

APPENDIX 1

PROCESS FOR NON-COMPETITIVE PROCUREMENT (SOLE SOURCING) NEEDS IMPROVEMENT

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Auditor General's Office

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EXECUTIVE SUMMARY

In certain circumstances, the City allows sole sourcing or non-competitive procurement

To achieve best value, fairness and transparency, the City undertakes a competitive procurement process for most goods and services that is open to all interested vendors. However, in certain circumstances the Chief Purchasing Official is authorized to enter into a commitment without a competitive process in accordance with the conditions outlined in the Purchasing By-law. This type of non competitive procurement, referred to as sole sourcing, is permitted for operational reasons such as in an emergency or where no alternative vendor exists.

Review objective

The overall objective of this review was to determine whether sole source contracts complied with the City's Municipal Code and purchasing policies and procedures.

This review addresses reporting and monitoring of sole sourcing, whether individual sole source purchases are justified, follow purchasing rules and whether the City is receiving the best price possible.

PMMD is not responsible for reviewing all sole source purchases prior to approval

Sole source purchases are approved through three different processes. Purchases under the divisional purchase order (DPO) limit are approved by the divisions. This amount has recently been increased to \$50,000 from \$7,500. Purchases above the DPO limit up to \$500,000 are generally approved by the Purchasing and Materials Management Division (PMMD). Finally, purchases above \$500,000 (or less if the appropriate division wishes) are submitted directly to Standing Committee and Council for approval. PMMD's review process is only applied to those sole source purchases approved by PMMD.

Generally, we found that staff in PMMD appropriately review sole source purchase requests from City divisions prior to approval.

Opportunities for improvement in sole sourcing

During the course of our review, we identified opportunities for improvement in reporting and processing sole source purchases. In summary, the significant findings were

Council is not aware of the total amount of sole sourcing

- The 2008 annual sole source report to the Government Management Committee includes only sole source purchases approved by PMMD and does not include sole source purchases approved by Standing Committee and Council and purchases less than \$50,000 which are approved at the divisional level.
- Purchasing rules are not always followed for sole source purchases made by divisions. For example, City divisions on occasions conduct informal bidding and engage vendors to perform work before obtaining appropriate approvals.
- Long-term contractual arrangements with certain consultants require evaluation. Certain of these contracts may in fact be employer/employee relationships as defined by the Canada Revenue Agency. If in fact such a relationship exists, there is a risk to the City that Canada Revenue Agency may require the City to remit statutory deductions normally deducted from employees' gross pay plus penalty and interest charges. There is also the possibility that if the consultant is deficient in remitting income tax the City would be responsible for this amount.

Conclusion

In our view, the implementation of the recommendations contained in this report will ensure that all sole source purchases are reported accurately to Council, facilitate compliance with purchasing rules and generate cost savings by minimizing non competitive procurement.

BACKGROUND

For operational reasons, some purchases are sourced to a specific vendor without competition

Sole source purchases are non-competitive procurements. Sole source procurement of goods or services occurs when one party enters into an agreement with another without a tender call, request for proposal or obtaining competitive quotes. In certain circumstances, there are valid operational reasons to sole source purchases such as emergency response, equipment compatibility, proprietary or situations where only one vendor can meet the City's timelines.

Except for emergencies, prior approval is required for sole source purchases

City policy requires that sole source procurement be used only under specific circumstances and must be, with the exception of emergencies, pre-approved prior to initiating work. Approvals are to be obtained by

- Presenting a report to a Standing Committee and Council – required for purchases greater than \$500,000
- Submitting a Sole Source Request form to PMMD – for purchase orders or blanket contracts greater than \$50,000 (previously \$7,500), or
- Approval from within a division for sole source divisional purchase orders.

In addition, the City’s Financial Control By-law outlines certain purchases, such as utilities, TTC tokens, property taxes, postage, membership fees, etc., that can be processed without a purchase order or sole source request form.

Annual report on sole source purchases

At the request of Council, PMMD submits an annual report to Government Management Committee on sole source purchases.

Approximately 6 per cent of purchases are sole sourced

In 2008, the City incurred approximately \$39 million on sole source purchases processed through PMMD. The divisions through the DPO process incurred sole sources purchases of \$13 million. In addition, PMMD estimates \$73 million in sole source purchases were approved directly by Standing Committees and Council. Thus the total value of sole source purchases were in the range of \$125 million representing approximately 6 per cent of annual City purchases.

AUDIT OBJECTIVES, SCOPE AND METHODOLOGY

In view of the significant funds expended on sole source contracts, a review of sole source activities was included in the Auditor General’s Audit Work Plan.

Audit objective

The overall objective of this audit was to determine if sole source contracts comply with the Municipal Code, purchasing policies and guidelines.

Specific audit objectives

The specific audit objectives are to determine if there is adequate and accurate documentation

- To support decisions to sole source purchases
- To demonstrate that the City is receiving the best price possible
- To enable staff to identify, track and report out on sole source contracts within the City

Scope of Review

This review covered sole source contracts requested, awarded or amended between January 1, 2008 and December 31, 2008. Sole source contracts for the purposes of this review included

- Purchase orders
- Blanket contracts
- Sole source purchases approved by Standing Committee and Council.

In order to ensure that the scope of this work was limited and to ensure that our audit results could be reported on a timely basis, a detailed review of sole source divisional purchase orders was excluded from this audit. In prior years we have conducted a number of divisional reviews which have included an evaluation of the appropriateness of DPO activities. For example, in 2005 we issued a report entitled “Maintenance and Administrative Controls Review – Facilities and Real Estate” which contained the following recommendation

“The Deputy City Manager and Chief Financial Officer take appropriate steps to ensure payments are in compliance with Corporate purchasing policies. In particular:

- (a) discontinue the practice of using Departmental Purchase Orders where the use of a blanket purchase order would be more appropriate;*
- (b) ensure that Departmental Purchase Orders are prepared prior to ordering goods and services;*
- (c) discontinue the practice of splitting Departmental Purchase Orders to keep the purchase amount below the maximum level of \$7,500 or below the \$3,000 limit for three quotes;”*

In addition, in 2007 we issued a report entitled “Toronto Water Division Review of Wastewater Treatment Program – Phase Two” which included further recommendations on the use of DPOs.

We have been advised that the Internal Audit Division within the City Manager’s Office has included in its 2009 work plan a project to “assess management oversight, procedures and training in place for Divisions to mitigate risk at the beginning of the process given increase in DPO limits.”

In view of the above, we have not conducted any further work on divisional DPOs.

***Audit
Methodology***

Our audit methodology included

- review of 35 contract files
- review of related reports and legislation
- examination of documents and records
- interviews with relevant City staff
- other procedures deemed appropriate.

***Reviewed audit
work of other
entities***

We also reviewed related audit work conducted by the following entities

- Auditor General of Canada
- Office of the City Auditor, Edmonton, Alberta
- Audit and Evaluation Division, Statistics Canada
- Internal Audit, Canadian International Development Agency
- Office of the City Auditor, City of San Jose
- Johnson County Auditor, Kansas
- Office of the Inspector General, U.S. Department of Defense.

***Compliance with
generally
accepted
government
auditing
standards***

We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence that provides a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

AUDIT RESULTS

A. SOLE SOURCE REPORTING AND MONITORING CAN BE IMPROVED

A.1. Annual Reports Do Not Include All Sole Source Purchases

Annual reporting of sole source purchases recommended by Auditor General

In a 2003 report entitled, "Procurement Processes Review" the Auditor General recommended that

"The Chief Financial Officer and Treasurer report annually to the Administration Committee outlining, by department:

- All single source purchases exceeding the Departmental Purchase Order limit and reasons therefore;*
- Percentage of purchase orders processed through the Purchasing Division using single source as justification; and*
- All instances where purchase orders have been issued after the fact."*

The intent of this recommendation was to ensure that Council was made aware of the extent of sole source purchases. Further, the public reporting of such purchases would likely provide an incentive for staff to minimize such purchases.

Annual reports exclude significant sole source purchases – DPOs and items reported separately to Committee and Council

In response to the Auditor General's recommendation, PMMD submits an annual report on sole source purchasing activity, including an analysis of reasons, to Government Management Committee and City Council. The latest report submitted was dated March 27, 2009. However, annual reports have always omitted sole source divisional purchase orders. In view of the significant increase in the level of DPO limits from \$7,500 to \$50,000, the reporting of this amount to Government Management Committee should be considered. The report also excludes purchases reported directly to Standing Committee and Council.

2008 report on sole source purchases lacks clarity

The 2008 report on sole source purchases reported that the value of sole source purchases has declined 16 per cent from the previous year. This statement is misleading since the 2007 and 2008 figures are not comparable. Because of the change in the value of the DPO level, the 2007 figures include all sole source purchases between \$7,500 and \$50,000. The 2008 figures include sole source purchases above \$50,000 only.

To improve transparency, full disclosure of sole source purchases is required

In addition, the value of sole source purchases is understated since it does not include the value of sole source purchases approved directly by Standing Committees and Council.

For future reports, we suggest that the annual report to Council include a summary of all sole source purchases.

Recommendation:

- 1. The Treasurer report annually to Government Management Committee a summary of all sole source purchases including divisional purchase orders, as well as sole source purchases reported to the Standing Committees and Council.**

A.2. Recording and Reporting Reasons for Sole Source Purchases

Prior to approval, purchasing staff appropriately review sole source purchases

For purchases approved by PMMD, City Divisions submit a Sole Source Request form that provides the justification for using sole source instead of a competitive procurement process. PMMD staff review sole source purchase requests from City Divisions prior to approval. The review process includes among other things

- a detailed explanation for the sole source purchase
- an assessment that sole sourcing is the correct purchasing method to obtain the needed goods and/or services
- suggestions for other methods to obtain the goods and/or services if sole sourcing is judged not to be the best method
- verification that the price is in accordance with current market conditions and price offered to other customers.

Inappropriate sole source activity is not tracked and reported to divisional senior management

As part of their review, purchasing staff identify and communicate inappropriate purchasing activity related to sole source requests to individual staff in City Divisions. However, problems identified are not tracked and reported to senior management. As a result, performance issues and related training needs of divisional staff may not be addressed.

High value purchases approved by Standing Committee and Council are not assigned a reason code

In order to identify the various reasons for sole sourcing, the financial information system contains 14 different “reason” codes. A reason code is assigned to each sole source purchase approved by PMMD and City Divisions but not for sole source purchases approved by Standing Committee and Council. Thus, it is not possible to easily identify the reasons for all sole source purchases.

Inappropriate use of the sole source process should be reported to senior divisional staff

Recently, PMMD added a number of additional codes to the financial information system in order to reduce the use of the “other” reason code. One of the new reasons is, “work already completed”. Since this is not a valid reason for sole sourcing, use of this code should be periodically reported to Divisional General Managers and continue to be reported in the annual report to Council.

Recommendations:

- 2. The Treasurer require that staff in the Purchasing and Materials Management Division report significant inappropriate sole source activity to senior divisional staff in order to address performance and training issues of divisional staff.**
- 3. The Treasurer require that the reasons for all sole source purchases, including those purchases approved in Standing Committee and Council reports, are recorded in the financial information system on a consistent basis.**

A.3. Sole Source Divisional Purchase Orders

In 2008, the City spent approximately \$13 million on sole source DPOs

In 2008, City Divisions sole sourced approximately \$13 million in purchases using divisional purchase orders. Approving DPOs is solely the responsibility of City Divisions and not PMMD.

New limits for DPOs will require monitoring

In 2008, the limit on divisional purchases was increased from \$7,500 to \$50,000. This increase is being phased in and has already occurred for most City divisions with the rest expected to begin using the new limits and process in 2009. In consultation with the Internal Audit Division of the City Manager's Office, PMMD staff are conducting audits of divisional purchases and reporting findings to senior management. Although initial draft policies and procedures for monitoring and controlling DPOs are being used, as of April 2009, they are still under development and have not yet been issued to divisional staff in final form. In a previous audit of divisional purchase orders by the Auditor General's Office, documentation was not always available to justify sole source purchases.

Recommendation:

- 4. The Treasurer ensure policies and procedures to control and monitor the new \$50,000 limit on divisional purchase orders are finalized and issued to divisional staff as soon as possible. Such procedures should address the justification and documentation requirements for sole source purchases.**

B. DECISION TO SOLE SOURCE IS NOT ALWAYS JUSTIFIED

B.1. Purchasing Rules Were Not Always Followed

Informal bidding occurred prior to sole sourcing

Purchasing rules were not always followed for sole source purchases by divisions. For example, for four sole source contracts we reviewed, City divisions conducted their own informal competitive process, (taking up to four months to complete), prior to requesting to sole source a specific vendor. The reasons given included “emergency” and “time constraint”. An informal bidding process is only allowed for purchases less than \$50,000 using a divisional purchase order. In circumstances where the process took up to four months to complete, it is unlikely that the sole source request was for “time constraint”.

Vendors conduct work prior to obtaining approval for sole sourcing

In non emergency situations, there were instances where goods were received or services rendered prior to obtaining approval for sole sourcing. In five out of 29 non-emergency sole source purchases we reviewed, the vendor began work and invoices were dated prior to the approval of the sole source request. Further, the “work already completed” code in the financial information system included four sole source contracts where invoices were dated prior to issuing a purchase order. Specified emergencies are the only acceptable reason for commencing work before obtaining appropriate approvals.

Sole sourcing of the first phase of a project that should have been competitively bid

We also noticed one instance where a contractor was sole sourced for the first phase of a multi-phase project. Based on our review of the supporting documentation, it appears that the first phase of this particular project could have been the subject of a competitive process. Multi-phased projects are required when, for example, there are options that the City needs help fully exploring before making a final decision on how to proceed. In such cases, the contractor performing the first phase of the project often has a distinct advantage in bidding for subsequent phases of the project. It is also usually advantageous to the City to engage the same contractor given their in depth knowledge of city operations and project specifications. Given this advantage, it is even more important to ensure that the initial project phase uses a competitive purchasing process, whenever possible.

Recommendation:

- 5. The Treasurer ensure that sole source procedures clearly state that solicitation of informal bids is not permitted. Similarly, for non emergency situations, vendors should not start work before purchase orders are approved and wherever possible, the first phase of multi-phased projects should undergo a competitive procurement process.**

B.2. Lack of Proper Planning

Time constraint is the reason for approximately 20 per cent of sole source purchases

In 2008, “time constraint” was the reason for approximately \$10 million of sole source purchases, excluding those approved by Standing Committee and Council. There are instances where City divisions legitimately require sole source purchases due to lack of time. However, inadequate planning can also result in too little time to conduct a competitive procurement process.

Proper planning would reduce the number of sole source purchases

In our view, with adequate planning, at least eight out of 35 sole source purchases we reviewed could have undergone a competitive process.

Treasurer directed divisions to adequately plan procurement processes

The Treasurer, in response to a 2003 audit recommendation has directed divisions to identify their procurement needs, including the volumes of good and services required, specifications and deliverables, and the timing of such requirements. However, in spite of the Treasurer’s directive, our review identified a number of cases where adequate and timely planning continued to be an issue.

Recommendation:

- 6. The Treasurer re-emphasize to divisional management the importance of identifying procurement requirements and ensure that this information is communicated to the Purchasing and Materials Management Division and City Legal on a timely basis. This process would allow for sufficient lead time, such that both the Purchasing and Materials Management Division and City Legal can schedule their respective resources to meet divisional timelines.**

C. USE OF CONSULTANTS

C.1. Risk that Consultants Could be Deemed Employees

City has a financial risk if consultants are deemed employees

The City has a long-term contractual arrangement with certain consultants that could create an employment relationship and a risk of liability to the City. If Canada Revenue Agency deemed these individuals to be employees, the City would be liable for payments such as Canada Pension, employee health and income taxes, other statutory payments, plus penalties and interest.

Some consultants are at risk of being deemed employees

Canada Revenue Agency assesses a number of factors to determine whether a worker is an employee or a self-employed individual. We identified several sole sourced consultants where a potential employment relationship may exist.

Guidance is needed for staff to identify potential employment relationships

Assessing whether or not the Canada Revenue Agency might rule that an employment relationship may exist with a consultant is a complex issue. There is currently no guidance available to assist City staff in identifying potential employment relationships. Organizations such as the Province of Alberta and the University of Toronto have published detailed guidelines to assist staff in addressing this particular issue. Similar guidance would be helpful for City staff responsible for engaging individuals on a contract basis.

Recommendations:

- 7. The Treasurer develop and communicate guidelines to assist divisional staff in identifying contractual relationships where the potential exists that the contractor could be deemed an employee by the Canada Revenue Agency.**
- 8. The City Manager direct City divisions to report back to the Treasurer on any consulting/contractor arrangements that may pose a significant risk of being deemed City employees by the Canada Revenue Agency.**

CONCLUSION

This report presents the results of our review of sole source procurement contracts. We have made recommendations relating to reporting and monitoring of sole sourcing, whether individual sole source purchases are justified and follow purchasing rules and whether the City is receiving the best price possible.

Addressing the recommendations in this report will improve the clarity and completeness of reporting sole source purchases, facilitate compliance with purchasing rules and generate cost savings by minimizing non-competitive procurement.