting department.

Test Of Open Purchase Orders

According to Purchasing's records, as of December 20, 1995, Purchasing issued 2,009 open purchase orders for 1995-96 totaling \$40.3 million.

Selection Criteria

We selected a sample of 221 of the 2,009 open purchase orders totaling \$24.7 million as of December 1995. We tested these 221 open purchase orders for compliance with the Code requirements for open purchase orders and Purchasing's

own policies and procedures. Our sample included all 101 open purchase orders over \$75,000 and a judgmental sample of 120 open purchase orders over \$5,000.

We reviewed our sample of 221 open purchase orders to determine whether Purchasing met the following compliance requirements:

- Purchasing solicited three or more quotes when practicable on purchases over \$5,000;
- Purchasing awarded the open purchase order to the vendor with the lowest quote;
- If Purchasing did not select the lowest quote vendor, Purchasing adequately justified or documented its selection decision;
- Purchasing's documentation was adequate;
- Purchasing issued open purchase orders for Code specified purposes;
- Purchasing reported open purchase orders to the City Council in accordance with Code requirements; and
- Departmental purchases off of open purchase orders did not exceed the maximum limit of \$20,000.

In addition, we reviewed Purchasing's selection decisions to determine if the selection process resulted in the best value for the City.

Test Results

Our audit results for the 221 open purchase orders we tested are summarized in Table I and Table II on the following pages. Table I shows the vendor selections that were in compliance with the Municipal Code and/or Purchasing's policies and procedures. Table II shows those vendor selections for which we noted compliance exceptions.

TABLE I

**NUMBER AND DOLLAR AMOUNT OF 1995-96 SAMPLED
VENDOR SELECTIONS THAT WERE IN COMPLIANCE
WITH THE MUNICIPAL CODE AND/OR
PURCHASING DIVISION'S POLICIES AND PROCEDURES**

Reason Selection In Compliance/Competitive Process Type	No Quote	One Quote	Two Quotes	Three Or More Quotes	Formal Bid/RFP/ RFQ	Total Numbers	Total Dollars
Formal Bid					29	29	\$ 4,912,438
Request for Proposal					15	15	4,506,798
Request for Qualification					1	1	75,000
Cooperative Agreements/State Discount Pricing	20					20	3,930,926
Vendor selection in compliance with policies and procedures: one or more quotations solicited		4	6	19		29	2,746,190
Vendor selection in compliance with policies and procedures: based on factors other than price	11	4	1			16	594,580
Sole source vendor selection	27					27	1,592,600
Totals	58	8	7	19	45	137	\$18,358,532

TABLE II
NUMBER AND DOLLAR AMOUNT OF 1995-96
SAMPLED VENDOR SELECTIONS THAT HAVE COMPLIANCE EXCEPTIONS
WITH THE MUNICIPAL CODE AND/OR
PURCHASING DIVISION'S POLICIES AND PROCEDURES

Exception Type/ Competitive Process Type	No Quote	One Quote	Two Quotes	Three Or More Quotes	Formal Bid	Total Numbers	Total Dollars
Buyer did not always obtain or adequately document that three quotes were solicited	28	17	7	7	2	61	\$2,411,139
Three or more quotes received, but vendor with the lowest quote not selected				13	1	14	3,112,663
Vendor selection based on product or service usage, however, usage analysis was not performed	1		1	3	3	8	670,100
Should have been handled as a Public Works project (see Finding II)				1		1	185,711
Total	29	17	8	24	6	84	\$6,379,613

*Vendor Selections That Have Compliance Exceptions
With The Municipal Code And/Or
Purchasing Division's Policies And Procedures*

As shown in Table II, 84 vendor selections representing 38 percent of the vendor selections we reviewed and 26 percent of the open purchase order dollar amounts we reviewed had either compliance exceptions or we could not verify compliance with the Code and/or Purchasing's policies and procedures.

Specifically, we noted the following:

- buyers did not always obtain or adequately document that they solicited three quotations when practicable;
- the City could have saved about \$200,000 if buyers had selected the lowest quote vendor;

- buyers did not perform any product or service usage analysis when vendor selection was based upon that criteria;
- Purchasing needs to document its compliance with the Code; and
- buyers issued some open purchase orders for purposes that did not fall under the Code definition for open purchase orders.

Buyers Do Not Always Obtain Or Adequately Document That They Solicited The Required Three Quotations When Practicable

For purchases in excess of \$5,000, the Code requires Purchasing to obtain at least three price quotations, whenever practicable. Our review, however, found that Purchasing's buyers did not always solicit three quotes before awarding open purchase orders in excess of \$5,000. Specifically, our review identified 52 open purchase orders in which Purchasing did not solicit at least three quotes and did not document a valid reason for not doing so, as Purchasing's policies and procedures prescribe.

The Procurement Manager estimates that buyers do not solicit the Code required number of quotes for open purchase orders about 50 percent of the time. This is because buyers do not have enough time and/or access to automated vendor lists. According to the Procurement Manager, the buyers process larger open purchase orders first and subject them to the three quotations or other competitive requirements. The Procurement Manager's statement is consistent with the results of our test sample which showed that buyers normally subject larger dollar open purchase orders to competitive bidding. However, due to time constraints, buyers do not appear to be competitively bidding smaller dollar amount open purchase orders as the Code requires.

We also noted that for certain products or services, buyers issued open purchase orders to some or all of the vendors that submitted a quote or bid. According to a buyer in Purchasing for services such as auto body work, Purchasing issues open purchase orders to several vendors. By so doing, departments can obtain quotes from several vendors for body work on a per job basis. While this approach seems reasonable, we noted that the open purchase order files for body work were on a vendor basis and only included the quote from the subject vendor and not the other vendors who were also awarded open purchase orders. In our opinion, if several vendors submit quotes and are issued open purchase orders, that information should be documented in each vendor's open purchase order file.

We recommend that the General Services Purchasing Division develop documentation standards for its buyers. These standards should address the following:

- number of bids or quotes solicited;
- the number of bids or quotes received;
- other factors considered in the award decision; and
- written justification for awarding business to other than the lowest bidder.

**The City Could Have Saved About \$200,000
If Buyers Had Selected The Lowest Quote Vendor**

As stated earlier, the Code allows Purchasing to consider other factors besides price when awarding open purchase orders. However, the Code requires that if Purchasing makes an award to a vendor other than the vendor with the lowest price quotation, the buyer must prepare in writing the reasons for the award decision and keep that document as part of the record. Our review, however, identified 14 open purchase orders for which the buyer did not select the lowest quote vendor or include a written reason for the award decision in the open purchase order file.

The following open purchase orders for petroleum, temporary employment services, landscape maintenance, and security services are examples of buyers awarding open purchase orders to vendors other than the lowest quote vendor without proper justification. We estimate the City could have saved about \$200,000 if the buyers had selected the lowest quote vendor.

Petroleum

In 1995-96, Purchasing issued six open purchase orders with five vendors for petroleum products such as gasoline. Because of the volatility of petroleum prices, Purchasing does not competitively bid this item before it issues vendors open purchase orders. Instead, Purchasing issues the open purchase orders to available petroleum vendors and solicits weekly quotes from them. In 1995-96, Purchasing awarded \$1.6 million in open purchase orders to one vendor and between \$100,000-\$200,000 in open purchase orders to the four other vendors.

Our review revealed that the City purchased most of its fuel from the vendor with the largest open purchase order regardless of which vendor had

the lowest weekly quote. For example, on April 5, 1996, Purchasing procured 7,968 gallons of gasoline at a cost of \$1.11 per gallon. However, one of the other vendor's weekly quote was \$0.949 per gallon. If Purchasing had selected the vendor with the lowest quote, the City could have saved nearly \$1,300 on gasoline purchased on that day.

According to the Procurement Manager, to avoid exceeding a vendor's open purchase order limit, the buyer does not always purchase from the vendor with the lowest quote. Therefore, if the lowest quote vendor has reached its open purchase order limit, the buyer does not purchase from that vendor until the City Council has approved an additional encumbrance to that vendor's open purchase order. Furthermore, near the end of the fiscal year, the buyer does not consider quoted prices and instead purchases from vendors with balances remaining on their open purchase orders. However, our review of the balances on the open purchase orders, as of June 1996, found that all open purchase orders had remaining balances. Moreover, other than an adjustment to increase an open purchase order awarded to the vendor with \$1.6 million in open purchase orders, the City Council approved only one encumbrance adjustment during the year for a petroleum open purchase order. In addition, it appears that the dollar amount difference between the vendor with the \$1.6 million in open purchase orders, and the other vendors with \$100,000 to \$200,000 in open purchase orders provides the vendor with the \$1.6 million in open purchase orders a tremendous advantage. Specifically, that dollar difference practically guarantees that the vendor with the \$1.6 million open purchase order will be the only vendor that does not exhaust its open purchase order award before the end of the fiscal year.

To address this problem, the Procurement Manager has requested the City Attorney to request City Council authorization to allow the General Service

Department to approve additional encumbrances on petroleum open purchase orders and report them to City Council after the fact. This would allow Purchasing to purchase from the lowest quote vendor regardless of the amount remaining on an open purchase order. The City Attorney has not yet responded to the Procurement Manager's request, but plans to do so before June 30, 1997.

The Procurement Manager also noted that occasionally, the buyer will not purchase from the lowest quote vendor if the amount to be purchased is less than a full truckload of petroleum. This is because some petroleum vendors will not deliver quantities less than a full truckload while the vendor with the largest open purchase order will. However, we found that the buyer did not always select the vendor with the lowest quote even when purchasing full truckloads of petroleum. Our review also revealed that the buyer sometimes selected the vendor with the \$1.6 million open purchase order for a certain fuel type even when the vendor had not submitted a quote for that fuel type.

Furthermore, we noted that Purchasing's petroleum vendor list is outdated and incomplete. For example, we found that Purchasing did not solicit quotes from the vendor that provides petroleum to Santa Clara County because the City's petroleum buyer was not aware of this vendor.

In our opinion, to ensure that the City pays the lowest possible cost for petroleum, Purchasing should do the following:

- document the reasons for the amount of each petroleum open purchase order issued; and
- work with the City Attorney's Office to facilitate increasing the amount of petroleum open purchase orders as necessary to ensure that the City can purchase petroleum from the lowest weekly quoted vendor.

We estimate that the City could have saved between \$59,500 and \$109,400 (annualized) if the buyer had selected the lowest quote vendor.

The range of savings results from the fact that the buyer indicated that the vendor that consistently quotes the lowest price will not sell less than a full truckload of petroleum. Therefore, when Purchasing buys less than a full truckload, the buyer must purchase from the lowest quote vendor that is willing to sell less than a full truckload. Our \$59,500 estimate represents the savings that would have resulted if the City had purchased all full truckload purchases from the lowest quote vendor.

Our \$109,400 estimated savings represents the cost savings the City would have realized if the City had purchased all fuel from the lowest quote vendor.

It should be noted that according to Purchasing's petroleum buyer, not all City tanks can hold a full truckload of fuel. This is why less than full truckload purchases are necessary. Further, the consistently low vendor does not always deliver on the date requested, such as, the next day. In our opinion, the buyer should document, when these factors came into play and resulted in the buyer not selecting the lowest quote vendor.

We recommend that the General Services Purchasing Division document the reasons for the amount of each petroleum open purchase order. We also recommend that General Services request the City Council to authorize the Director of General Services to adjust the amount of approved open purchase orders for petroleum purchases to ensure that the City purchases petroleum from the lowest weekly quoted vendor.

Temporary Employment Services

As of December 1995, Purchasing issued a total of \$1,162,328 in open purchase orders related to temporary employment services. Our review of a judgmental sample of open purchase orders revealed:

- for some open purchase orders, if there was a competitive selection process, the buyer did not document it;
- buyers did not always select the vendor with the lowest quote and/or document the reason for selecting a vendor other than the vendor with the lowest quote;
- departments increased the agreed upon rate for temporary agency employees;
- some departments are using temporary employees on a long term basis; and
- City departments were employing retired City employees through temporary employment agencies.

Our review of temporary agency open purchase orders revealed that for some open purchase orders, if there was a competitive selection process, the buyer did not document the process. For example, on open purchase orders for temporary employment services that were continued from previous years, we could not always find documentation that the buyer used a competitive selection process to select the agency in either the current or previous years.

Our review also revealed that the buyers did not always select the vendor with the lowest quote and/or document the reason for selecting a vendor other than the vendor with the lowest quote. We noted two instances where the lowest quote

vendor was not selected. We estimate that by selecting the lowest quote vendor, the City would have saved \$4,146.

We also noted that departments occasionally raise the agreed upon hourly rate for temporary agency employees. To grant a raise, departments send a memo to Purchasing to direct the temporary agency to increase the employee pay rate, which subsequently increases the City's hourly bill rate. In one case, a temporary agency clerical support employee received two raises totaling \$5 per hour representing a 50 percent increase over a six month period. We also noted several other situations where the City hired a temporary agency employee and subsequently increased the agreed upon rate. In two of these instances, the increases occurred less than six months after the temporary employee was hired. Human Resources is not involved in the setting, increasing, or timing of the increases of temporary agency salaries.

We reviewed several open purchase orders that showed departments are using temporary employees on a long term basis. In our opinion, continuously using the same temporary agency employee for several years raises the question of whether departments are using temporary employees to fill frozen full time City positions.

The City does not have a policy on temporary agency employment services. However, full time equivalent employees (FTEs) require City Council approval. Although the Budget Office approves funding for temporary agency employees, it does not concurrently authorize corresponding FTEs. In our opinion, this practice appears to circumvent the City's Civil Service policies and budget process, unless the use of a temporary employee for more than one year is specifically approved in the budget.

The Procurement Manager also raised the issue of "payrolling". Payrolling occurs when a department finds the person they want to hire, sends that person to a temporary employment agency, and the temporary employment agency gives the City a discount because they did not have to recruit an employee for the position. According to the Procurement Manager, payrolling does occur in the City, and the issue has recently received some attention because it was discovered that the City was payrolling retired employees. City policy prohibits retired employees from collecting both a retirement check and a City paycheck. The City Attorney's Office has since directed General Services to stop the practice of payrolling because it appears to circumvent the City's Civil Service and Retirement policies. While we could not document that payrolling occurred in the open purchase order files we tested, payrolling would explain some of the inconsistencies we found in the vendor selection process for temporary employment services.

According to the Director of Human Resources, some of the problems relating to the use of temporary employment agencies stem from problems and the inflexibility inherent within the Civil Service System. She also noted that the New Realities Task Force recommended: "*Reform the Civil Service System to increase flexibility in hiring, to streamline the recruiting and hiring process . . .*"

Furthermore, the report states that

For temporary positions, the Human Resources department reports that temporary City programs are often delayed in getting started due to delays in the hiring process resulting from time consuming Civil Service hiring requirements. If employees being hired temporarily, such as for a summer program, could be exempted from these requirements, they could be added to the payroll more quickly and the Human Resources department could provide more timely and responsive service to City departments.

Streamlining the hiring and recruiting processes are recommended to enable the Human Resources department to fill vacant positions more quickly and in a manner that better meets requesting department needs. The Task Force

believes that a more flexible and decentralized process would be of benefit to the City.

Our review revealed that Purchasing does not initiate an open purchase order competitive selection process until a department requests a temporary agency employee. Currently, General Services is addressing temporary employment agency procurement problems and is considering the possibility of issuing Citywide open purchase orders with temporary employment agencies. Also under consideration is making the Human Resources Department responsible for the selection of temporary employees and the determination of comparable City salaries for position classifications. In our opinion, Purchasing should annually use the competitive selection process to award Citywide open purchase orders to a temporary employment agency for frequently used position types. In addition, the Human Resources Department should develop a temporary employment agency policy for City Council approval in conjunction with the New Realities Task Force recommendation on Civil Service Reform.

We recommend that the General Services Purchasing Division annually perform a competitive selection of temporary service agencies for frequently used position classifications. In addition, we recommend that the Human Resources Department develop a temporary employee policy for City Council approval in conjunction with the New Realities Task Force recommendation on Civil Service Reform.

Landscape Maintenance Services

Purchasing issued an open purchase order for landscape maintenance services for the second phase of a multi-phase maintenance district development. In this case, the buyer did not select the vendor with the lowest quote or document in the file the

reason why. According to the buyer, she selected the second lowest quote vendor because that vendor did landscape maintenance services for the developer of the first phase. After soliciting vendor quotes, the buyer decided to use the same vendor for other development phases of the district. The buyer intends to select a landscape vendor on a competitive basis once the development is completed.

We estimate that the City would have saved \$34,813 had Purchasing awarded the open purchase order for landscape maintenance to the lowest quote vendor.

Security Services

Our review of security services revealed that Purchasing did not always select the lowest quote vendor. We also noted the request for quotation was vague and did not provide enough detail to bidders, thus giving an advantage to vendors that had previously done business with the City. For example, in 1994-95, Purchasing issued 11 open purchase orders totaling \$485,957 to four vendors for security services. The Request for Quotation provided for two options to renew the open purchase order for one additional year. As a result, in 1995-96, Purchasing issued 12 open purchase orders totaling \$491,353 to the same four vendors. In May 1994, the buyer handling security services solicited quotes from 11 security services vendors and received six responses. The Request for Quotation indicated that the request was for security services at various locations as per schedule provided and also as needed on a short-term emergency basis. However, Purchasing only provided the vendors with a schedule of needed security services for one of several City locations that were the subject of the open purchase orders. As such, this Request for Quotation was vague, did not provide adequate information to bidders, and gave a distinct advantage to the vendors that provided the City with security services in prior years.

We also noted the Request for Quotation requested hourly rates for "Regular" and "Special" security services. However, Purchasing did not define the terms "Regular" or "Special" hours. Furthermore, Purchasing indicated in its Request for Quotation that the open purchase order was for security services at "various locations" which it did not identify.

Chart II illustrates the range of quotes received from specific vendors. The vendors are listed in order from lowest to highest regular rates.

CHART II
RANGE OF SECURITY SERVICES QUOTES RECEIVED
FROM SPECIFIC VENDORS IN MAY 1994

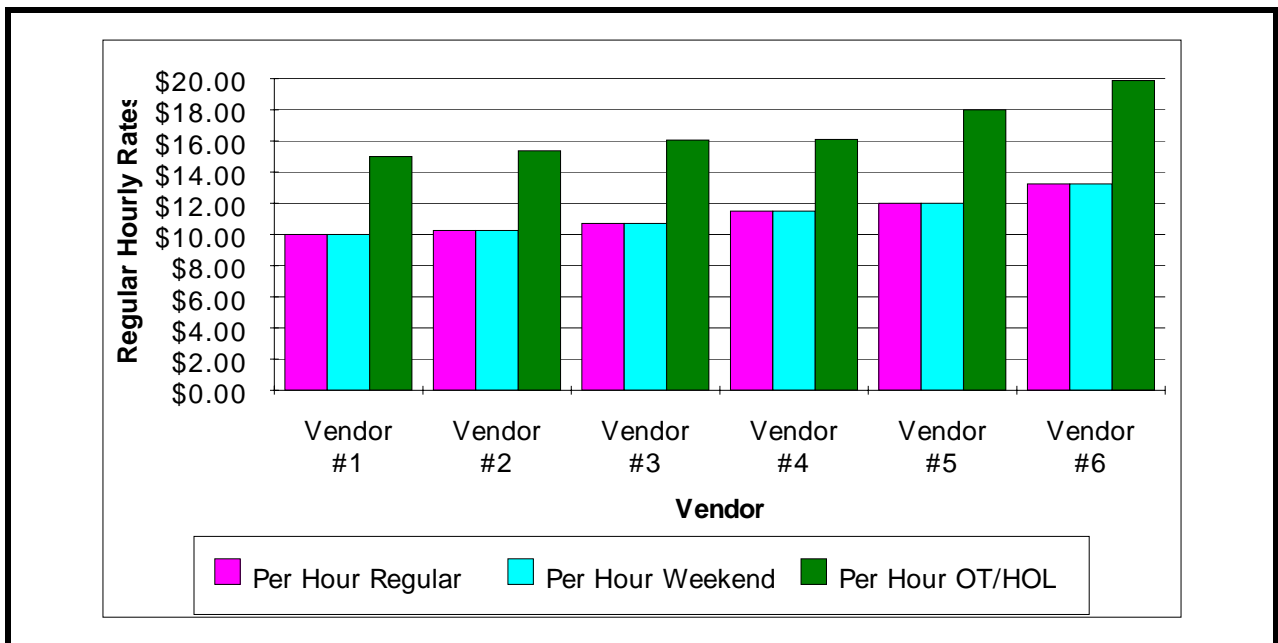


Table III summarizes the vendors to whom Purchasing awarded security services open purchase orders in 1994-95 and 1995-96:

TABLE III

**SUMMARY OF THE VENDORS TO WHOM PURCHASING
AWARDED SECURITY SERVICES OPEN PURCHASE ORDERS
IN 1994-95 AND 1995-96**

Fiscal Year	Dollar Amount And Number Of Purchase Orders Awarded					
	Vendor #1	Vendor #2	Vendor #3	Vendor #4	Vendor #5	Vendor #6
1994-95	\$0	\$180,057 (5)	\$0	\$170,900 (3)	\$10,000 (1)	\$15,000 (1)
1995-96	\$0	\$187,353 (6)	\$0	\$169,000 (3)	\$10,000 (1)	\$15,000 (1)

As noted above, Purchasing did not award any open purchase orders for security services to the lowest quote (Vendor #1) or the third lowest quote (Vendor #3) vendors. Further, the buyer did not document why she did not select the lowest quote vendor. In response to our inquiry, the buyer said that based on her experience, some vendors are better equipped to provide security services to the City than others. The buyer evaluated "better equipped" based upon her knowledge of the vendor's staffing levels, hidden costs, and past service. However, the buyer did not document how she knew these things about the vendor when the vendor was never asked to provide such information. The buyer also stated that the lowest quote vendor had too many "hidden costs." However, the buyer did not document what hidden costs were or how she evaluated them. Ironically, our review of security services invoices revealed that the vendors selected charged the City for items that were not in accordance with the terms of the open purchase order. These vendor charges may be what the buyer referred to as hidden costs. See Finding III for further discussion of these service charges.

In October 1994, Purchasing solicited quotes from security service vendors again. However, this time Purchasing specified that this award would be for an annual contract. The job description the requesting department provided to

Purchasing indicated the need for at least one on-site security guard 24 hours per day, seven days per week for one year. Only Vendors #1 and #6 from the May 1994 solicitation (see Chart II) responded to Purchasing's request for quotes. Vendor #6 had the previous year contract for the subject security service. Vendors # 1 and #6 responded as follows:

TABLE IV
VENDOR #1 AND VENDOR #6'S
OCTOBER 1994 SECURITY SERVICES QUOTES

	Vendor #1	Vendor #6
Per Hour Regular	\$10.95	\$12.20
Per Hour Weekend	\$10.95	\$12.20
Per Hour Overtime and Holidays	\$16.43	\$12.20

The buyer made the following analysis:

TABLE V
BUYER CALCULATION OF ANNUAL COST
FOR VENDOR #1 AND VENDOR #6'S
OCTOBER 1994 SECURITY SERVICES QUOTES

Annual Charge	Vendor #1	Vendor #6
354 days regular/weekend	\$93,031	\$103,651
11 days holiday	4,338	3,221
Total	\$97,369	\$106,872

The buyer selected Vendor #6, in spite of the fact that Vendor #6 had the higher quote. In addition, the buyer did not document why she selected Vendor #6. According to the buyer, she did not select Vendor #1 because they could not provide their own equipment, a requirement the Request for Quotation did not

mention. Further, we saw a letter from Vendor #1 dated after the date of the Request for Quotation which stated that it could provide its own equipment.

A standard statement on the Request for Quotation form is "*City may accept the quote which is the most advantageous to the City, which may not necessarily be the lowest quote. The City has the right to accept all or part of this quote.*" Buyers customize the request form depending on the product or service. On the Request for Quotation for the security services, the buyer added the following notice: "*The City of San Jose shall evaluate the quotes and award shall be based on the most advantageous proposal to the City.*" (Emphasis added). The buyer should not have included this statement on the Request for Quotation because a proposal was not requested. According to the buyer, she selected the security service vendor based on factors other than price that were not part of the Request for Quotation. Accordingly, Purchasing needs to provide its buyers with guidelines that define the selection criteria for security services.

We reviewed the 12 open purchase orders issued for security services. We compared the rates between the vendor with the lowest quote and the selected vendor and found that the differences ranged from \$0.50 to \$3.25 per hour for regular rates. We estimate that the City would have saved \$41,383 in 1995-96, and \$36,598 in 1994-95, for a total of \$77,981 if the buyer had selected the lowest quote vendor. As noted above, the buyer selected the security service vendors based on factors other than price. However, the criteria for selection was not well defined and the reasons the buyer did not select the vendor with the lowest quote were not documented. Furthermore, the buyer was unable to satisfactorily explain why the lowest quote vendor was not selected.

**Buyers Did Not Perform Any Product Or Usage Analysis
When Vendor Selection Was Based Upon That Criteria**

We reviewed eight open purchases orders where vendor selection was based on product or service usage, but the buyer did not perform any usage analysis. As a result, the vendors the buyers selected did not provide the City with the best value. For example, the quote for printing services required vendors to indicate several different prices for different quantities of printing. The buyer summed the prices for all the quantities quoted and selected the vendor with the lowest total. However, our review found that while the buyer selected the vendor with the lowest overall total, another vendor had the lowest prices for some larger quantities as shown in Table VI.

**TABLE VI
SUMMARY OF PRINTING SERVICE QUOTES
FROM TWO VENDORS**

Printing Service Description	Quoted Prices From:		Differences
	Vendor Awarded Open Purchase Order	Vendor Not Awarded Open Purchase Order	
8.5 x 11 Standard Color Sequence, Printed 1 Side, 1 Color (Black)			
2-Part 5,000 Sets	\$ 516.20	\$451.00	\$ 65.20
3-Part 5,010 Sets	809.75	627.00	182.75
4-Part			
500 Sets	150.68	136.00	14.68
1,000 Sets	292.68	280.00	12.68
5,000 Sets	1,298.12	739.90	558.22
8.5" x 5.5", Standard Color Sequence, Printed 1 Side, 1 Color (Black)			
4-Part 5,000 Sets	\$649.06	\$511.80	\$137.26

Our analysis of a sample of invoices indicates that the City could have saved approximately \$19,000 on one of the printing service open purchase orders. Specifically, Purchasing could have realized these savings if it had issued two separate open purchase orders for printing services--one for certain large quantity printing orders and the other for small quantity printing orders.

Similarly, we noted that some vendor selections for sidewalk repair services were not based on total price, but rather various different hourly rates for different types of repairs. Often, the lowest rates or prices vary with no one vendor offering the lowest rates in all requested categories. According to the buyer, in that situation, Purchasing tries to obtain the department's vendor preference in writing. However, because of time constraints, buyers either do not obtain or file the department's input. In our opinion, buyers should obtain and file any department input that they use to determine which service rates or product prices should most influence their vendor selection.

Our review of an open purchase order for the testing of water samples, revealed that the buyer did not obtain any vendor quotes. According to available documentation, the reason the buyer did not solicit any quotes for this open purchase order was because there were too many miscellaneous tests to quote. In our opinion, "too many" is not definitive enough to justify awarding a \$50,000 open purchase order without the benefit of vendor quotes.

If a buyer selects a vendor because the vendor quoted the lowest price for the items used most, then departments should provide Purchasing with usage information. Accordingly, Purchasing should provide its buyers with detailed procedures for selecting vendors based upon department provided product or service usage information.

We recommend that the General Services Purchasing Division develop guidelines requiring buyers to document vendor selection criteria when:

- price and/or location are not the primary factors for vendor selection; or
- bidding multiple rates for services or supplies on a single open purchase order.

**Buyers Issued Some Open Purchase Orders
For Purposes That Did Not Fall Under The Municipal Code
Definition For Open Purchase Orders**

Section 4.12.146 of the Code defines when open orders may be used. The Code states:

Open purchase orders may be used as a means of procuring supplies, materials, equipment, or services when the amount or nature of the specific items or services cannot be predicted before they are needed, or where it is necessary that the place from which the items are purchased is strategically located. More than one vendor may be issued an open purchase order for the same item.

Our review revealed that buyers issued some open purchase orders for purposes that did not fall under the Code definition. According to the Procurement Manager, leases (annual or multi-year) and purchase orders which require monthly payments are processed as open purchase orders. Because of FMS limitations, Purchasing cannot process these purchase orders as standard purchase orders because FMS requires proof of receipt for each payment.

We met with the City Attorney and the Procurement Manager to explore solutions to this problem. The Procurement Manager proposed setting up a new designation in FMS for those purchases which do not fall under the Code definition of an open purchase order but which need monthly payments such as leases and

annual service agreements. In our opinion, General Services needs to pursue changing the FMS classification for those transactions which do not currently fall under the Code definitions of an open purchase order.

We recommend that the General Services Purchasing Division pursue changing the FMS designation for those transactions which do not fall under the Municipal Code open purchase order definition.

Purchasing Needs To Document Its Compliance With The Municipal Code

Our review found that Purchasing needs to improve its documentation to demonstrate that it is complying with the Code. Many of the compliance exceptions noted in Table II are the result of inadequate documentation. Specifically, Purchasing needs to improve documentation of the following:

- number of vendors solicited;
- reasons for selection;
- reasons for multiple selections; and
- reasons for awarding to other than the lowest bid or quote.

The Council of State Governments report entitled State and Local Government Purchasing highlights the need for documentation in the procurement function. Specifically the report states:

The importance of adequate documentation of the reasons for determining the successful bidder can scarcely be overstated. The evaluation process, by nature, is inclined to unexplained assumptions by purchasers and misunderstandings on the part of bidders and the public. Protests on matters, ranging from determinations of responsiveness and responsibility to methods of testing products to the application of evaluation factors, should be anticipated. Reasonable documentation, if only a brief notation, concerning any action likely to need an explanation is the best defense.

After award, the bid file should contain a record sufficient for a reader . . . to follow the course of the transaction especially as to the method of evaluation and basis of award. The latter can range from a simple indication that award was made to the low price bidder to a listing of the completed life cycle cost calculations made of all the bids received. In preparing documentation, the purchasing officer should be aware of yet another of the laws of contrariety: if something can be misinterpreted, it likely will be.

It appears that the large workload precludes the buyers from adequately documenting reasons or methods for vendor selection. However, we noted that open purchase order awards between \$20,000 and \$75,000 were documented better than open purchase order awards under \$20,000 or over \$75,000. The reason buyers appear to better document open purchase order awards between \$20,000 and \$75,000 is because Purchasing's procedures require buyers to use a specific form (Approval of Awards under \$75,000 Form) to document why they selected vendors for open purchase awards between \$20,000 and \$75,000. In our opinion, Purchasing can improve its vendor selection documentation for open purchase orders by requiring its buyers to use an approval of awards form for all open purchase order awards over \$20,000.

During our review, we noted several open purchase orders with only one or two vendor quotes attached. According to the buyers who awarded these open purchase orders, they solicited three quotes for many of these open purchase orders but only one or two vendors responded. In our opinion, if buyers are taking the time to solicit three quotes, then they should document that fact for future reference.

We recommend that the General Services Purchasing Division require buyers to use an approval of awards form for all open purchase orders over \$20,000.

Survey Of Other Cities' Open Purchase Order Process

The table in Appendix C shows that five of the seven cities we surveyed process their open purchase orders on a multi-year basis, or staggered throughout the year, or both. Specifically, Portland, Oregon; Seattle, Washington; and Phoenix, Arizona negotiate multi-year contracts with vendors and issue open purchase orders that equal the term of the contract. For example, for a three-year contract, a three-year open purchase order is issued. Conversely, when Purchasing negotiates multi-year contracts with vendors, it issues an open purchase order for one year and re-issues the open purchase order for each subsequent year of the contract. The reasons for this inefficient processing are twofold: (1) the Code appears to restrict the open purchase order term to 12 months and (2) the FMS encumbrance process.

Portland and Seattle do not need to re-issue an open purchase order each year because they do not input or encumber a dollar amount when they issue an open purchase order. Conversely, FMS encumbers the full dollar amount of the entire open purchase order at the time of issuance. Each purchase made against the open purchase order decreases the encumbrance amount accordingly. Consequently, Purchasing must issue a multi-year open purchase order for the amount estimated to be spent in the first year and re-issue the open purchase order each July 1, thereafter.

Benefits Of Multi-Year Open Purchase Orders

We found that the competitive selection process can be improved with the increased use and the efficient processing of multi-year open purchase orders. We found that many of the problems we noted in this Finding stem from the buyers' workloads. Specifically, buyers process approximately 2,000 open purchase orders in a two month time period every year.

According to management and staff, for many years, they have been aware of the problems associated with processing most of the open purchase orders within the last two months of each fiscal year. However, the annual budget process coupled with the FMS restrictions are the primary obstacles to smoothing out or staggering the issuance of the open purchase orders to even out the workload. According to one of the buyers, when the City Council added staff to Purchasing several years ago in response to a City Auditor report, buyers had more time to figure out the most efficient way to process purchases. Another factor, which contributes to the heavy workload during the last two months of the fiscal year, is the fact that departments are fearful of exceeding their budgets. As a result, departments delay spending their budgeted funds until the end of the fiscal year.

The Open Purchase Order Process Is Labor Intensive Paper Shuffling That Is Not As Value Added As It Could Be

We found that the open purchase order issuance process is labor intensive paper shuffling that is not as value added as it could be. Purchasing is not efficiently or effectively processing open purchase orders in compliance with the Code and its own policies and procedures.

We identified two ways to cut time from the open purchase order process to allow buyers more time to concentrate on adding value to the competitive selection

process. In reviewing the open purchase order process, we found that the process can be broken down into two main areas: (1) the competitive selection process and (2) the issuance process. As a result, we can save time by (1) negotiating more multi-year contracts and (2) allowing for multi-year open purchase orders. We estimate that an efficient multi-year open purchase order process would reduce open purchase order re-issuance time by 86 percent. This should result in buyers improving their compliance with the Code or policy requirements. In addition, buyers will be able to concentrate on those open purchase orders with the highest value added potential.

Negotiate More Multi-Year Contracts

Purchasing currently negotiates some of its service and product contracts for multiple years subject to annual appropriation. These contracts are usually in the form of a one-year contract with extension options. Unlike the City, our surveys of other jurisdictions found that multi-year contracts are the rule rather than the exception. For example, the City of Seattle sets up their open purchase order contracts for two to five years. In our opinion, negotiating multi-year contracts would reduce the amount of time buyers have to spend on competitive vendor selections each year and increase the time buyers can spend on complex vendor selections that have the most value added potential.

According to the Procurement Manager, service purchases lend themselves more to multi-year contracts than product or commodity purchases. This is because annual increases for service contracts can be tied to the Consumer Price Index. While product multi-year contracts can be tied to a price discount, we found that other jurisdictions sometimes negotiate any subsequent year price increases annually.

If Purchasing were to set up more of its service and product open purchase orders on a multi-year basis, we estimate that buyers could realize significant time savings. This is because the longest part of the open purchase order process is the selection process. This is true for a formal bid, quote, RFP, or request for qualification. Furthermore, the more complex the purchase the greater the time savings buyers would realize under a multi-year open purchase order process.

Reduce The Number Of Open Purchase Orders Issued - Processing Time Reduced 86 Percent

We reviewed the open purchase order process and found that buyers spend a lot of time creating a new open purchase order in the system and processing the paper work. Our review revealed that in spite of an automated Purchasing system, the issuance of an open purchase order is a labor intensive paper shuffling process. Further, much of this time consuming process is the result of FMS inefficiencies (see Finding IV for the description of FMS inefficiencies). Given these FMS inefficiencies, the only way Purchasing can save a great deal of time is by not issuing as many open purchase orders. Purchasing can reduce the number of purchase orders it issues by processing multi-year open purchase orders more efficiently.

According to the Procurement Manager, after the first year, Purchasing could avoid spending time on multi-year contracts by using multi-year open purchase orders. In addition, if departments merely added an additional encumbrance to an existing open purchase order instead of requesting a new open purchase order, FMS dictated inefficiencies could be avoided. Further, according to the FMS administrator, adding an additional encumbrance to an existing open

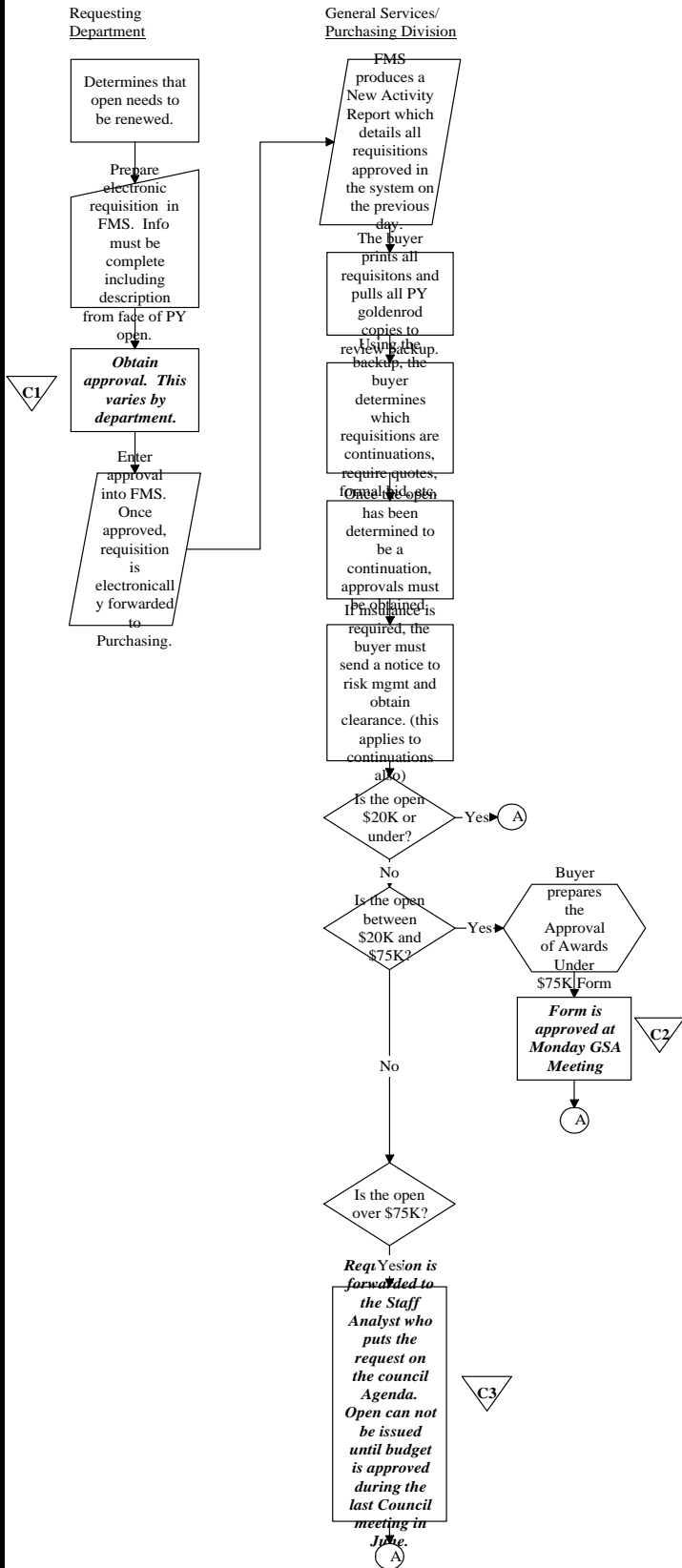
purchase order would not be a problem because FMS allows open purchase orders to be used indefinitely.

In order to streamline the FMS open purchase order process, Purchasing should give departments the authority to enter encumbrance adjustments into the FMS for electronic forwarding to Purchasing for approval. This process would be significantly more efficient than the current encumbrance adjustment process. Specifically, when a department needs an encumbrance adjustment, the department has to type a three part encumbrance adjustment form, and forward it to Purchasing for review, approval, and entry into the FMS. By allowing departments to enter encumbrance adjustments into the FMS for Purchasing's review and approval, the current duplication of entry into FMS effort would be eliminated with no reduction in control. According to the Procurement Manager, relieving Purchasing of the burden of retyping encumbrance adjustments would significantly reduce Purchasing's year end encumbrance adjustment workload.

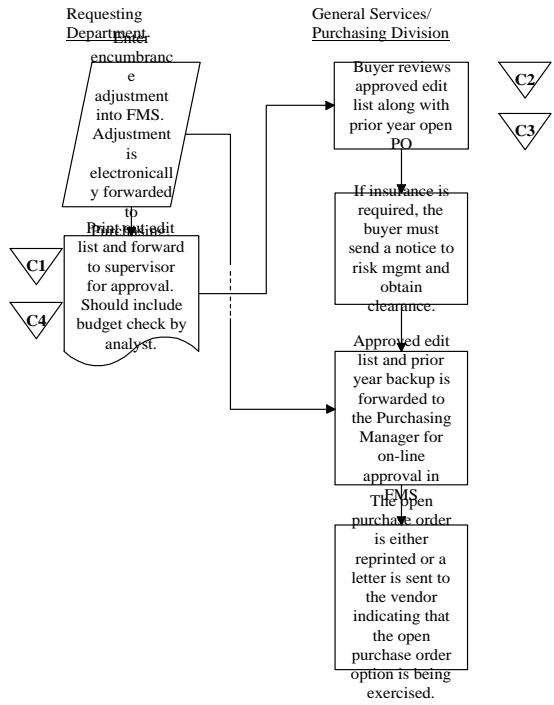
We recommend that the General Services Purchasing Division coordinate with Finance and IT to facilitate departments entering encumbrance adjustments into the FMS.

Chart III describes, in detail, the steps required after the first year of a multi-year open purchase order under the current method of re-issuing an open purchase order and our recommended procedural change.

CURRENT RENEWAL PROCESS



POTENTIAL PROCESS



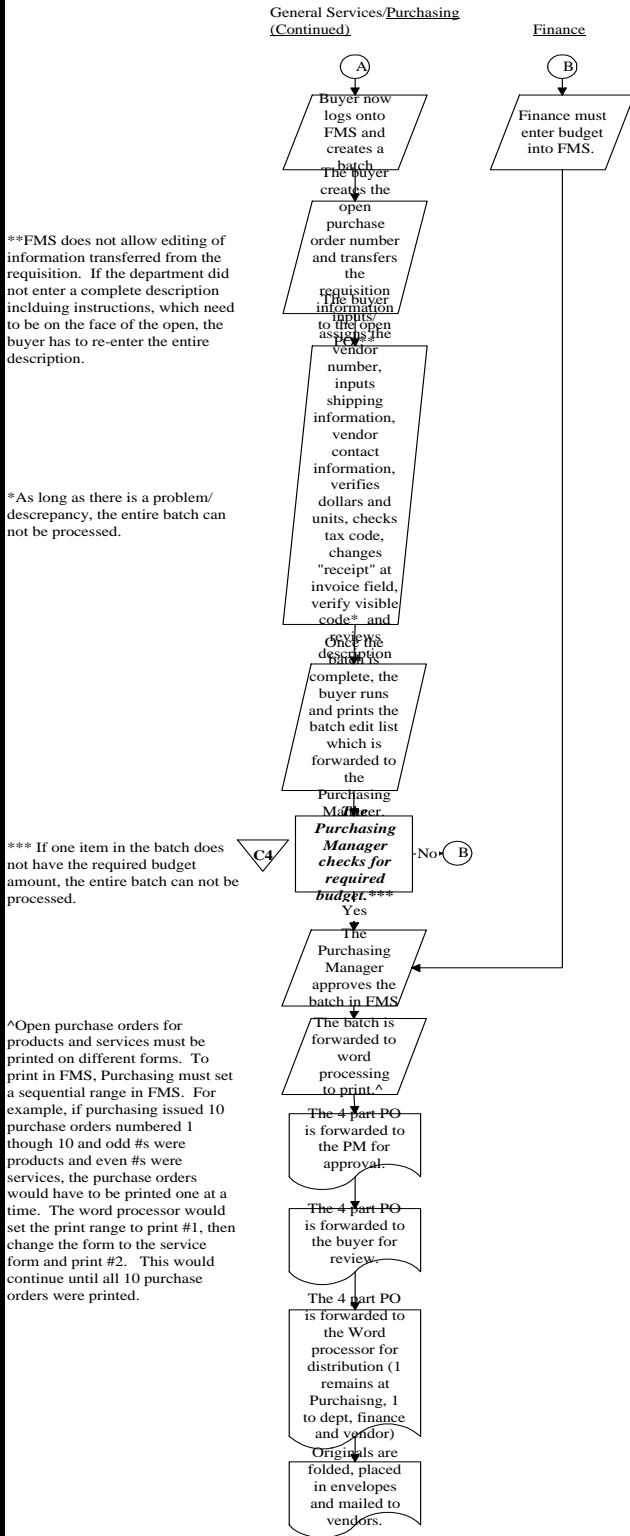
*This review should consist of verifying that the proper approvals were obtained in the issuance year. Instead of obtaining approvals every year, multi-year open purchase orders will be approved in the issuing year. **The same approval limits will be applied to the estimated annual amount to be spent each year.** For example, if the estimated annual amount to be spent exceeds \$75,000, the open purchase order will require council approval (subject to appropriation in future years) based on the estimated amounts. If the estimated amount increases over the approved amounts, the excess will have to be approved by council. If the estimated annual amount to be spent is between \$20,000 and \$75,000, the annual amount to be spent will have to be approved by the City Manager, who has delegated approval to the Director of General Services.

Flowchart I (continued)

PROCESS TO RENEW AN OPEN PURCHASE ORDER (continued):

CURRENT RENEWAL PROCESS (continued)

POTENTIAL PROCESS (continued)



The process to initially issue an open purchase order cannot be changed. However, as shown in Chart III, under our recommended process, the time buyers spend on multi-year open purchase orders is significantly reduced after the first year. We estimate that by using a multi-year processing approach and automating the additional encumbrance process, the City can reduce the time it takes to renew an open purchase order by 86 percent. According to the Procurement Manager, a recent Purchasing focus group study showed that it takes about 36 minutes to process an open purchase order from requisition to issuance. By way of contrast, our recommended process as shown in Chart III would only take 5 minutes.

The Procurement Manager pointed out that departments would have to monitor open purchase orders for additional encumbrances or new requisitions. However, according to Purchasing's Principal Account Clerk, other department Account Clerks know their open purchase orders well enough that this should not be a problem.

Another benefit of multi-year open purchase orders is that it eliminates the re-issuance time spent on issuing open purchase orders which do not require a competitive process. During our review, we noted that 1,074 open purchase orders are \$5,000 or less and therefore need not be competitively bid. However, Purchasing still re-issues these 1,074 open purchase orders every year. Purchasing could eliminate the re-issuance time it spends on open purchase orders under \$5,000 by issuing them as multi-year open purchase orders. Further, because Purchasing does not competitively bid open purchase orders under \$5,000 anyway, Purchasing could establish multi-year contracts for an indefinite number of years for these 1,074 open purchase orders.

In our opinion, once the competitive selection process is performed in the first year, the time Purchasing spends re-issuing open purchase orders adds little value to the Procurement process. Buyers can spend their time more productively by concentrating on value added activities such as improving the competitive process or obtaining better quality services or products.

Improved Compliance

As noted in the subsection *Test Results*, our review revealed that 38 percent of the vendor selections comprising 26 percent of the open purchase order dollar amounts reviewed had compliance exceptions with the Code and Purchasing's policies and procedures. In our opinion, using multi-year open purchase orders should increase the number of open purchase orders Purchasing issues in compliance with the Code or its own policies and procedures.

Buyer Time Concentrated On Those Open Purchase Orders With Highest Value Added Potential

Only 5 percent of the open purchase orders Purchasing issues account for 54 percent of open purchase order dollars. Some of these larger open purchase orders may also be set up as multi-year open purchase orders depending on the service or commodity.

The City of Los Angeles performed a Procurement Reengineering Study that recommended that the City of Los Angeles

... adopt a longer-term continuous improvement approach with its new contract vendors. Generally, a minimum of three years should be allowed depending upon the commodities being purchased. However, if the relationship is not working, both parties should have the ability to cancel with agreed upon notice.

Longer term contracts require more innovative and responsive mechanisms to reflect market price changes, including price decreases. By focusing longer-term, the City would be able to work with suppliers to improve service, quality, and prices.

This recommendation does not ignore the need for the City to obtain the best prices possible. Market research should be routinely performed to ensure that contract prices stay competitive. However, it is important to factor in all costs when making this analysis. Poor service, poor quality, and multiple vendor management all have costs associated with them. . . . The City would be better off working more closely with a smaller number of performance oriented suppliers to improve service and reduce costs.

Accordingly, to further increase the effectiveness of multi-year open purchase order processing and increase competition, Purchasing should analyze its commodities and services to determine which open purchase orders can best be accommodated on a multi-year basis, subject to annual City Council appropriation. Purchasing should also determine the frequency with which commodities and services should be bid or quoted.

We recommend that the General Services Purchasing Division develop and implement policies and procedures regarding the issuance of multi-year open purchase orders and analyze commodities and services to determine:

- open purchase orders that can be set up on a multi-year basis, subject to annual City Council appropriation and
- the frequency with which commodities and services should be bid or quoted.

Obstacles To Overcome

Code Restrictions

Currently, the Code states "*An open purchase order may remain valid for a period up to but not to exceed twelve calendar months from date of issue.*" This clause appears to limit the length of time the City is allowed to contract with a vendor. However, we determined that the 12-month limit is essentially an administrative restriction. In actual practice, Purchasing often negotiates the terms of a contract for more than one year, either in the form of a multi-year contract or a one-year contract with extension options. However, to comply with the Code, Purchasing must annually issue a new purchase order to renew these multi-year open purchase orders. If open purchase orders could be issued for more than 12 months, Purchasing could significantly reduce the amount of time it spends on paperwork for those open purchase orders that add no value to the purchasing process. Furthermore, we identified that changing the encumbrance adjustment process from a manual to an on-line procedure would further expedite the open purchase order process.

City Attorney Response

Our recommendation to allow for multi-year open purchase orders only changes the way Purchasing processes open purchase orders. Specifically, Purchasing will be able to renew the same open purchase order number each year instead of issuing a new open purchase order. According to the City Attorney's Office the purpose of the Code is ". . . *to prevent the creation of a contract for an amount of expenditure that would exceed the annual appropriation for that activity. The creation of a new contract for an additional year by renewing a*

purchase order, following approval of the next year's budget, does not violate this Code Section."

Finance Concerns

According to the Finance Department's (Finance) Director of Accounting (Director), there should be dollar limits on the amount of multi-year purchase orders issued each year so that departments cannot manipulate the budget by encumbering all of the money at the issuance of the open. Our recommendation to allow for multi-year open purchase orders should not change the way Purchasing contracts with vendors or the way City departments budget for purchases.

The Director is also concerned that the amount encumbered for open purchase orders will exceed the amount budgeted for the year. The Director noted that some departments request purchase orders mid-year but encumber the amount estimated to be spent on the purchase order during the next 12 months. This can be addressed by encumbering open purchase orders at the time of issuance for only the number of months left in the fiscal year.

Another concern of the Director was the problem of unliquidated encumbrances. Finance recently did a study on open purchase orders and determined that there was approximately \$1.2 million in unliquidated encumbrances in the FMS system. Although these encumbrances have since been liquidated, the Director is still concerned that multi-year open purchase orders would exacerbate the situation.

We determined that most of the \$1.2 million in unliquidated encumbrances in Finance's study was for the Water Pollution Control Plant (WPCP) and the Airport. About \$400,000 was for a single WPCP open purchase order. According

to staff at the WPCP, this \$400,000 unliquidated encumbrance was an oversight during a period of understaffing and should not happen again. Most of the remaining \$1.2 million in unliquidated encumbrances was the result of the Airport simply not liquidating any of its encumbrances. The Airport now plans to liquidate its encumbrances every January. Since both the WPCP and Airport have addressed their unliquidated encumbrances, the amount of unliquidated encumbrances Citywide should be relatively insignificant.

Departments also noted that the FMS Unliquidated Encumbrance Report that all departments use to monitor encumbrances, is inaccurate. Specifically, the report sometimes includes encumbrances which were liquidated several years before. According to Finance and IT, this system problem has been solved and current year liquidations will not appear on future reports. However, the report may continue to show prior year encumbrances that were, in fact, already liquidated.

We recommend that Purchasing and the Finance Department establish a procedure for liquidating encumbrances on multi-year renewals of open purchase orders.

CONCLUSION

Our review revealed that the open purchase order process is a labor intensive paper shuffling process that is not as value added as it could be. We found that revising the processing of multi-year year open purchase orders significantly reduces the amount of processing time spent on multi-year open purchase order renewals. Should Purchasing use multi-year open purchase orders, we estimate that the time required to re-issue an open purchase order would be reduced by 86

percent. As a result, compliance with Code and policy requirements should improve and Purchasing buyers should be able to concentrate on those open purchase orders that have the highest value added potential.

RECOMMENDATIONS

We recommend that the General Services Purchasing Division:

Recommendation #1:

Develop documentation standards for its buyers. These standards should address the following:

- number of bids or quotes solicited;
- the number of bids or quotes received;
- other factors considered in the award decision; and
- written justification for awarding business to other than the lowest bidder.

(Priority 3)

Recommendation #2:

Document the reasons for the amount of each petroleum open purchase order. (Priority 3)

Recommendation #3:

Request the City Council to authorize the Director of General Services to adjust the amount of approved open purchase orders for petroleum purchases to ensure that the City purchases petroleum from the lowest weekly quoted vendor. (Priority 2)

Recommendation #4:

Annually perform a competitive selection of temporary service agencies for frequently used position classifications. (Priority 3)

Recommendation #5:

Develop guidelines requiring buyers to document vendor selection criteria when:

- price and/or location are not the primary factors for vendor selection or
- bidding multiple rates for services or supplies on a single open purchase order.

(Priority 3)

Recommendation #6:

Pursue changing the FMS designation for those transactions which do not fall under the Municipal Code open purchase order definition. (Priority 3)

Recommendation #7:

Require buyers to use an approval of awards form for all open purchase orders over \$20,000. (Priority 3)

Recommendation #8:

Coordinate with Finance and IT to facilitate departments entering encumbrance adjustments into the FMS. (Priority 3)

Recommendation #9:

Develop and implement policies and procedures regarding the issuance of multi-year open purchase orders and analyze commodities and services to determine:

- open purchase orders that can be set up on a multi-year basis, subject to annual City Council appropriation and
- the frequency with which commodities and services should be bid or quoted.

(Priority 3)

In addition, we recommend that the Human Resources Department:

Recommendation #10:

Develop a temporary employee policy for City Council approval in conjunction with the New Realities Task Force recommendation on Civil Service Reform. (Priority 2)

Further, we recommend that Purchasing and the Finance Department:

Recommendation #11:

Establish a procedure for liquidating encumbrances on multi-year renewals of open purchase orders. (Priority 3)

FINDING II

OPPORTUNITIES EXIST TO FURTHER IMPROVE THE OPEN PURCHASE ORDER PROCESS

During our review of the open purchase order process, we identified several areas where additional improvements are possible. Specifically, we noted that:

- The Municipal Code (Code) is unclear regarding public works type of maintenance projects;
- General Services Purchasing Division (Purchasing) needs to provide assurance that the use of specific cooperative purchasing agreements provide the City of San Jose (City) with the best value;
- Purchasing does not always combine open purchase orders to determine reporting or approval requirements;
- Purchasing does not monitor leases or advise City departments regarding expiration dates;
- Buyers' workloads are inequitably distributed;
- Purchasing issued as many as 100 open purchase orders to the same vendor for the same commodity; and
- Purchasing's vendor lists were not current.

Purchasing can improve the efficiency and effectiveness of the open purchase order process by (1) working together with Public Works and the City Attorney's Office to clarify the distinction between public works projects and general services, (2) developing procedures for cooperative purchasing agreements and leases, (3) improving its open purchase order reporting and approval process, (4) developing buyer workload management information, (5) issuing only one open purchase order for the same commodity or service purchases from the same vendor, and (6) automating its vendor lists.

**The Municipal Code Is Unclear Regarding
Public Works Type Of Maintenance Projects**

We reviewed an open purchase order for \$185,000 to repave an airport parking lot. This open purchase order appears to be a project which the Public Works Department should have formally bid. According to the Procurement Manager, both the General Services and Public Works sections of the Code assign responsibility for maintenance projects. As a result, some projects fall under either category, thus creating an overlap in departmental responsibility.

Specifically, the Code states the following as it relates to General Services and Public Works definitions:

A. General services shall mean:

- 1. Any work performed or services rendered by an independent contractor, with or without the furnishing of materials, to do the following:*
 - a. Maintenance or nonstructural repair of city buildings, structures or improvements, which does not require engineering plans, specifications or design, including but not limited to unscheduled replacement of broken window panes, fire extinguisher maintenance, minor roof repairs, elevator maintenance, custodial services and pest control; . . .*
 - d. Replanting, care, or maintenance of public grounds, including but not limited to trees, shrubbery, flowers and lawns, which does not require engineering plans, specifications or designs; . . .*

B. General services shall not include any public works project as defined in Section 14.04.140 of the San Jose Municipal Code, or any purchases of materials, supplies or equipment. (Ords. 21605, 21847, 21971.)
(Emphasis added)

14.04.140 Public works project

As used in this chapter, the term "public works project" means any project for the construction, erection, improvement or demolition of any public building, street, bridge, drain, ditch, canal, dam, tunnel, sewer, water system, fire alarm system, electrical traffic-control system, street-lighting system, parking lot, park or playground; provided and excepting that such term shall not be deemed to mean or include the maintenance of any of such things, or any repairs incidental to such maintenance, or the planting, care or maintenance of trees, shrubbery, or flowers.
(Emphasis added)

As shown above, the Code allows the Department of General Services to perform minor maintenance projects which do not require engineering plans or specifications. However, the Code also defines a miscellaneous public works project to include the following:

14.04.100 Miscellaneous public works

As used in this chapter, the term "miscellaneous public works" means and includes the following:

- A. The maintenance of any of the properties and facilities mentioned in the definition of "public works project," (emphasis added) including any repairs incidental to such maintenance;
- B. The planting, care and maintenance of trees, shrubbery and flowers;
- C. The construction, erection, improvement, alteration, removal, demolition, maintenance or repair of any buildings, structures, improvements, facilities or property, for the doing or accomplishment of which moneys shall have been appropriated to the public works department of the city, or to the head of such department, but excepting any and all work which is included in the definition of "public works project."

According to the Director of General Services, the distinction between a public works project and a general service has been the source of recurring problems for the City. Accordingly, in our opinion, General Services, Public Works and the City Attorney's Office should work together to clarify the distinction between public works projects and general services.

We recommend that General Services, Public Works and the City Attorney's Office work together to clarify the distinction between public works projects and general services.

**Purchasing Needs To Provide Assurance That The Use
Of Specific Cooperative Purchasing Agreements
Provide The City With The Best Value**

The City uses several governmental agency and vendor cooperative purchasing agreements. For example, the City purchases computer products through a cooperative agreement between Santa Clara County and Computer Biz. In addition, the City also purchases office supplies through a cooperative agreement between the City of Fresno and Boise Cascade.

According to the Procurement Manager, there are several reasons for using a cooperative agreement with another jurisdiction, primarily cost and time savings. Because most open purchase orders are processed within a short period of time and the buyers may not have the time to obtain a better price, the cooperative agreement can provide a good value for the City. However, when using these agreements, Purchasing should try to document that the use of a specific cooperative agreement can provide the City with the best value. According to the Procurement Manager, buyers use their experience and knowledge and perform

price comparisons to other cooperative purchasing agreements to verify that the City is receiving the best value.

The City purchased over \$4 million worth of computers and computer products in 1995-96 most of which was purchased through the cooperative purchasing agreement with Santa Clara County. The agreement provides for current competitive pricing and two-week delivery. City departments receive a current price list approximately every two months, however, if prices are reduced, the vendor passes on the price reductions as often as daily. According to the Procurement Manager, the computer buyer periodically performs and documents a price comparison to ensure the City is obtaining the best value. However, Purchasing was unable to provide the documentation that any price comparisons were performed. Similarly, the buyers responsible for administering several of the other cooperative agreements were unable to provide us with documentation of price comparisons.

The Mayor's March 1996 budget message memorandum noted that many City employees are concerned that the City may not be achieving the best possible prices for office equipment. In light of the significant price fluctuations resulting from the rapid changes in computer technology, comparing computer prices is a difficult process. For example, according to the City's computer vendor representative, City employees sometimes have price misconceptions because two computer models may appear to be identical, when in fact, they are not. Specifically, if the same model computer has a business version and a consumer version, the two computers are not identical. The business version may require additional testing and networking requirements which results in a higher price. The representative added that if a department identifies a lower price for an identical computer, the vendor will match the price. However, the Procurement

Manager cautioned that the vendor will not sell at a loss and cannot match the "loss leaders" some retail vendors advertise.

We also interviewed the Santa Clara County buyer responsible for the computer cooperative purchasing agreement. She noted that when she periodically compares prices on the vendor price lists to the State Computer Contract prices, which are on the Internet, the prices are usually the same. We compared a few prices from one of the State's contract vendors with those of the City's computer vendor. For the most part, we found that the computer products were identical but that the State's prices were slightly lower. Further, we found that unlike the City's vendor, the State's vendor offers early pay discounts (5 percent discount if paid within 20 days) and volume discounts.

During our audit, we also contacted the City of Seattle, Washington regarding its computer purchases. According to Seattle's Purchasing Manager, Seattle uses several Citywide open purchase orders. Departments can choose from several vendors and usually end up selecting the vendor with the best service. An alternative to using an open purchase order based on a single computer cooperative agreement would be to issue more than one Citywide computer open purchase order. The City could competitively bid several open purchase orders, use cooperative purchasing agreements, or both. This would allow departments to purchase computers from vendors that offer the best price and service.

We recommend that the General Services Purchasing Division document that the use of specific cooperative agreement(s) provide the City with the best value and consider competitively bidding several computer open purchase orders and/or using cooperative purchasing agreements.

Purchasing Does Not Always Combine Open Purchase Orders To Determine Reporting Or Approval Requirements

We noted that Purchasing does not always combine open purchase orders with the same vendor to determine if administrative or City Council review or approval is necessary. For example, as of December 1995, Purchasing awarded 105 open purchase orders totaling \$523,517 to one vendor. Each of these open purchase orders was for less than the \$75,000 City Council approval limit. Further, only four of these 105 open purchase orders exceeded the \$20,000 report to the City Council limit. In our opinion, when Purchasing awards one vendor several open purchase orders for the same commodity or service, Purchasing should total these awards to determine approval or reporting requirements.

We recommend that the General Services Purchasing Division when appropriate, combine multiple open purchase order dollar amounts to the same vendor for the same commodity or service to determine City Council approval or reporting requirements.

Purchasing Does Not Monitor Leases Or Advise City Departments Regarding Expiration Dates

Purchasing processes leases as open purchase orders. During our audit, we reviewed a lease and found that the 1995-96 open purchase order was for a 60 month, Wang computer equipment lease that expired on October 31, 1995.

Upon further investigation, we found that the lease was executed on April 20, 1990, and provided the City with two options at the end of the five-year term: (1) purchase the computer equipment at the end of the five-year lease term at the greater of the fair market value or 16 percent of the original cost of the equipment or (2) extend the lease for one year. Because the City took no action when the lease expired, the lease was automatically renewed for one year to June 30, 1996, at a one-year cost of \$93,822. We estimate that had the City exercised its number 1 option shown above, it could have saved \$23,306. Specifically, the City could have purchased the equipment for \$70,516 (16 percent of the original cost)¹ instead of paying \$93,822 in lease payments in 1995-96.

The lease amendment also indicates that at the end of the sixth year, the City has the option to:

- renew the equipment schedule using the current fair market value of the equipment and continue to rent based on the renewed schedule (must be done within 60 days of the expiration of the one-year extension);
- purchase the equipment at the mutually agreed to fair market value;
- continue to lease at the current monthly payment of \$7,818.51 on a month to month basis; or
- return the computer equipment to the lessor.

¹ We assume 16 percent of principal cost would be greater than the fair market value of outdated or obsolete Wang computer equipment.

According to the Department of Information Technology (IT) staff, IT plans to purchase the equipment at the fair market value of \$12,000. Therefore, because the City did not purchase the equipment at the end of the five year lease, the City paid an extra \$23,306 in 1995-96 and will pay an additional \$12,000 to purchase the equipment at the end of the sixth year, for a total of \$35,306 in excess costs.

According to the Procurement Manager, Purchasing did not include the terms and conditions of this lease on the face of the open purchase order or subsequently monitor this lease because IT wanted to monitor the lease. In our opinion, the Purchasing buyer still should have included the expiration date of the lease on the face of the open purchase order. This may have alerted the buyer or IT of the expiration on June 30, 1995, and saved the City \$35,306. Finally, Purchasing should include lease information such as the expiration date on the face of the open purchase order and communicate to departments that they are responsible for monitoring equipment lease contracts.

We recommend that the General Services Purchasing Division develop and implement procedures to ensure buyers include on the face of open purchase orders for equipment lease contracts the lease start date; lease number and lease expiration date; and communicate to departments that they are responsible for monitoring lease contracts.

Buyers' Workloads Were Inequitably Distributed

Our review revealed that the Purchasing buyers' workloads were inequitably distributed. According to the Procurement Manager, she does not have the management information to monitor the buyer workload. We prepared buyer

workload information from the open purchase order database we downloaded. The following table shows the number of open purchase orders by buyer.

TABLE VII
OPEN PURCHASE ORDERS PROCESSED WORKLOAD
FOR FISCAL YEAR 1995-96 AS OF DECEMBER 31, 1995

Staff	Number Of Opens Over \$75,000	Dollar Amount Over \$75,000	Total Number Of Opens Processed	Total Dollar Amount
Procurement Manager	0	0	10	\$ 57,171
Senior Buyer #1	31	\$ 6,361,363	291	9,386,998
Senior Buyer #2	15	5,939,477	151	7,788,614
Senior Buyer #3	2	674,000	60	1,246,605
Buyer II #1	14	1,916,105	214	4,242,161
Buyer II #2	12	3,292,000	261	4,875,074
Buyer II #3	11	1,690,871	195	3,413,741
Buyer II #4	13	1,692,000	507	6,242,325
Buyer I #1	3	295,000	320	3,085,353
Totals	101	\$21,860,816	2,009	\$40,338,042

It should be noted that Table VII does not reflect the varying complexities of the 2,009 open purchase orders shown. In other words, some open purchase orders take far less time to process than others. For example, the 100 annual open purchase orders, which one buyer issues to only one photocopier vendor, are purchased through the Alameda County cooperative agreement and are included in the 507 open purchase orders workload for Buyer II #4. On the other hand, many of the open purchase orders over \$75,000 involve complex time-consuming requests for quotations, requests for proposals, or formal bids.

Further, the Senior Buyer #3 does have some open purchase orders over \$75,000 which are renewed in January or February of each year and are not included in the above table. We gave the Procurement Manager a copy of the workload information in Table VII, and she acknowledged the need to have this type of information in order to even out the buyers' workloads. She also noted that commodity specialization assignments can affect buyer workloads.

We recommend that the General Services Purchasing Division develop and use buyer workload management information to monitor buyers' open purchase order workloads.

Purchasing Issued As Many As 100 Open Purchase Orders To The Same Vendor For The Same Commodity

Purchasing's Accounting Unit spends a great deal of time allocating costs to different departments on Citywide open purchase orders. For example, the City's office supply vendor sends one semi-monthly invoice to the City that details all departments' charges. An account clerk in Purchasing is responsible for charging the costs to each department and entering the charges by charge code into FMS. To avoid having its account clerks spending time allocating costs on Citywide open purchase orders, Purchasing issues numerous open purchase orders to the same vendors for the same commodities or services. As we noted above, Purchasing issues over 100 open purchase orders with the same copier vendor.

We surveyed other cities to determine how they charge costs to departments on their Citywide opens. We found that other cities instruct vendors to send invoices detailing charges to each department. Each department then processes its own payments to the vendor. We inquired as to why Purchasing did not process payments on Citywide open purchase orders in the same manner. Purchasing responded that the FMS would not process multiple invoices for the same open purchase order for different departments at the same time. However, according to IT, the FMS will allow departments to process individual invoices for the same Citywide open purchase order.

In our opinion, Purchasing should issue one open purchase order for products with the same vendor such as copiers and fax machines. This will eliminate buyers having to issue more than 100 open purchase orders each year. The Procurement Manager should have the Network Coordinator set up a database containing all copier information such as department and lease terms so that buyers can keep track of department usage and agreement terms.

We recommend that when practical, the General Services Purchasing Division issue one open purchase order for the same commodity or service with the same vendor.

Purchasing's Vendor Lists Were Not Current

We reviewed Purchasing's vendor files and noted that they are extremely outdated. As a result, several buyers maintain their own manual vendor lists. The State and Local Government Purchasing report cites the purpose of a formal bidders' list. The report states,

The purpose of a bidders list should be to canvass prospective sources of supply accurately and efficiently. To this end, there must be means for identifying prospective suppliers, categorizing them according to goods and services they can furnish, and for avoiding unproductive and wasteful solicitations.

The report also states,

In a public purchasing program where competitive bidding is required on a large variety of items, good management practices dictate that the list be handled in some planned, systematic manner. The public purchasing office has the duty to seek a full range of competition for its requirements and should have an organized, ongoing program for adding qualified suppliers to its bidders list. The public interest is not met by mere routine solicitation or an assumption that the current degree of competition is sufficient. Purchasing has the duty both to solicit and to obtain representative, available competition. Regular efforts to locate new sources of supply are a vital part of this responsibility.

During our review, we noted that for at least 66 percent of the open purchase orders in our sample there was an open purchase order in the prior year for the same product or service with the same vendor. According to a Purchasing buyer, certain commodities or services do not lend themselves to an annual or periodic competitive selection process because buyers know that a certain vendor provides the best service, product, selection of merchandise, and/or has the best location. Consequently, many buyers issue open purchase orders year after year to the same vendors without documenting why they did not use a competitive selection process. A current vendor list that showed, for example, only one vendor in a specific and required location could help buyers justify their decision to forego a competitive selection process. Conversely, a current vendor list could increase competition and result in buyers selecting a different vendor.

The Procurement Manager acknowledged that vendor files are outdated and need development. Purchasing plans on implementing an automated vendor list. According to the Procurement Manager, Purchasing will input into the automated

vendor list those vendors interested in supplying certain commodities or services to the City. Buyers will have on-line access to these vendor lists. When Purchasing receives a requisition for a certain commodity or service, buyers will send a request for a quotation to every vendor that indicated interest in the requisitioned commodity or service. In our opinion, once Purchasing establishes the automated vendor list, buyers should periodically review and update the lists.

We recommend that the General Services Purchasing Division automate and periodically review and update vendor lists.

It should be noted that in February 1996 the City Manager directed all City departments to place all contracting opportunities including, but not limited to, construction, professional consulting, concessionaire, and purchasing on the Virtual Valley electronic network. The Procurement Manager believes that this process will improve competition for City open purchase orders as well as contracting opportunities.

CONCLUSION

During our review of the open purchase order process, we identified several areas where additional improvements are possible. In our opinion, Purchasing can improve the efficiency and effectiveness of the open purchase order process by (1) working together with Public Works and the City Attorney's office to clarify the distinction between public works projects and general services, (2) developing procedures for cooperative purchasing agreements and leases, (3) improving its open purchase order reporting and approval process, (4) developing buyer workload management information, (5) issuing only one open purchase order for

the same commodity or service purchases from the same vendor, and (6) automating its vendor lists.

RECOMMENDATIONS:

We recommend that the General Services Purchasing Division, Public Works, and the City Attorney's Office:

Recommendation #12:

Work together to clarify the distinction between public works projects and general services. (Priority 3)

In addition, we recommend that the Purchasing Division:

Recommendation #13:

Document that the use of specific cooperative agreement(s) provide the City with the best value and consider competitively bidding several computer open purchase orders and/or using cooperative purchasing agreements. (Priority 3)

Recommendation #14:

When appropriate, combine multiple open purchase order dollar amounts to the same vendor for the same commodity or service to determine City Council approval or reporting requirements. (Priority 3)

Recommendation #15:

Develop and implement procedures to ensure buyers include on the face of open purchase orders for equipment lease contracts the lease start date; lease number and lease expiration date; and communicate to departments that they are responsible for monitoring lease contracts. (Priority 3)

Recommendation #16:

Develop and use buyer workload management information to monitor buyer open purchase order workloads. (Priority 3)

Recommendation #17:

When practical, issue one open purchase order for the same commodity or service with the same vendor. (Priority 3)

Recommendation #18:

Automate and periodically review and update vendor lists. (Priority 3)

FINDING III

ADMINISTRATIVE IMPROVEMENTS ARE NEEDED IN ORDER TO STANDARDIZE AND SPEED UP CITY DEPARTMENT PAYMENTS TO THOSE VENDORS AWARDED OPEN PURCHASE ORDERS

Each City of San Jose (City) department is responsible for ordering goods and services off open purchase orders and processing for payment vendor invoices for open purchase order purchases. However, our audit revealed that administrative controls over the payment of open purchase order vendor invoices need improvement. Specifically,

- vendor invoice terms could not be compared to the terms stipulated in the open purchase order award;
- City departments made unauthorized purchases;
- mathematical errors on vendor invoices went undetected;
- departments lacked adequate information to properly review invoices before making payment; and
- the City lost discounts on vendor invoices because of slow department payment processes.

We also noted that the Purchasing Chapter of the City Administrative Manual (CAM) has not been updated since 1987 and the Finance Administrative Manual (FAM) - Accounts Payable Section is out of date. In our opinion, Purchasing and Finance should update the Purchasing Chapter of the CAM. In addition, Purchasing should reduce the volume of invoices sent to the City by requiring vendors to submit summary invoices. Furthermore, the Finance Department should update the Accounts Payable section of the FAM. These improvements should facilitate the consistent, efficient and proper payment of open purchase order vendor invoices.

City Departments' Open Purchase Order Responsibilities

Individual departments are responsible for reviewing and approving invoices for payment. With the exception of Citywide invoices, which General Services Purchasing Division (Purchasing) reviews and approves, vendors send invoices directly to the accounting/fiscal unit of the department that requested and received the goods/services. The process for reviewing and approving invoices varies by department. In some departments, if the receiving document is on file, staff in the accounting/fiscal unit perform the complete invoice review. If there is no receiving document or one is not on file, the divisions that ordered the items review and approve the invoices. In other departments, the ordering divisions review and approve the invoices.

Once the invoices are approved and returned to the accounting/fiscal unit, an account clerk inputs the payment into the Financial Management System (FMS) and prints out an edit list. The clerk then forwards the invoice and the edit list to the supervising accountant for final review and approval. This review is to ensure that (1) charges have been reviewed, (2) there is evidence of receipt, and (3) invoices were entered into the system accurately. Once the accountant reviews and approves the invoices, an approved edit list is forwarded to the Accounts Payable Section (Accounts Payable) of the Finance Department. Accounts Payable verifies that the edit list is accurate and properly approved. If it is, Accounts Payable prepares the invoice for payment.

Test Of Open Purchase Orders

As noted in the Scope and Methodology section, we selected and tested a judgmental sample of invoices for 1995-96 open purchase orders issued for eight departments. As part of our testwork, we compared the charges on the invoice with the corresponding open purchase order formal bid or request for quotation information. The results of our testwork, which are described below, revealed that (1) departments' payments on invoices were not in accordance with open purchase order awards, (2) vendor invoice terms were not or could not be verified, (3) departments made unauthorized purchases, (4) mathematical errors on vendor invoices went undetected, and (5) departments lacked adequate information to properly review invoices before making payment. Therefore, even though Purchasing may obtain competitive bids to achieve the best price, the City may pay higher prices than necessary because controls are not sufficient to ensure that payments are in accordance with the terms of the open purchase order agreements.

Our review also revealed that because departments route invoices to divisions for approval, the department payment process has been slow and has resulted in lost discounts. Moreover, the slowness of the invoice review and approval process causes vendors to be paid late or could cause vendors to refuse to do business with the City.

Department Payments On Invoices Were Not In Accordance With Open Purchase Order Awards

Our limited review of invoices identified charges which were paid but were not consistent with vendors' quoted rate sheets. The examples listed below indicate that Purchasing needs to provide departments with information on rates and prices and departments need to improve their invoice review and approval process. For

instance, we reviewed a \$24,000 invoice for a lighting retrofit kit. The prices charged on this invoice did not agree with the formal bid prices. We investigated this matter and found that staff did not verify the prices on the invoice because Purchasing did not provide a quoted price sheet. Although the dollar amount of this loss was not significant, it demonstrates that the lack of adequate review increases the City's exposure to greater losses.

We also reviewed invoices for an open purchase order to provide lab sample analysis and found that the charges on the invoices were not consistent with the vendor's quoted rate sheet. On some invoices, the charges were lower than the vendor's rate sheet and on other invoices the charges were higher. In investigating this matter, we found that the staff responsible for approving the invoices did not have a copy of the price sheet. As a result, staff lacked the information they needed to verify that the invoice charges were in accordance with the vendor's quoted prices.

We also identified several discrepancies on invoices for security services. In bidding these services, Purchasing requested quotations for various hourly rates (regular, overtime/holiday and weekend hours) for "regular" and "special" services. In reviewing the invoices, we found that some of the charges on the invoices were identified as "special coverage." However, instead of charging the special coverage rate of \$13 per hour for all hours, the vendor charged all hours at the overtime rate of \$15.02 per hour. In addition, the vendor's invoices included other charges which were not identified on the bid document. These charges included additional patrol service charges, alarm retainer charges and on-call fees for alarm responses.

In investigating this matter, we found that the open purchase order specified "*regular rates*" and made no mention of "*special rates*." We also found that this particular open purchase order did not refer to an attachment or other rates which the vendor quoted. Further, the staff responsible for approving the security service invoice did not even have a copy of the open purchase order. Consequently, instead of verifying security service charges, the staff normally just approved the invoice for payment.

Vendor Invoice Terms Were Not Or Could Not Be Verified

Our review of invoices also identified charges which were not verified or could not be verified because the rates and prices were not itemized on the invoice in the same manner as the formal bid or request for quotation. For example, our review found that Purchasing does not provide departments with the information required to verify invoiced petroleum prices. During 1995-96, the City purchased petroleum products off open purchase orders totaling \$2.2 million. Because of the volatility of petroleum prices, Purchasing competitively bids petroleum products on a weekly basis. Vendors fax weekly quotes to Purchasing. We interviewed departmental staff to determine the procedures in place to review and approve these invoices. We found that because department staff do not receive the weekly quotes, they only verify the receipt of the goods and the mathematical accuracy of the invoices. As a result, there is no assurance that the prices on the invoices agree with the vendors' weekly price quotations.

Our review also found that the invoice terms for open purchase orders issued for electrical parts and supplies purchases could not be verified against the prices quoted. Specifically, Purchasing issued 11 open purchase orders totaling \$661,000

with one electrical parts and supplies vendor. We reviewed one of the open purchase orders with this vendor and found that the vendor selection decision was based on the highest discount percentage off list prices. We reviewed invoices for this open purchase order and found that we were unable to determine: (1) the products purchased, (2) whether the products purchased were authorized under the terms of the open purchase orders, and (3) whether the appropriate discounts were applied.

When we interviewed an account clerk at the department that purchased the parts and supplies, we found that the department relies on copies of the open purchase order and does not receive copies of the discount sheet. Thus, the department has no way of verifying the price that should be paid. We also noted that the terms of the open purchase order specify the "*vendor shall supply the City's Purchasing Division with monthly usage reports.*" We discovered that the vendor did not provide such reports in 1995-96. In addition, we noted that the open purchase order specifies that the "*vendor shall invoice once per month.*" However, we noted that the vendor provided nine separate invoices related to one open purchase order in December 1995.

Purchasing also issued seven open purchase orders with a printing vendor totaling \$523,000. We reviewed four invoices related to one open purchase order and attempted to verify the unit pricing against the formal bid price list. However, we found that the prices on the invoices were not itemized in the same manner as the formal bid sheet. As a result, we could not verify that the invoice charges were in accordance with the open purchase order agreement. The following table details the difference between the invoiced price and the price according to the formal bid sheet.

TABLE VIII
SAMPLED INVOICES NOT IN ACCORDANCE
WITH THE OPEN PURCHASE ORDER AGREEMENT

Invoiced Printing Service	Invoiced Price	Price Per Bid Sheet	Invoiced Charges That Could Not Be Verified To Open Purchase Order
8.5 x 5.5 Newsletter, 2500 copies	\$ 926.10	\$ 97.00	\$ 829.10
8.5 x 5.5 Brochure, 6150 copies	2,115.42	129.15	1,986.27
8.5 x 11 Form, 40,000 copies	1,644.00	627.44	1,016.56
8.5 x 11 Form, 30,000 copies	1,434.00	470.58	963.42

The account clerk who processes the payments on this open purchase order confirmed that this vendor does not itemize charges and noted that they only review the invoices for reasonableness. Without an itemized listing of charges, the departments cannot be assured that the invoice prices are in accordance with the bid.

We were also unable to verify labor charges on invoices against the rates specified on an open purchase order for repair services because the invoice charges were per job instead of per hour. The open purchase order specified two rates, the shop rate of \$46.25/hour and the overtime rate of \$58/hour. However, the invoices only identified a lump sum for the job such as "Repair Labor \$795." We reviewed 13 invoices for this open purchase order and found that all labor charges were listed in the same lump sum manner. Thus, the labor charge per hour could not be verified.

When we interviewed the account clerk at the department, we found that the labor rates are not verified. Instead, the invoice is merely matched to the receiving document, which shows only the same lump sum charge.

Departments Made Unauthorized Purchases

Open purchase orders represent written contracts between the City and vendors who have agreed to provide specified goods or services at a specified rate or price. Generally, the agreed upon price is based on a competitive bidding or selection process. Using these open purchase orders to procure items other than those specified circumvents the competitive bidding process because only the items specific to that open purchase order have been bid.

Our review, however, found that departments are using open purchase orders to procure items not authorized on the open purchase order. For example, each department that we surveyed indicated that they have made unauthorized purchases during the year. In addition, the Procurement Manager noted that unauthorized purchases under open purchase orders are common.

Furthermore, our review of invoices identified examples of unauthorized purchases. For instance, Purchasing issued a \$185,000 open purchase order for trucking/hauling services. However, our review of invoices revealed that this open purchase order was also used to purchase fill material that the vendor hauls. In fact, approximately 50 percent of all the charges on the invoices were for the fill material which was not specified in the open purchase order.

We also noted a purchase which exceeded the authorized limit for an open purchase order. The San Jose Municipal Code specifies that purchases made under an open purchase order cannot exceed \$20,000, which is the formal bid limit. Our review of an open purchase order for printing revealed that one department purchased 100,000 copies of a requisition form at a cost of \$30,280, exceeding the authorized limit by \$10,280.

Undetected Mathematical Errors On Vendor Invoices

The invoice review process should ensure that the invoices are mathematically correct. That is, the extended prices should be verified and totaled to ensure that the invoices are mathematically correct. Our limited review, however, identified invoices which were not mathematically correct. Specifically, we found errors on two invoices on an open purchase order to rent portable toilets. The price per unit charges agreed to the prices included on the open purchase order; however, we found an error on one of the extended prices. On one invoice, the quantity was two and the unit price was \$15; however, the extended price was \$132.84 instead of \$30. We also found a similar error on another invoice. Division supervisors approved both of these invoices for payment. Staff in this division stated that if the total appears reasonable, they approve it. Moreover, after an invoice is approved, the accounting unit merely processes the payment without further review.

**Departments Lacked Adequate Information
To Properly Review Invoices Before Making Payment**

An important payment control is to ensure that the goods, services, prices, and terms on vendor invoices are authorized and in accordance with the terms of the open purchase order. However, our review revealed that the rates or prices of specific products or services are not always shown on the face of the open purchase order form. This is especially true when the service or product has been either formally bid or was a multiple service or product quotation. Instead, the open purchase order refers only to the formal bid or quotation document. Without this information, departments cannot verify that the rates or prices charged are in accordance with the rates or prices specified in the bid documents. To correct this control weakness, Purchasing should provide the departments with price or rate sheets along with a copy of the open purchase order.

**Update The CAM To Facilitate More Consistent,
Efficient And Proper Department Invoice Payment Processes**

The invoice review and approval process problems we identified are the result of inadequate Citywide procedures. The CAM procedures, which departments rely upon to review and approve invoices, predate the installation of the FMS in 1989 and describe the manual process that was in place at that time. In our opinion, Purchasing and the Finance Department should develop Citywide open purchase order invoice approval process procedures and document them in the CAM. In addition, Purchasing needs to provide departments with rate sheets to allow for the proper review of invoices. These procedures should ensure that the invoice review and approval process is standardized throughout the City. These standardized procedures should ensure the following:

- goods or services were authorized under the open purchase order;
- goods or services were received;
- invoiced quantities, prices/rates and terms are in accordance with the terms of the open purchase order; and
- invoices are mathematically correct.

The Procurement Manager acknowledged that the CAM is outdated. The Procurement Manager also stated that Purchasing has updated about 50 percent of these procedures. When Purchasing completes these procedures, they will be included in the CAM.

We recommend that Purchasing and the Finance Department develop and implement invoice review and approval procedures to be included in the City Administrative Manual. The procedures should provide assurance that:

- goods or services were authorized under the open purchase order;
- goods or services were received;
- on open purchase orders over \$5,000, invoiced quantities, prices/rates and terms are in accordance with the terms of the open purchase order;
- invoices are mathematically correct;
- departments receive the pricing and rate documentation necessary to properly review invoices; and
- receiving documents are forwarded to accounting units to match to the invoices.

Slow Department Payment Processes Result In Lost Discounts

Our review of invoices also revealed that the current accounts payable process is labor intensive and slow. Based on our judgmental sample of approximately 160 invoices, we found that the City pays invoices on open purchase orders in an average of 44 days. Comparatively, a recent procurement study showed that the City of Los Angeles took an average of 40 days to pay vendors. The study concluded that the City of Los Angeles was "habitually late" as far as payments were concerned and added that "the process takes so long that it is often difficult to capture early payment discounts without expediting payments." The study also noted that late payments can cause vendors to refuse to do business with the City of Los Angeles. Consequently, the pool of vendors that the City of Los Angeles can get to bid on contracts was reduced with resultant less competition and higher prices.

Our review also found that the City is not taking advantage of about one-third of all cash discounts available from vendors. This finding is consistent with

our departmental surveys, in which staff indicated that they try to take large discounts whenever possible. To estimate the amount of lost discounts, we judgmentally selected one large and one small check run and manually reviewed each paid invoice. For the two check runs we tested, we identified \$1,092 and \$582 in lost discounts, respectively. Based upon our test results, we estimate that the City loses about \$43,000 in discounts per year.

Our review of the City's payment process indicates that routing invoices to departmental divisions for review and approval increases the time to process payments. Most department accounting units route invoices to departmental divisions to verify receipt of goods or services. A few departments only route invoices to departmental divisions when the accounting unit does not have a receiving document to verify receipt. While the City has automated certain aspects of the payment process, the departmental division review and approval process is inefficient and ultimately results in slow payments to vendors and lost discounts for the City.

We identified two improvements which should reduce the time to process invoices for payment. First, departments should route fewer invoices to departmental divisions for payment. In our opinion, Citywide procedures should clarify the review and approval process so that fewer invoices need to be routed to the departmental divisions. This is feasible if Citywide procedures require that receiving documents should be forwarded to departmental accounting units for processing. We estimate that this change will reduce the processing time for invoices from several weeks to two days. The processing time saved depends on how long it currently takes a departmental division to return the invoice to the department's accounting unit and how long it takes the accounting unit to approve the invoice.

A second improvement to reduce invoice processing time is to decrease the volume of invoices. This could be achieved in two ways. First, the City should develop procedures which do not require departments to review invoices related to open purchase orders for \$5,000 or less. This change poses minimal risk to the City because buyers do not take quotes on these purchases and the dollars involved are small. Second, Purchasing should require vendors to provide departments with summary billings. Currently, some open purchase orders, such as the electrical parts and supplies open purchase order cited earlier require the vendor to submit one monthly invoice instead of for each individual purchase. However, because Purchasing does not enforce these provisions, the vendors submit invoices for individual purchases which unnecessarily add to the invoice processing workload. By enforcing existing summary billing requirements for open purchase orders and expanding the use of summary billings for other open purchase orders, Purchasing could significantly reduce the volume of invoices that departments need to review, approve, and process. As a result, departments will process invoices faster and the City will pay vendors sooner. The benefit should be a reduction in the overall processing time of invoices.

We recommend that Purchasing when appropriate, reduce the volume of invoices sent to the City by requiring vendors to submit summary invoices.

The FAM Needs Updating

We reviewed the Finance Administrative Manual (FAM) and noted that the Accounts Payable procedures section had been revised several times and many of the revisions were marked "draft." We were not able to obtain approved copies of the procedures.

According to the Deputy Director of Finance, the Finance Department is currently in the process of updating the FAM. He acknowledged that the FAM is outdated and has not been revised; however, they did not have the available staff time to devote to this project.

We recommend that the Finance Department finalize revisions to the Finance Administrative Manual Accounts Payable Section.

CONCLUSION

Individual departments are responsible for ordering and approving invoices on open purchase order purchases. We noted that the Purchasing Chapter of the CAM has not been updated since 1987 and the FAM is out of date. Without the proper controls in place over the invoice review and approval process, there is no assurance that the City is being charged in accordance with the terms of the open purchase order agreements. In our opinion, Purchasing should update the Purchasing Chapter of the CAM. In addition, Purchasing should reduce the volume of invoices sent to the City by requiring vendors to submit summary invoices and eliminating the need for departments to review invoices related to open purchase orders for \$5,000 or less. Furthermore, the Finance Department should update the Accounts Payable Section of the FAM. These improvements

should facilitate the consistent, efficient, and proper payment of open purchase order vendor invoices.

RECOMMENDATIONS

We recommend that Purchasing and the Finance Department:

Recommendation #19:

Develop and implement invoice review and approval procedures to be included in the City Administrative Manual. The procedures should provide assurance that:

- goods or services were authorized under the open purchase order;
- goods or services were received;
- on open purchase orders over \$5,000, invoiced quantities, prices/rates and terms are in accordance with the terms of the open purchase order;
- invoices are mathematically correct;
- departments receive the pricing and rate documentation necessary to properly review invoices; and
- receiving documents are forwarded to accounting units to match to the invoices.

(Priority 2)

We also recommend that Purchasing:

Recommendation #20:

When appropriate, reduce the volume of invoices sent to the City by requiring vendors to submit summary invoices. (Priority 3)

In addition, we recommend that the Finance Department:

Recommendation #21:

Finalize revisions to the Finance Administrative Manual Accounts Payable Section. (Priority 3)

FINDING IV

THE QUALITY AND USABILITY OF OPEN PURCHASE ORDER INFORMATION IN THE CITY'S FINANCIAL MANAGEMENT SYSTEM NEEDS IMPROVING

An organization's computerized management information system should provide management and system users with reliable information to perform daily operations and assess organizational performance. The City of San Jose (City) installed its computerized Financial Management System (FMS) in 1989 and subsequently enhanced the FMS several times. The City's Department of Information Technology (IT) is responsible for operating and maintaining the FMS. During our audit of open purchase orders, we noted a number of deficiencies that were the direct result of the FMS' limitations. Specifically, we identified that the FMS:

- does not produce enough management information to allow the General Services Purchasing Division (Purchasing) to measure the performance of its buyers or the cost effectiveness of the open purchase order process;
- produces open purchase order reports that contain so many discrepancies and are so unreliable that Purchasing does not allow City departments to have access to these reports;
- does not produce open purchase order management reports on Minority and Women Business Enterprises (M/WBE) purchases, recycled products, multi-year contracts, goods versus services, and lost payment discounts;
- does not produce management reports that summarize City department open purchase order activity; and
- is perceived by City departments as not being user friendly and is unresponsive to their processing and information needs.

As a result, Purchasing's ability to manage the open purchase order process is impaired and City departments spend unnecessary time on open purchase order activities. Accordingly, Purchasing should (1) input City department codes into the FMS and (2) instruct those users of open purchase orders who review and approve vendor invoices to indicate "final payment" on the final invoice or receiving document. Further, IT should (1) evaluate upgrading the FMS purchasing module, (2) program the FMS to generate a report that extracts open purchase orders by department, (3) allow departments to have access to such reports, and (4) evaluate programming the FMS to generate a report which details purchase discount information. In addition, Purchasing and IT should train City department personnel who enter, retrieve, or process the FMS open purchase order information. Finally, City departments should input purchase discount information into the FMS subject to IT successfully programming the FMS to generate purchase discount reports.

Computerized Management Information Systems

Computerized management information systems should provide organizations with information necessary to monitor, evaluate, and adjust performance. These management information systems are processes by which transactions are recognized, authorized, classified, recorded, summarized and reported. To be useful, these systems should provide accurate, reliable, timely and understandable information on key performance measures.

A number of performance measures have been developed to evaluate the efficiency and effectiveness of the procurement function. For instance, the Government Finance Officers' Association has developed the following literature on measuring the performance of the procurement function.

Evaluation (of the purchasing function) must be linked to the purchasing objectives. . . . The twin objectives of efficiency and effectiveness are key objects for evaluation. Efficiency depends on the economy of the administrative process of procuring, and on the ability of procurement to buy goods and services at the least cost. Effectiveness is the extent to which the goods and services acquired are of the desired quality and available for the use of government programs when they are needed.

Many jurisdictions conduct annual audits of procurement activity. In those cases, audit comments will serve as useful indicators of performance in terms of meeting legal requirements.

Objective measures are more difficult. The following suggestions may be useful if it is possible to collect accurate relevant data to quantify them.

The very availability of data (management information) is, by itself, a useful indicator of procurement performance. If such data are not collected, compiled, and reported routinely, then it is quite likely that the procurement function is disorganized-and therefore neither efficient nor effective.

Objective performance measures include:

- *Average length of time to complete a solicitation (this will be different for different types of solicitations, and much shorter for small purchases);*
- *Average number of bidders/proposers for each type of solicitation;*
- *Ratio of bid/proposal protests to solicitations issued broken down by type of solicitation;*
- *Percentage of protests sustained;*
- *Number and type of vendor complaints;*
- *Percent of procurement employees receiving training, continuing education, or holding some kind of certification, such as the CPPO or CPPB credentials;*
- *Percentage of contract monitoring reports filed on time;*
- *Percent of early payment discounts taken;*
- *Penalties for failure to meet prompt payment requirements;*
- *Average number of solicitation amendments (segregated by type of solicitation); and*

- *Average number of change orders, i.e., contract amendments (segregated by type of contract).*

The FMS

The City's computerized Financial Management System (FMS) is comprised of the Purchasing, General Ledger, Accounts Payable and other modules. It was installed in 1989 making it inherently outdated as compared to currently available application software. IT has made improvements to the system in recent years, such as changing its platform from Wang to Unix.

Department Of Information Technology

IT's mission is to provide accurate and timely computer data and communications services to City staff to assist them in managing resources for the efficient and effective delivery of City services. IT has three staff dedicated to the FMS.

Open Purchase Order Deficiencies That Resulted From The FMS Limitations

Our audit evaluated the adequacy of the FMS as a management tool for the City's procurement function. Our review of open purchase orders revealed that many of the inefficiencies we discovered result from restrictions or limitations with the FMS. Moreover, it does not provide Purchasing with the information it needs to effectively monitor, evaluate, and adjust its essential activities. Although the FMS has been improved and upgraded since it was installed in 1989, it does not reflect current technological efficiencies. As a result, we identified that FMS:

- does not produce enough management information to allow Purchasing to measure the performance of its buyers or the cost effectiveness of the open purchase order process;

- produces open purchase order reports that contain so many discrepancies and are so unreliable that Purchasing does not allow City departments to have access to these reports;
- does not produce open purchase order management reports on Minority and Women Business Enterprises (M/WBE) purchases, recycled products, multi-year contracts, goods versus services, and lost payment discounts;
- does not produce management reports that summarize City department open purchase order activity; and
- is perceived by City departments as not being user friendly and is unresponsive to their processing and information needs.

*Purchasing Cannot Measure The Performance Of Its Buyers
Or The Cost Effectiveness Of The Open Purchase Order Process*

According to the Purchasing Manager, the FMS does not track the necessary information required to produce reports which measure the performance of the Purchasing Division or of the individual buyers. As a result, management lacks objective information to benchmark their performance against other cities or identify areas needing improvement. For instance, the FMS does not track the City's cost to procure a dollar or turnaround time on requisitions or any other of the performance measurements discussed on page 86 which should be used to evaluate the efficiency and effectiveness of the procurement function. In addition, the Procurement Manager cannot monitor the buyers' workload to ensure the work is distributed evenly.

Our review found that while the FMS maintains the data required to produce most Purchasing management reports, this data is difficult to retrieve. According to the FMS Administrator and Purchasing's Network Coordinator, the only way to obtain data is to run a report that contains the data. This can be done in one of

three ways: (1) create a report using the FMS report writer, (2) submit a request to IT to have them write a report or (3) run a FMS generated report. However, we determined that there are problems with options 1 and 2. Specifically, creating a report using the FMS report writer is not always feasible because the report writer only accesses data contained in the general ledger module. Therefore, Purchasing information cannot be accessed. Further, it takes IT a long time to respond to a request for a report. According to the FMS Administrator, IT takes between six months to one year to complete report-writing requests.

We found that the most practicable way to obtain data is to run a FMS-generated report. However, since the report may have been created to summarize different information, the data may not be organized in a meaningful manner. For example, as part of our audit, we wanted to analyze buyer workload. We reviewed the FMS generated reports, but found no reports which sorted open purchase orders according to buyer. Therefore, to attain this information, we ran the *Approved Open Purchase Order Listing Report*, which showed each open purchase order listed, the buyer and the dollar amount issued. However, since the report was not sorted by buyer and users cannot modify reports in the FMS, we had to improvise. Specifically, we imported the report into Excel, unformatted the report, deleted all the unnecessary information, and sorted the resulting data by buyer.

Given the difficulty of accessing the FMS information in a usable format, Purchasing recently established a Network Coordinator position. Among other duties, this person is responsible for creating management reports. The Network Coordinator is trying to produce such management reports. However, the process is proving to be very time consuming because the FMS information is difficult to retrieve or may reside in several different FMS reports. As a result, Purchasing must manually manipulate the FMS information which increases the risk of Purchasing producing management reports which contain incorrect information. In order to reduce this risk, Purchasing verifies the information in its management reports.

According to the FMS Administrator, two upgrades are planned which should make data retrieval and management reporting easier. One upgrade will provide "Windows type" overlays that would allow users to use a mouse to maneuver through the system. There is no charge for this upgrade. The other upgrade that is planned will convert the database to an Oracle relational database system. The vendor plans to begin beta testing of the new database during the spring of 1997. Oracle requires licensing of all users, in the same manner as Excel and Word. The FMS Administrator estimates such licensing will cost the City more than \$100,000.

According to the Procurement Manager, the vendor has already completed an upgrade to the Purchasing module of the FMS which is free and available for installation. According to the FMS Administrator, this upgrade has not yet been ordered from the vendor. If ordered and installed, this upgrade should improve the FMS' capability to provide Purchasing with useful management reports.

*The FMS Open Purchase Order Report Contains
Discrepancies And Is So Unreliable Purchasing
Does Not Allow Departments To Access These Reports*

As part of our review, we tried to determine the amount of open purchase orders issued in 1994-95. We found, however, that the FMS does not provide reliable information on the amount of open purchase orders issued. For example, the Approved Open Purchase Order Listing Reports for 1994-95 show that Purchasing issued \$29 million in open purchase orders. However, Purchasing's Bi-Monthly Summary reports show that Purchasing issued about \$45 million in open purchase orders in 1994-95. When we attempted to reconcile this \$16 million discrepancy by manually totaling the balances for all 1994-95 open purchase orders, we found that Purchasing had issued about \$51 million in open purchase orders - a difference of \$22 million. Because these FMS-generated reports are so unreliable, Purchasing does not allow departments to access these reports.

Further investigation revealed that when departments cancel instead of liquidate open purchase orders, the *Original Amount* issued reverts to zero. In addition, the *Outstanding Amount*, which represents the unspent balance on the open purchase order, changes to the negative value of the amount previously spent on the open purchase order. This is illustrated in the following example.

TABLE IX

APPROVED OPEN PURCHASE ORDER LISTING REPORT

	Approved Open Purchase Order Listing Report	
	Original Amount	Outstanding Amount
Before Department Cancellation	\$35,600	\$ 4,015
After Department Cancellation	- 0 -	\$<31,585>

Because there is no documentation to explain the change in numbers, it is easy to misinterpret the amounts shown on the *Approved Open Purchase Order Listing Report*. Furthermore, the change in numbers is misleading and makes year to year comparisons difficult or even meaningless. Our review revealed that this change in numbers does not occur when a department liquidates the balance on the open purchase order. According to the Deputy Director of Finance, they have repeatedly instructed departments to automatically liquidate open purchase orders by "flagging" the last invoice as a "final payment" in the FMS. However, according to the Procurement Manager, it is often difficult for departments' accounts payable staff to determine which invoice received represents the final payment.

It is much easier for the user of an open purchase order to identify the final payment. In our opinion, Purchasing and Finance should instruct those users of open purchase orders who review and approve vendor invoices to indicate "final payment", on the final invoice or a receiving document.

We recommend that Purchasing and Finance instruct those users of open purchase orders who review and approve vendor invoices to indicate "final payment" on the final invoice or receiving document.

The FMS Does Not Produce Open Purchase Order Management Reports On Minority And Women Business Enterprises (M/WBE) Purchases, Recycled Products, Multi-Year Contracts, Goods Versus Services And Lost Payment Discounts

The FMS does not produce open purchase order management reports on M/WBE purchases, recycled products, multi-year contracts, goods versus services and lost payment discounts. As a result, Purchasing lacks adequate information on key program elements.

During our audit, we met with Purchasing and IT officials to discuss this problem. The meeting's participants agreed that the new FMS Purchasing upgrade (see page 90) should allow the FMS to report on these program elements. This upgrade will provide Purchasing with 17 reference tables which should facilitate management reporting. IT can assign certain types of information to these tables which will allow the FMS users to access specific information. For example, IT can assign a reference table to M/WBEs. When processing an open purchase order related to a M/WBE, Purchasing can code it as such. If the upgrade comes with reports that access the tables, Purchasing should be able to run a report which shows the number of M/WBE vendors with which the City deals. The FMS Administrator indicated that he will verify whether the upgrade comes with reports that access the tables. The Purchasing Manager noted that Purchasing is considering assigning tables for recycled products, multi-year contracts, services versus products and M/WBEs. According to the Purchasing Manager, this upgrade is free and available for installation. However, because of the amount of time needed for testing, IT will evaluate installation of the upgrade.

We recommend that the Department of Information Technology evaluate upgrading the FMS purchasing module to improve the module's management reporting capability.

*The FMS Does Not Produce Open Purchase Order
Management Reports By City Department*

We surveyed the eight City departments with over one million dollars in open purchase orders. We found that in addition to processing open purchase orders in the FMS, each department must maintain their own manual list or database of open purchase order records in order to monitor their open purchase order balances. This duplication of effort is required because the FMS does not produce open purchase order reports sorted by department.

If the FMS could produce accurate open purchase order information, by department, in a timely and consistent manner, this duplication of effort could be eliminated. We met with Purchasing and IT officials to discuss solutions to this problem. According to the FMS Administrator, departmental codes are not entered into the system; therefore, it is impossible to create a report that would sort open purchase orders by department. All participants at our meeting agreed that Purchasing buyers could input a department code at the time they process open purchase orders and IT could write a report which would extract open purchase order information by department based on that code. In addition, allowing departments to access such a report would eliminate the duplication of departmental effort noted above.

We recommend that Purchasing (1) input department codes at the time it processes an open purchase order and (2) that the Department of Information Technology program the FMS to generate a report that extracts open purchase order information by department and allow departments to have access to such reports.

*City Departments Perceive The FMS As Not Being User Friendly
And Unresponsive To Their Processing And Information Needs*

We surveyed eight City departments and found that departments perceive the FMS as not being user friendly. Survey respondents noted that the FMS is cumbersome with which to work and requires the users to have an extensive knowledge of the FMS in order to use it effectively. Respondents also felt that an information system should provide easier access to data. Our own experience with the FMS supports these statements. For example, as part of our audit testwork, we reviewed vendor invoices for the open purchase orders we selected for testing. Finance files paid invoices by check date. In order for us to obtain a check date in the FMS, we had to input the invoice number and the vendor number for each invoice we reviewed. As a result, we had to maneuver through four FMS screens to obtain the vendor number, three FMS screens to obtain the invoice number, and six more FMS screens just to obtain the check date--a total of 13 or more different FMS screens.

A department also noted frustration when a vendor claimed that the City had not paid an invoice from two years ago. When the department researched this invoice, it found that it did not have enough information to access the FMS screens that contained the information necessary to resolve the issue. The department took two weeks to finally find the necessary information in the FMS.

All of the departments we surveyed also noted that the FMS frequently goes down and when that happens, they cannot gain access to the FMS information. Departments reported that, in addition to the scheduled down-times for payments and the monthly closing, they often cannot log onto the FMS. When this occurs, all processing stops. We noted similar problems while performing our testwork.

According to the FMS Administrator, the FMS is rarely down and what appears to be the FMS problems are actually Local Area Network (LAN) problems. For instance, although departments frequently complain about not being able to log on to the FMS, the problem is usually with the department's LAN. According to the FMS Administrator, the FMS vendor provides a technical support hotline to field questions and assist users, such as the City. However, the FMS vendor is so busy that it takes months for them to return a user's call. He added that the FMS vendor is a very small company and must prioritize requests for help. The FMS administrator acknowledged that we pay the FMS vendor \$15,000 to \$20,000 per year for user support, an amount that the FMS administrator feels is extremely reasonable.

Our departmental survey revealed that departments have two main concerns regarding IT's FMS technical support:

- when a problem or a question arises, only the FMS administrator can solve the problem. If he is not available, users must wait until he is available.
- no other IT employee is sufficiently trained to perform the FMS administrator duties.

According to the FMS Administrator, there are two other employees that can handle approximately 95 percent of any FMS problems. Further, if for some reason he cannot perform his job, the City can hire the FMS vendor as a consultant. Also, it would be difficult to find another IT employee to cross-train because his position requires expertise in both systems and accounting.

IT noted that although the FMS is not user friendly, the problems we identified could be lessened with more training. According to the FMS

Administrator, IT has not held FMS training classes in several years due to a lack of funding. As a result, most users are not well trained on the FMS. The FMS Administrator believes that if users knew how to use the system properly, fewer problems would occur. In our opinion, the FMS Administrator and Purchasing should hold periodic (at least annually) FMS training classes for department Network Coordinators and the FMS users to attend.

We recommend that the Department of Information Technology and Purchasing train City department personnel who enter, retrieve or process the FMS open purchase order information.

Purchasing's Ability To Manage The Open Purchase Order Process Is Impaired

Purchasing's ability to manage the open purchase order process is impaired because the FMS does not produce reliable management information. As a result, it lacks objective information to monitor, evaluate, and, if necessary, adjust its performance. According to the Procurement Manager, Purchasing used to have performance objectives but these objectives were eliminated when the FMS was installed. The Procurement Manager is in the process of trying to establish some of the performance objectives that the International City Managers' Association recommended for turnaround time.

City Departments Spend Unnecessary Time On Open Purchase Order Activities

City departments and Purchasing staff waste significant amounts of time because:

- all eight departments with open purchase orders in excess of \$1 million, duplicate information which is on the FMS but cannot be extracted in the format departmental management and staff require;
- department staff must correct errors such as unliquidated encumbrance system errors; and
- FMS is not user friendly causing lengthy research time.

Also, as noted in Finding I, buyers perform several FMS required tasks that do not add value to the open purchase order process and are unnecessary and wasteful. Furthermore, our review revealed FMS creates unnecessary work because processing is tedious, cumbersome and prone to error.² The following highlights the inefficient portions of the FMS process:

- buyers create open purchase orders from the information contained in the purchase requisitions. The FMS does not allow users to modify this information. Therefore, in order to change the open purchase order information in the FMS, the buyer must re-enter the entire requisition;
- the New Activity report, detailing all the new purchase requisitions departments forward to Purchasing, does not distinguish between next year's requests and current year requests;
- users frequently enter dollar amounts into the FMS in the wrong place because the FMS requires departments to enter the dollar and quantity in opposite places for line item purchase orders versus open purchase orders;
- the FMS requires items to be "received" in the system before vendor payments can be processed. This must be changed in order to allow periodic payments to open purchase order vendors;

² Appendix D describes the open purchase order issuance process.

- Finance cannot process an entire batch of vendor payments if only one item in the entire batch does not have the required budget amount; and
- the FMS sequentially assigns open purchase order numbers at the time an open purchase order is created. Therefore, if a buyer creates a service open purchase order at the same time another buyer creates a product open purchase order, the FMS assigned numbers would be sequential. To print the open purchase orders, FMS requires the users to set a range. This results in inefficient printing of open purchase orders because the system does not allow the user to print products and services in the same range.

While performing testwork on the invoice review and approval process, we noted that FMS can track purchase discounts. However, because departments usually only input net amounts into the FMS, instead of the gross or discount amounts, purchase discounts taken or lost cannot be FMS generated. Further, according to the FMS Administrator even if departments entered purchase discount information into the system, he is not certain if FMS can track lost discounts information. In our opinion, the FMS Administrator should evaluate programming FMS to generate a report which details purchase discount information. In addition, upon generating such a report, City departments should input purchase discount information into the FMS.

We recommend that the Department of Information Technology evaluate programming the FMS to generate a report which details purchase discount information. Finally, we recommend that City departments input purchase discount information into the FMS subject to the Department of Information Technology successfully programming the FMS to generate purchase discount reports.

CONCLUSION

An organization's computerized management information system should provide management and system users with reliable information to perform daily operations and assess organizational performance. Although the FMS has been improved and upgraded since it was installed in 1989, it does not reflect current technological efficiencies. As a result, management information is inadequate and departments' ability to manage the open purchase order process is impaired. In our opinion, Purchasing should (1) input City department codes into the FMS and (2) instruct those users of open purchase orders who review and approve vendor invoices to indicate "final payment" on the final invoice or receiving document. Further, IT should (1) evaluate upgrading the FMS purchasing module, (2) program the FMS to generate a report that extracts open purchase orders by department, (3) allow departments to have access to such reports, and (4) evaluate programming the FMS to generate a report which details purchase discount information. In addition, Purchasing and IT should train City department personnel who enter, retrieve, or process the FMS open purchase order information. Finally, City departments should input purchase discount information into the FMS subject to IT successfully programming the FMS to generate purchase discount reports.

RECOMMENDATIONS

We recommend that Purchasing and Finance:

Recommendation #22:

Instruct those users of open purchase orders who review and approve vendor invoices to indicate "final payment" on the final invoice or receiving document.

(Priority 3)

Also, we recommend that the Department of Information Technology:

Recommendation #23:

Evaluate upgrading the FMS purchasing module to improve the module's management reporting capability. (Priority 3)

Recommendation #24:

Upon implementation of Recommendation #26, program the FMS to generate a report that extracts open purchase order information by department and allow departments to have access to such reports. (Priority 3)

Recommendation #25:

Evaluate programming the FMS to generate a report which details purchase discount information. (Priority 3)

In addition, we recommend Purchasing:

Recommendation #26:

Input department codes at the time it processes an open purchase order.
(Priority 3)

Further, we recommend that Purchasing and the Department of Information Technology:

Recommendation #27:

Train City department personnel who enter, retrieve or process the FMS open purchase order information. (Priority 3)

Finally, we recommend that City departments:

Recommendation #28:

Input purchase discount information into the FMS subject to the Department of Information Technology successfully programming the FMS to generate purchase discount reports. (Priority 3)

RECEIVED

DEC 06 1996

CITY AUDITOR


CITY OF SAN JOSE - MEMORANDUM

TO: Gerald A. Silva
City Auditor

FROM: Ellis Jones, Jr.
Director of General
Services

RE: Response to "An Audit of the
City of San Jose's Open Purchase
Order Process"

DATE: December 5, 1996

APPROVED: 

DATE: 12/6/96

The General Services Department has reviewed the *Audit of the City of San Jose's Open Purchase Order Process*. The Department is generally in agreement with the findings and recommendations in the audit. Specific comments to selected recommendations for which the General Services Department/Purchasing Division has direct responsibility are provided below.

Before providing specific comments to the recommendations, the Administration would like to point out while recommendation #9, issuing multi-year open purchase orders, should provide reductions in workload for the Purchasing Division, many of the recommendations are additions to workload. These additional controls, such as documenting the reasons for the amount of each petroleum open purchase order, the Department agrees are good actions to take, however, these steps will add to the buyer's workload. The Department believes these additional steps should be evaluated as to whether the risk involved merits the additional administrative cost. As each recommendation is being implemented, if staff finds that the resources required does not merit benefits received, staff will work with the Auditor's Office on the resolution.

Since 1991, the Division has undergone much change and numerous reductions in staff. The Division has initiated several continuous improvement projects with the objective of streamlining operations in an effort to respond to the downsizing occurring in the Division. These efforts have resulted in several improvements, such as the increase in the quote limit for approval authority and the credit card program. These programs target repetitive, small dollar purchases that took as much time to process as a much larger dollar purchase. The Division determined that streamlining these processes made sense given the time and resources involved in processing them and that the buyer's expertise is much more valuable in providing savings to the City in the larger dollar purchases. This is also the

reason the buyers spend more time processing the larger open purchase orders and subjecting them to competitive requirements.

As the audit report indicates, the findings of noncompliance with the Municipal Code or policy requirements are a result of a constricted time frame for processing the open purchase orders. The Department does believe that the implementation of multi-year open purchase orders, coupled with City-wide implementation of the credit card program, will provide relief to this problem by reducing the volume of open purchase orders processed.

It is important to note that many of the recommendations relate to documenting processes or procedures that Purchasing staff are already currently performing. For this reason, most of the recommendations in this audit are Priority 3 recommendations which are designated as the lowest risk to the City. Specific comments to selected recommendations for which the Purchasing Division has direct responsibility are provided below.

Recommendation #3

Request the City Council to authorize the Director of General Services to adjust the amount of approved open purchase orders for petroleum purchases to ensure that the City purchases petroleum from the lowest weekly quoted vendor.

Response

The department agrees with this recommendation. A memorandum requesting authority for the Director of General Services to adjust the amount of open purchase orders for petroleum will be sent to Council in January, 1997.

Recommendation #4

Annually perform a competitive selection of temporary service agencies for frequently used position classifications.

Response

The Purchasing Division currently performs a competitive process for each new request for temporary help. This recommendation would result in one or two City-wide open purchase orders for temporary services for classifications that are frequently used.

Recommendation #9

Develop and implement policies and procedures regarding the issuance of multi-year open purchase orders and analyze commodities and services to determine:

Open Purchase Order Audit

December 6, 1996

Page 3

- *open purchase orders that can be set up on a multi-year basis, subject to annual City Council appropriation; and*
- *the frequency with which commodities and services should be bid or quoted.*

Response

This recommendation will greatly reduce the amount of time buyers spend processing paperwork for multi-year contracts. It is Purchasing's intent to implement this recommendation for the 1997-98 fiscal year.

Recommendation #12

That the General Services Purchasing Division, Public Works, and the City Attorney's Office: Work together to clarify the distinction between public works projects and general services.

Response

The definition of a public works contract to a general service has always had a degree of overlap. It is not possible, or desirable, to have a complete separation of the two processes to project type. General Services will work with the City Attorney's Office and the Department of Public Works to formalize a process to determine projects that will be handled by one process or the other on a case by case basis.

Recommendation #13

Document that the use of specific cooperative agreement(s) provide the City with the best value and consider competitively bidding several computer open purchase orders and/or using cooperative purchasing agreements.

Response

The General Services Department/Purchasing Division has been verifying that cooperative agreements provide the best value for the City. For example, in December 1994, Purchasing chose to bid police cars to compare the price with the State bid. It was determined that a local vendor was the low bidder at a price lower than the State in that particular case, resulting in a purchase exceeding one million dollars being made from a local Chevrolet Dealer. Cost comparisons have been conducted for computer equipment. When local vendors do not provide true costs, prices with State bids and other government contracts are used.

Purchasing has just issued purchase orders to two vendors to provide departments an option for their computer equipment requirements. This bid was proceeding independently of the audit and satisfies the second part of the recommendation.

Recommendation #14

When appropriate, combine multiple open purchase order dollar amounts to the same vendor for the same commodity or service to determine City Council approval or reporting requirements.

Response

The General Services Department/Purchasing Division has been combining multiple open purchase order dollar amounts to the same vendor for appropriate approval and reporting requirements whenever possible. Combining multiple open purchase order dollar amounts to the same vendors can occur when requests are received at the same time.

Recommendation #20

When appropriate, reduce the volume of invoices sent to the City by requiring vendors to submit summary invoices.

Response

Based on a continuous improvement team in 1993, the General Service Department has implemented summary billing. At that time, an employee team determined that open purchase orders that had numerous invoices each month would be targeted for summary invoicing. In 1994-95, Purchasing required vendors to submit summary invoicing once a month. In the 1997-98 open purchase order process all vendors will be required to submit summary invoicing when appropriate.

General Services Department/Purchasing Division would like to thank the Auditor's Office for their time and effort in performing this audit. The department expects significant changes in the open purchase order process in the 1997-98 processing period as a result of the various department streamlining efforts, as well as, the recommendations included in this report such as Recommendation #9 which would allow for processing multi-year open purchase orders.



Ellis M. Jones, Jr.
Director of General Services

CITY OF SAN JOSE - MEMORANDUM

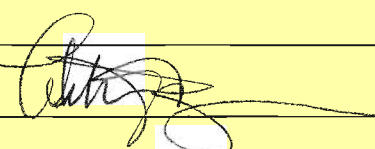
TO: Gerald A. Silva
City Auditor

FROM: Nona Tobin
Human Resources
Director

RE: Response to "An Audit of the
City of San Jose's Open Purchase
Order Process"

DATE: December 4, 1996

APPROVED:



DATE:

12/5/96

The Human Resources Department agrees with Recommendation #10 *Develop a temporary employee policy for City Council approval in conjunction with the New Realities Task Force recommendation on Civil Service Reform.* The Department is in the process of implementing the recommendation through the New Realities Task Force team on Civil Service Reform.



Nona Tobin
Director of Human Resources

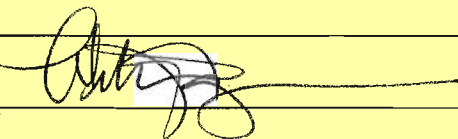
CITY OF SAN JOSE - MEMORANDUM

TO: Gerald A. Silva
City Auditor

FROM: John Guthrie
Director of Finance

RE: Response to "An Audit of the
City of San Jose's Open Purchase
Order Process"

DATE: December 5, 1996

APPROVED: 

DATE: 12/6/96

The Department of Finance has reviewed *the Audit of the City of San Jose's Open Purchase Order Process*. The Department agrees with most of the recommendations contained in the audit report. The Department has some disagreement with Recommendation #19 and will explain the specific issue below. Specific comments to the recommendations for which the Finance Department has direct responsibility are provided below.

Recommendation #8

Coordinate with Finance and Information Technology to facilitate departments entering encumbrance adjustments into the FMS.

Response:

The Department agrees that the departments should enter encumbrance adjustments into FMS. The Department will coordinate with the General Services Department to facilitate implementation.

Recommendation #19

Develop and implement invoice review and approval procedures to be included in the City Administrative Manual. The procedures should provide that:

- *goods or services were authorized under the open purchase order;*
- *goods or services were received;*
- *on open purchase orders over \$5,000, invoiced quantities, prices/rates and terms are in accordance with the terms of the open purchase order;*
- *invoices are mathematically correct;*
- *departments receive the pricing and rate documentation necessary to properly review invoices; and*
- *receiving documents are forwarded to accounting units to match to the invoices.*

Response

The Department disagrees with where the procedures should be located. The Department believes that the Finance Administrative Manual is the appropriate manual in which to place invoice review and approval procedures since the purpose of the manual is to provide detailed guidelines for departments to follow in relation to review, approval and payment of invoices. The City Administrative Manual contains City policies rather than detailed procedures.

Recommendation #21

Finalize revisions to the Finance Administrative Manual Accounts Payable Section.

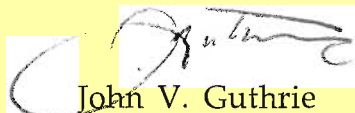
Response

The Department agrees that revisions to the Finance Administrative Manual Accounts Payable Section should be finalized. The procedures contained in the Finance Administrative Manual have been under review by staff and revisions are currently being made. We expect the process to be completed by June 30, 1997 at which time updated manuals will be distributed to the departments.

Recommendation #28

To all City Departments: Input purchase discount information into the FMS.

The Department agrees conceptually with this recommendation and will evaluate it's feasibility. Implementation is contingent upon the capabilities of FMS and our ability to develop procedures that would permit capturing of all discount information in a cost effective manner while maintaining the integrity of accounts payable information.


John V. Guthrie
Director of Finance

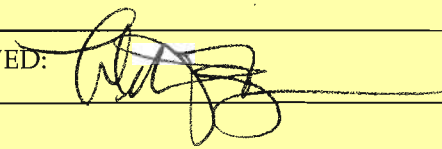
CITY OF SAN JOSE - MEMORANDUM

TO: Gerald A. Silva
City Auditor

FROM: Ellis Jones
Acting Director
Information Technology

RE: Response to "An Audit of the
City of San Jose's Open Purchase
Order Process"

DATE: December 4, 1996

APPROVED: 

DATE: 12/6/96

The Department of Information Technology has reviewed the *Audit of the City of San Jose's Open Purchase Order Process*. The Department is generally in agreement with the findings of the audit and provide the following general comment and specific responses to the recommendations in regard to the audit.

The Department of Information Technology is responsible for installing software releases and upgrades supplied by the FMS vendor, providing help-desk type information to the user community, acting as liaison between the City of an Jose and the FMS vendor, providing additional systems and programming expertise to help solve the City's informational needs in relation to the FMS system as well as operate the FMS System. The Department of Information Technology does not have access to the source code which comprises the FMS system and therefore cannot alter the FMS software or the data elements which are stored by the FMS.

It is important to note that the information stored by the FMS and the resulting reports created by the FMS materially fulfill the requirements set forth in the Request for Proposal for a computerized financial system issued by the City in 1988. The City's current requirements for information should not be the basis on which to evaluate the merits or usability of the technology or the comprehensiveness of a system which was selected more than eight years ago by a committee made up of users from nearly every City department.

Most of these recommendations (#23, 24, 25) will require additional time and resources to implement and since Information Technology has limited staff time, additional funding may be required. As each recommendation is being implemented, if staff finds the resources required does not merit pursuing the

recommended action, the Auditor's Office will be consulted on the resolution.

Recommendation #8

General Services Department/Purchasing Division: Coordinate with Finance and Information Technology to facilitate departments entering encumbrance adjustments into the FMS.

Response:

The Department of Information Technology will coordinate with the Purchasing Division and Finance to facilitate departments entering encumbrance adjustments into the FMS.

Recommendation #23

Evaluate upgrading the FMS Purchasing module to improve the module's management reporting capability.

Response

The Department agrees that an evaluation of the management reporting of the FMS Purchasing module is desirable. The Department will work with the Purchasing Division and with user departments to define the management reporting requirements and request a quote from the FMS vendor for reporting which cannot be accomplished using current City staff.

Recommendation #24

Upon completion of Recommendation #26, program the FMS to generate a report that extracts open purchase order information by department and allows departments to access this report.

Response

The Department will create a program outside of the FMS to generate a report which extracts and prints open purchase order information by department. The report will include open purchase orders which have the department designation entered for the open purchase order. The timing of the creation of the program will be dependent upon the availability of City FMS staff.

Recommendation #25

Program the FMS to generate a report which details purchase discount information.

Response

The Department of Information Technology will work with the Purchasing, Finance and user departments to design a report to be generated which includes the details of purchase discount information which has been entered

Open Purchase Order Audit

December 6, 1996

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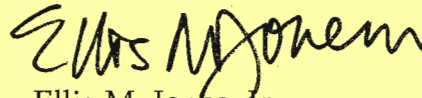
by the departments and which can be stored by the FMS for open purchase orders.

Recommendation #27

Train City department personnel who enter, retrieve or process the FMS open purchase order information.

Response

The Department of Information Technology will work with the Purchasing Division to train City department personnel who enter, retrieve or process the FMS open purchase order information, dependent upon the availability of City FMS staff.



Ellis M. Jones, Jr.

Acting Director

Information Technology Department

APPENDIX A

DEFINITIONS OF PRIORITY 1, 2, AND 3 AUDIT RECOMMENDATIONS

The City of San Jose's City Administration Manual (CAM) defines the classification scheme applicable to audit recommendations and the appropriate corrective actions as follows:

Priority Class ¹	Description	Implementation Category	Implementation Action ³
1	Fraud or serious violations are being committed, significant fiscal or equivalent non-fiscal losses are occurring. ²	Priority	Immediate
2	A potential for incurring significant fiscal or equivalent fiscal or equivalent non-fiscal losses exists. ²	Priority	Within 60 days
3	Operation or administrative process will be improved.	General	60 days to one year

¹ The City Auditor is responsible for assigning audit recommendation priority class numbers. A recommendation which clearly fits the description for more than one priority class shall be assigned the higher number. (CAM 196.4)

² For an audit recommendation to be considered related to a significant fiscal loss, it will usually be necessary for an actual loss of \$25,000 or more to be involved or for a potential loss (including unrealized revenue increases) of \$50,000 to be involved. Equivalent non-fiscal losses would include, but not be limited to, omission or commission of acts by or on behalf of the City which would be likely to expose the City to adverse criticism in the eyes of its citizens. (CAM 196.4)

³ The implementation time frame indicated for each priority class is intended as a guideline for establishing implementation target dates. While prioritizing recommendations is the responsibility of the City Auditor, determining implementation dates is the responsibility of the City Administration. (CAM 196.4)

APPENDIX B

CITY OF SAN JOSE - MEMORANDUM

TO: Gerald Silva, Auditor

FROM: Ellis M. Jones, Jr.

SUBJECT: ACCOMPLISHMENTS FOR PURCHASING

DATE: April 15, 1996

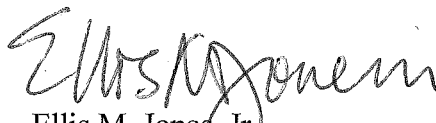
APPROVED:

DATE:

The purpose of this memorandum is to respond to your request for program accomplishments for Purchasing. Purchasing has achieved the following:

- Developed a credit card program for small dollar purchases. The program has been in use on a pilot basis for 6 months and has proven to be very successful. Citywide implementation is imminent.
- Established Citywide contracts for office supplies and computers. This has greatly reduced delivery times and Information Systems Department's workload. It addressed a former audit recommendation.
- Increased quote limit to \$5,000 and obtained administrative approval authority toward purchases up to \$75,000. This accomplishment has decreased the turnaround time on purchases significantly.
- Developed and implemented a bid hot line for all purchases over \$20,000. Recently increased the input to all City contracts where a competitive process occurs for award. This is the first time there has been a centralized data base of City contract opportunities for potential bidders.
- Developed an aggressive outreach for small, minority businesses. Have developed presentations on how to do business with the City, revised our vendor brochure and attend various minority business shows to discuss doing business with the City.
- Developed a Request for Proposal Manual for use Citywide.
- Developed a Specification Writing Handbook for use Citywide.

The above are major accomplishments for the Purchasing Division. If you have any questions, please call Carol Reed at ext. 4510.


Ellis M. Jones, Jr.
Director of General Services

APPENDIX C

OPEN PURCHASE ORDER SURVEYS OF OTHER JURISDICTIONS
 COMPARED TO SAN JOSE

	CITY							
	San Jose	Portland	Seattle	Phoenix	San Diego	Sacramento	Oakland	San Francisco
Approximate Amount Of Opens	\$40,000,000	\$21,000,000	\$53,000,000	n/a	\$30,000,000	n/a	\$16,000,000	n/a
Approximate Number Of Opens	2,000	200	n/a	n/a	n/a	n/a	n/a	n/a
Workload Information	Most processed by 8-11 buyers within a two month period	One buyer processes all renewals throughout the year. Workload is reduced due to the fact that most opens are City-wide and are multi-year.	Processed throughout the year and usually multi-year. Vendors allowed to request price increases once per year.	Processed throughout the year and usually multi-year. Vendors allowed to request price increases as necessary	Renewals not restricted to specific time of the year.	Renew annual open purchase orders on July 1.	Annual Renewals are staggered	Renewed annually at July 1.
Multi-year Opens	Yes. However, most are set up with an option for annual renewal and the open purchase order paperwork needs to be processed annually.	Yes.	Yes	Yes	No	No	No	No
Departmental Purchasing Authority 1	\$1,000	\$5,000	\$1,000	\$500	\$5,000	\$2,000	\$2,500	\$5,000
Petty Cash Limit	\$200	\$100	\$50	\$100	\$200	\$50	\$150	None. Revolving Account Limit \$200.
Performance Objectives	No	Cost to procure a dollar, and transactions per year or per month.	No	Yes, cycle times.	Monitor time it takes to process a transaction.	No	No	No
Procurement Card Program	General services has completed a pilot program and is ready to implement in City departments.	No, looking into the State's program.	No. However, they are considering a program.	No	Are beginning to pilot a program.	Yes. Ready to be implemented.	No	No

1 Other jurisdictions have decentralized departmental purchasing authority for standard purchase orders. The departmental purchasing authority limit amounts range from \$500 to \$5,000. Required quotations from vendors range from none to three. San Jose's authority is limited to credit card purchases.

APPENDIX D

THE OPEN PURCHASE ORDER PROCESS

Department

The department enters and approves a requisition in FMS. Purchasing directs all departments to enter complete requisitions including the description/directions/approvals on the face of the open purchase order--all this information can be obtained from the prior year's open purchase order. FMS then produces an approval register which should be routed for proper approvals. The requisition is electronically forwarded to Purchasing.

Purchasing/Buyers

Each morning, FMS produces a New Activity Report, which includes the previous day's approved requisitions. This report does not distinguish between requests for the new year versus current year requests. The buyers print each requisition and pull the previous year's open purchase order to review backup documentation and to determine which ones (1) are continuations (i.e., multi-year) and (2) require quotes, formal bids, etc. If insurance is required, the buyer must send a notice to risk management and get clearance (this must be done even on continuations, since a new open purchase order is being issued). This may require a letter to the vendor. Once the open has been determined to be a continuation, approvals must be obtained. The approval process varies based on the dollar amount of the requisition if the open is:

- \$20K or under, no approvals are necessary at this point;
- between \$20K and \$75K, the buyer prepares the Approval of Awards Under \$75K Form and forwards to the Procurement Manager for approval at the Monday General Services meeting; and

- over \$75K, the requisition is forwarded to the Staff Analyst who puts the request on the Council Agenda. (The City Attorney's office will not allow processing until the last Council meeting in June).

Once approvals have been obtained, the buyer can now enter FMS and create a batch. To create the open purchase order, the buyer creates the open purchase order number and transfers the requisition information to the open purchase order. The buyer also (1) inputs/assigns the vendor number, (2) inputs shipping information, (3) provides vendor contact information, (4) insures dollars are entered correctly by the department (the dollar amount is often entered in the wrong place because FMS has the department enter the dollar and unit in opposite places for line item purchase orders and open purchase orders), (5) checks tax code, (6) changes Receipt at invoice field (FMS requires items to be "received" in the system before the payment to the vendor can be processed. The Receipt at invoice field must be changed on open purchase order entries to allow for payments to be made periodically), and (7) reviews the description for propriety. FMS does not allow editing of information transferred from the requisition. Therefore, if the department did not enter a complete description including instructions (who can use, what open can be used for), which need to be on the face of the open purchase order, the buyer has to re-enter the entire description. If the visible code has been closed or the department has input an invalid visible code on the requisition, this must be investigated before the buyer can proceed with the batch.

Once the batch is complete (usually ten POs to a batch), the buyer runs and prints the batch edit list and forwards it to the Purchasing Manager. The Purchasing Manager must then check each batch for budget. Finance must enter the proposed budget for every fund that is requested to be used in the batch of opens. If Finance has not entered the entire budget, and one item in the batch does not have the required budget amount, the entire batch cannot be processed.

Finance cannot simply log onto FMS and enter the budget. To enter, the budget requires a bud-link, which only occurs periodically. As a result, the budget is not always entered in a timely manner.

After the Procurement Manager approves the batch, it is forwarded to Word Processing to print. Open purchase orders for products and services must be printed on different forms. To print in FMS, Purchasing must set a range of open purchase order numbers. Often Purchasing ends up printing the opens one at a time since the open purchase order number was assigned by the system sequentially at the time the open was created. Therefore, if a buyer created a service open purchase order at the same time another buyer created a product open purchase order, the numbers would probably be sequential and the print range would have to consist of the one product open number. After the product open was printed, the range would be set with the service order number and that open would be printed.

After the opens are printed, they must be separated (4-part form) and all the back up is attached to the goldenrod copy (Purchasing's copy). All copies are then forwarded to the Purchasing Manager for approval and signature. After approval, all copies are sent back to the buyer for review. The buyer then forwards all copies to the Word Processor for distribution (one copy is filed at Purchasing, one copy to Finance, Department, and vendor). All originals are then folded, placed in envelopes and mailed to the vendors.